Dashboards
How to make the dream of pensions dashboards a reality

Building industry trust
Why the pensions industry is mis-trusted and how to overcome this

Housing
The investment opportunities within private-rented and social housing

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November 2019

PENSIONS Age

The leading pensions magazine

Superfunds: *The struggle to find the regulatory 'sweet spot' to kick-start DB scheme consolidation to superfunds*

Streamlining: *How can schemes not consolidating improve efficiencies and streamline their processes?*

Size matters

The relationship between the size of the DB scheme and its employer

Case study: Telent's completion of the UK's largest bulk annuity deal

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Editorial Comment

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

Take me to your leader.

That command would be somewhat difficult to comply with at the moment. Ostensibly, we still have Boris Johnson as the boss, but it's been a while since any UK Prime Minister has been seen to be confidently running the show.

And with the government currently in purdah, looking here for leadership can be a frustrating exercise right now.

This is something the pensions industry knows only too well. A mere matter of days after being handed its long-awaited Pension Schemes Bill, it was snatched away again as a General Election was called for 12 December.

Comments from Pensions Minister Guy Opperman that the pensions bill has cross-party support offers reassurance that it will move forward when the new government enters parliament.

Hopefully Opperman's confidence is not misplaced and the bill will finally provide the instructions needed to kickstart the latest evolution of the pensions sector. But until then, where can the industry turn to for true leadership?

It's often been found that people look to their peers for guidance. Indeed, a lot of pension communications is based upon this premise, showcasing what a saver's peers may be doing to encourage greater levels of saving *['80 per cent of people your age are putting additional contributions into their pensions pot' etc]*.

The pensions industry itself is no different – magazines such as the illustrious one you are currently reading exist in part to provide the reader with information as to what other pension schemes are doing.

The pensions sector is not often fond of being a first mover, instead preferring to be a second-mover (or third, fourth, fifth…), waiting to see how things pan out for those taking the first step and adopting a new process, technique or technology, before possibly, cautiously, following in their footsteps.

When looking around to peers, The Pensions Regulator – itself a beacon of leadership for the sector, with its role to 'educate, enable, enforce' the quality running of workplace pensions – recently recommended that eyes fall onto master trusts.

Speaking at the Pensions Age Western Conference, The Pensions Regulator executive director, David Fairs, said: "The high levels of governance we can see with master trusts does mean to some degree that master trusts are trailblazers in terms of standard and quality of governance.

"We would love them to fully embrace approaches to tackle climate change and ESG, look for innovation within at-retirement products, and, because of the size and nature of their membership, we think they could also be leaders in promoting diversity within a trustee board."

DC master trusts have long been heralded as the future of pensions saving. But with great power comes great responsibility.

However, now the authorisation process of master trusts is complete – and the regulator reassuring that those 37 that have gone through the authorisation process and made it out the other side will still be subject to continued regulatory scrutiny – master trusts seem well-placed to take on the challenge of being held up as a shining example to the others in the industry.

Lead the way.

Laura Blows, Editor

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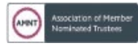

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** Pensions Age named WTW Media Awards Pensions Publication of the Year 2019 – as determined by industry vote*

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Dateline - October 2019

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

1 October Royal London and **LCP** publish a report calling for the introduction of wider access to partial DB transfers. The study concludes that partial transfers could be a solution to the ongoing controversy surrounding DB pension transfers. It estimates that since the implementation of the pension freedoms in 2015, half a million people have given up their rights in a DB pension scheme in exchange for a lump-sum transfer into a DC plan.

Editorial credit: jax10289 / Shutterstock.com

2 October The overall pension deficit of **Tesco**'s UK pension schemes falls by £240m to £2,098m in the six months preceding August 2019, its interim results report reveal. Strong asset performance was cited as the key driver behind the fall in deficit.

3 October Pensions Minister **Guy Opperman** backs calls for the creation of a new Pensions Commission, saying it is something that the Department for Work and Pensions is currently exploring. Opperman says a Pensions Commission is necessary to bring together the political parties to form long-term retirement policy.

4 October Sixty per cent of pension schemes have moved away from a traditional investment approach to a responsible or sustainable approach, according to **XPS**. The survey of over 400 trustees and employers at XPS Pensions Group's annual conference finds that the remaining 40 per cent still have a traditional investment approach.

9 October The **Financial Ombudsman Service** (FOS) sees complaints relating to defined benefit transfers rise by 44 per cent in the year 2018/19. A Freedom of Information request by Duff and Phelps reveals that FOS received 798 complaints during the 2018/19 financial year and upheld 39 per cent of cases in favour of the customer. In 2017/18, FOS received 553 complaints and upheld 30 per cent of cases in favour of the consumer. The percentage increase in cases upheld was 87 per cent year on year.

11 October Around 85 per cent of DB schemes are likely to implement a flexible retirement option, according to **Aon**'s *2019 Global Pension Risk Survey*. The firm says the figure represents a "staggering" change in attitude among UK DB schemes towards the implementation of liability management. When Aon conducted the same survey in 2013, 74 per cent of DB schemes declared that they were unlikely to implement a flexible retirement option.

14 October The newly-introduced **Pensions Schemes Bill** will include a legislative framework for the implementation of collective defined contribution (CDC) pension schemes. Following its announcement in the Queen's Speech, the bill states that it will be "providing a framework for the establishment, operation and regulation of collective money purchase schemes (commonly known as CDC pensions)".

Editorial credit: Markus Mainka / Shutterstock.com

15 October The **Thomas Cook Pension Plan** is not expected to enter the Pension Protection Fund as it is estimated that it has enough assets to provide benefits to its members in excess of PPF levels. However, in a letter to Work and Pensions Select Committee chair, Frank Field, Southern Trustees chair of trustees, Steve Southern, says that recent calculations by the appointed scheme actuary estimated that the scheme did not have sufficient assets to provide members with their full benefits.

16 October Pensions data needs around £25m invested in it over a four-year period to "get it up to scratch", and it is not currently good enough for pensions dashboards, according to **Pensions Administration Standards Association** president, Margaret Snowdon.

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

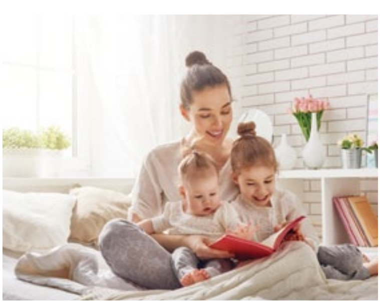
17 October Pensions Minister **Guy Opperman** says the government is taking forward the Pensions Scheme Bill "with cross-party support". He says: "At a time when parliament is divided, some would say, on other matters, I'm pleased to say that we are taking forward the bill's reform with cross-party support and general consensus amongst parliamentarians and stakeholders alike. Consensus is vital to the bill."

18 October The Pensions Regulator (TPR) proposes introducing two ways for defined benefit schemes to comply with funding regulations – 'fast track' and 'bespoke'. It plans to consult on whether it should introduce the scheme options, which aim to make it easier for smaller schemes to comply by prescribing what TPR expects of them.

21 October The **Financial Conduct Authority** (FCA) calls on pensions policy to be simplified for consumers due to the overly complex nature of defined contribution schemes. Speaking at a Cicero event on the future of regulation, FCA executive director of strategy and competition, Christopher Woolard, says that choices that members may not understand can make a "huge difference" to their retirement outcomes.

23 October The **Whitbread defined benefit pension scheme** funding level swings into a surplus of £222m after a one-off contribution of £381m following the sale of Costa Coffee.

25 October Behavioural trials designed to work out the best way to persuade people to use Pension Wise have begun. The **Money and Pensions Service** is overseeing the trials, which are being carried out with Aviva, Hargreaves Lansdown and Legal & General Investment Management.



28 October The government should subsidise the pensions of women who take time out of work to care for children or elderly relatives, The **Social Market Foundation** says. It states that society still overwhelmingly expects women to bear most of the burden of looking after children and elderly relatives, meaning that they often end up with lower earnings than men.

29 October There will be a marked increase in the use of alternative methods of de-risking among DB schemes within the next 10 years, according to the **Pensions Policy Institute** (PPI). In a new report, the PPI says that de-risking solutions such as merging schemes or transferring liabilities to a third party will soon be seriously considered by many trustees and sponsors. Traditional approaches such as bulk annuity purchases and investment reform remain popular options, but the PPI believes that by 2030 the proportion of schemes in a position to secure full buyout can be expected to rise from a current level of 6 per cent to 72 per cent.

30 October Over £30bn has been flexibly withdrawn from pensions since the introduction of pension freedoms in 2015. The latest figures from **HMRC** on flexible pension payments show that £2.4bn was withdrawn from pensions in the third quarter of 2019 by 327,000 individuals, a 21 per cent increase from the £2bn that was taken out during the same period in 2018.

The upcoming **General Election** means the current Pension Schemes Bill will go no further, due to parliament entering purdah in advance of the General Election. Pensions Minister Guy Opperman's recently-launched Pension Schemes Bill reached the House of Lords before parliament dissolved. However, as Opperman has said that the reforms set out in the bill have cross-party support, there is hope that a new government will move forward with them.

News focus

Pensions Schemes Bill dreams dashed as election called

The Pension Schemes Bill will currently go no further due to the upcoming General Election, but it is hoped it will be picked up by the next government, regardless of who wins, due to the cross-party support the bill has

The upcoming General Election puts planned pension reforms in jeopardy, as the current Pension Schemes Bill will go no further with parliament set to be dissolved.

Last month, parliament voted in favour of holding a General Election on 12 December. It means that Pensions Minister Guy Opperman's recently-launched Pension Schemes Bill will go no further at present.

However, as Opperman has said that the reforms set out in the bill have cross-party support, there is hope that a new government will move forward with them.

"The General Election means that the present government's pensions bill will go no further. But most of the measures, such as support for a pensions dashboard, collective DC pensions and stronger regulator powers have broad cross-party support. This means that a new government, of any complexion, is likely to bring forward pretty much the same legislation, albeit much delayed," Royal London director of policy, Steve Webb, said.

"If we were to have a change of government, the main differences would be that a Labour government would be less keen on multiple pension dashboards and would prefer a single one hosted by a public body. A Labour pensions bill might also include other measures such as changes to automatic enrolment and state pension measures such as financial support for the Women Against State Pension Inequality (Waspi) campaign."

Webb added that the delay to the legislation means that the legal framework for the pensions dashboard will be further delayed. However, he said the industry needs to "crack on in the meantime with getting systems and data in place ready to go live as soon as possible".

The bill was set to create a legislative framework for the introduction of a pensions dashboard, strengthen The Pensions Regulator's (TPR) powers to take action against irresponsible employers and establish a framework for collective defined contribution (CDC) schemes. LCP partner David Everett said the issues in the bill will "confront the post-election government whatever its hue".

"TPR will still need its powers to be strengthened in order to effectively tackle issues of concern, and it will still need to deliver a modified approach to DB funding to better regulate DB schemes and to reflect the increasing maturity within the DB landscape. Royal Mail will still be seeking legislation to enable their collective money purchase scheme proposals to come to fruition."

The bill had only been announced by the Queen at the State Opening of Parliament on 14 October, before a General Election was approved by parliament on 29 October.

Background documents for the bill had confirmed that it would create a legislative framework for the introduction of pensions dashboards,

strengthen TPR powers to take action against irresponsible employers and provide a framework for the establishment and regulation of collective defined contribution (CDC) schemes.

The document stated: "A Pension Schemes Bill will enable people to plan their saving for later life by giving them access to information on their pensions' savings in one place online for the first time. It will also improve the protection of people's pensions, strengthening the powers of the regulator to tackle irresponsible management of pension schemes."

Opperman, who was due to speak at the PLSA's Annual Conference in October but had to pull out due to parliamentary duties, sent a short video message instead.

In his video address, he said: "At a time when parliament is divided, some would say, on other matters, I'm pleased to say that we are taking forward the bill's reform with cross-party support and general consensus amongst parliamentarians and stakeholders alike. Consensus is vital to the bill." He also said that the government has consulted "extensively with TPR and various partners" whilst formulating the bill.

His words of cross-party support for the bill may give some hope that it will be picked up by the next government and taken forward.

Many of the key elements of the bill were expected and welcomed by those in the industry. Royal Mail in particular, which plans to adopt a CDC scheme for its employees, praised the inclusion of CDC legislation.

"The announcement of the bill puts us one step closer towards making CDC a reality for Royal Mail and its people. We have worked closely and jointly with CWU at all levels on this important issue and will continue to do so," a Royal Mail spokesperson said.

The industry also welcomed legislation in the bill that would have compelled schemes to provide data for pensions dashboards. TPR CEO, Charles Counsell, said pensions dashboards will be a "vital tool for savers to understand their pensions and plan for retirement".

The People's Pension director of policy, Gregg McClymont, said that without compulsion of data for the dashboard, the project is a "pipe dream".

However, he said that there remains a package of measures necessary if the public is to have confidence in dashboard.

In addition, the government had planned to give TPR more power to help tackle irresponsible employers and protect savers. It would have given TPR the powers to better respond to employers not taking their pension responsibilities seriously, excessive shareholder payments at the expense of pension contributions and to obtain relevant information about schemes in a timely manner.

It would have strengthened the regulator's powers and the existing sanctions regime, including introducing new criminal offenses and taking tougher action against those who fall foul of pensions law.

Furthermore, with the announcement of the framework for the pensions dashboard in the bill, it had been planned to give the regulator new powers to ensure that relevant schemes provide accurate information to consumers.

Written by Jack Gray and Natalie Tuck

NEWS IN BRIEF

Behavioural trials designed to work out the best way to persuade people to use Pension Wise have begun. The **Money and Pensions Service** is overseeing the trials, which are being carried out with Aviva, Hargreaves Lansdown and Legal & General Investment Management. The research will involve 4,300 interactions with savers.

A Welsh local authority has voted to divest its local government pension scheme from fossil fuels as it moves towards more sustainable investments. **Powys County Council** passed a motion by four votes, which stipulated that the pension scheme would halt investments in fossil fuels. The motion was put forward at a full council meeting by Green Party MP Emily Durrant.

Office for National Statistics (ONS) figures have revealed that there are 4.2 million self-employed UK workers that are not saving into a pension scheme. The statistics showed that the number of people called self-employed increased by 162,000 year-on-year to almost five million. AJ Bell analysis of the ONS data found that just 14 per cent of self-employed workers are saving into a pension scheme.

Penfold has launched a new pension scheme aimed at self-employed workers. The self-employed make up 15 per cent of the workforce but 86 per cent do not have a pension. The provider described it as a digital alternative to traditional pensions, allowing users to set up, manage and track their pensions online. It allows users to choose their investments and contribution levels.

VIEW FROM TPR

We are continuing to implement our new regulatory initiatives to challenge scheme governance and improve outcomes for savers. Through this approach we are contacting hundreds of schemes about specific governance duties, taking action against those that don't comply.

Most recently we've contacted the trustee boards of 400 schemes, of all types and sizes, asking them to examine the data they hold to ensure it is accurate and up to date.

Good data is key to good scheme governance – and it is also essential to the government's dashboard plans.

Whether it is poor record-keeping or other practices that put the scheme at risk, we will use our powers to prosecute people when they put savers at risk, if necessary.

We therefore welcome the measures announced in the Pensions Schemes Bill, which would give us the power to set and enforce clearer scheme funding standards in defined benefit schemes.

New criminal sanctions and civil fines will act as a strong deterrent against risky and reckless behaviour and give us the flexibility to issue fines appropriate to the severity of a case. But we're not an enforcement-led regulator – we would much rather those we regulate work within the law, within our guidelines and with us.

The Pensions Regulator executive director of regulatory policy, analysis and advice, David Fairs

No real improvement in UK retirement system – Mercer

The UK was ranked in 14th place, having been awarded a C+ grade, behind many other European countries

Little improvement has been made in strengthening the adequacy of the UK retirement system, meaning that employers may have to play a bigger role in helping to close the retirement savings gap.

Mercer, which has ranked the UK in 14th position in its latest annual *Melbourne Mercer Global Pension Index*, has said that the UK needs to improve by raising the minimum pension for low income, increasing contributions to workplace pension schemes and enabling better coverage for the self-employed.

The consultant has given the UK a C+ mark, after scoring it highly for its integrity, which prompted Mercer UK head of wealth, Benoit Hudon, to say that the country's retirement system needs to see its adequacy score improve dramatically.

"A lack of understanding of what they will receive and of what they will actually need in retirement has led to a gap in retirement savings for many employees," he said. "This begs the question as to whether employers should play a greater role, both in educating and supporting their workforce.

"Taking a more active role in securing employees' retirement could support engagement and productivity, and help in attracting top talent," added Hudon.

The UK received a score of 60.0 for adequacy, 55.3 for sustainability and 84.0 for integrity.

The Netherlands and Denmark have retained first and second place respectively on the index, with both being given an A grade. The Netherlands had the highest index value (81.0), and has consistently held first or second position for 10 out of the past 11 index reports. Thailand had the lowest index value at 39.4.

For each sub-index, the highest scores were Ireland for adequacy (81.5), Denmark for sustainability (82.0) and Finland for integrity (92.3). The lowest scores were Thailand for adequacy (35.8), Italy for sustainability (19.0) and the Philippines for integrity (34.7).

Mercer senior partner and author of the report, David Knox, said: "Systems around the world are facing unprecedented life expectancy and rising pressure on public resources to support the health and welfare of older citizens. It's imperative that policy makers reflect on the strengths and weaknesses of their systems to ensure stronger long-term outcomes for the retirees of the future."

Written by Marek Handzel

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VIEW FROM THE PLSA

Launching Hitting the Target, the Pension and Lifetime Savings Association (PLSA) said that its ambition for retirement living standards was for them to become a widely-adopted industry standard.

Just over a year later, that ambition has taken a massive leap forward.

The new standards we launched during our annual conference have been designed to help people picture the lifestyle they want when they retire – and understand the cost.

These are divided over three levels of retirement lifestyle: minimum, moderate and comfortable.

For each level there is a basket of goods and services, and their costs: household bills, food and drink, transport, holidays and leisure, clothing, helping others.

It's worth remembering that this is not a prescriptive definition of what individuals should aim for, more an illustration of the kind of lifestyle each standard could offer. Most people will probably identify with a mixture of the standards.

The next step for us is to ensure the pensions sector and the government – including the Money and Pensions Service – adopt the retirement living standards to help many more people plan effectively for retirement. A lofty target but we believe it's achievable.

It's our ambition that the retirement living standards become a widely adopted industry standard – used by schemes representing 90 per cent of active savers by 2025.

We believe that the standards will support better saver engagement and will go a long way to help everyone achieve a better income in retirement.

For more information about the new standards visit *www.retirementlivingstandards.org.uk*

PLSA director of policy and research, Nigel Peaple

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

DB transfer complaints to FOS increased by 44% in 2018/19

PPI report finds that, while charging structures play a significant role, it is contributions that have the greatest impact on pot sizes

The Financial Ombudsman Service (FOS) has seen complaints relating to defined benefit transfers rise by 44 per cent in the year 2018/19.

A Freedom of Information (FOI) request by Duff and Phelps revealed that FOS received 798 complaints during the 2018/19 financial year and upheld 39 per cent of cases in favour of the customer. In 2017/18, FOS received 553 complaints and upheld 30 per cent of cases in favour of the consumer. The percentage increase in cases upheld was 87 per cent year-on-year.

According to data by the Financial Conduct Authority (FCA), since the introduction of the pension freedoms, 69 per cent of individuals have been advised to transfer out of their DB pension. Duff and Phelps' compliance and regulatory consulting practice managing director, Mark Turner, noted that the FCA is concerned that unsuitable transfer advice has been, and is still being, given. "The FOI data reveals the FOS is upholding more cases in favour of the customer this year than last, which sends a clear message that the DB transfer market is very much under the eye of the regulator."

The FCA is responding with plans to ban contingency charging for DB pension transfers in most cases due to the difficulty it sees with managing conflicts of interest this creates for advisers. The regulator has also proposed the concept of abridged advice, which aims to extend the availability of advice at a low cost to customers.

According the XPS Pensions Group's Transfer Value Index, the number of people transferring their defined benefit pension schemes fell in September to

an annual equivalent of 0.80 per cent of eligible members, down from 0.86 per cent in August. While this is broadly in line with the rates seen in recent months, it is significantly down on the 1.30 per cent rate observed this time last year, suggesting a continuing downward trend in transfers. XPS said that the average age of members taking transfer values from schemes they administer has increased from 52 to 57 over the past three years.

XPS believes this significant rise is likely to be a result of recent changes to guidance from the FCA which makes it more difficult for advisers to recommend a transfer to members below the UK minimum retirement age of 55. For those members looking to transfer, how much they get is likely to vary significantly. The index found the DB transfer values varied significantly during September 2019. The Transfer Value Index reached a record high of £260,400 before dropping sharply to a low of £247,700, but then recovered to finish the month at £254,300.

Written by Natalie Tuck and Sara Benwell

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VIEW FROM THE ABI

Nobody can dispute the fact that pensions tax relief is too complex. The current rules are confusing for many. This was confirmed by the recent ACA survey, which found 75 per cent of employers think the current tax regime was too complicated and should be simplified.

A new government presents the opportunity to clear up the system, to make it simpler for consumers to understand and to be fair, especially for those on low earnings. Preventing low-income earners from missing out on this vital tax relief is one of four transformational changes to the system the ABI is calling for, alongside changes to annual and lifetime allowances.

The choice between 'net pay' and 'relief at source' (RAS) means some employees who earn under the personal allowance effectively pay more for their pension than others.

It is estimated that 45 per cent of workers earning less than the personal allowance are missing out on pension tax relief due to being part of a net-pay scheme. Employees do not have a choice in the scheme, leaving them at the mercy of their employer – who understandably want simplicity.

A dynamic solution proposed by the Net Pay Action Group involves a small change to enable HMRC to use net-pay data for end-of-year reconciliations, which results in a tax refund being issued to those who paid more than those on a RAS.

The simple change will ensure lower earners are no longer missing out. It involves a cost to the Treasury but it is essential to ensure all savers can be confident they are getting the most from their workplace pension.

ABI policy adviser for long-term savings, Hetty Hughes

AE gender and age gap shrinking – TPR

However, the SMF has called on the government to subsidise women's pensions when they take time out to raise children or care for relatives

The amount of young people and women saving into an auto-enrolment workplace pension scheme has increased, shrinking the gender and age gap, according to The Pensions Regulator's (TPR) latest figures.

It found that participation from people aged 22 to 29 increased from 24 per cent in 2012, the year auto-enrolment was introduced, to 84 per cent in 2018. In its annual *Automatic enrolment commentary and analysis*, TPR revealed that both male and female participation in the private sector increased to 85 per cent, whereas before 2012 there was a higher proportion of male employees in workplace schemes.

Despite the narrowing of the gap, BBC journalist Paul Lewis said at the Pensions and Lifetime Savings Association Annual Conference that auto-enrolment is "very anti-women".

"I think auto-enrolment is very anti-women because if you earn less than £10,000 you're not automatically enrolled and I think that's a disgrace. I think if you do three jobs on £8,000 and earning £24,000, you're still not auto-enrolled, that is an absolute disgrace, and I think that affects women quite disproportionately compared to men. That has to change."

In order to narrow the pensions gender gap, one think-tank has suggested that the government subsidise the pensions of women who take time out of work to care for children or elderly relatives. The Social Market Foundation (SMF) has said that society still overwhelmingly expects women to bear most of the burden of looking after children and elderly relatives, meaning that they often end up with lower earnings than men.

With increasing lifespans, the think-tank is concerned that women's wealth will fall further behind, unless significant new support for women's pensions is introduced by the state.

In a report, *Gender equality and the 100-year life*, the SMF shows that five years after graduation, men's median wages are £3,600 higher than that of female graduates. Ten years after graduation, this figure rises to £8,400. It also states that women in their late 50s typically have around half the pension savings of men the same age.

The report says that taking time out of the labour market to raise children or care for relatives is one of the key causes of the pension gap.

According to 2016 estimates from the ONS, a woman on maternity leave carries out weekly unpaid work with an economic value of £762.75. By applying the current 3 per cent minimum contribution rates from auto-enrolment pensions schemes to such unpaid work, the SMF says that the government should contribute £22.88 per week, or £1,189.89 per year, to a woman's pension pot.

SMF chief economist, Kathryn Petrie, said: "For all the strides we've made towards equality, social attitudes that push women to give up work to care for children and parents remain strong. As well as trying to give women and men more flexibility and choices, government policies should do more to help women with the financial implications of taking time out of work."

Written by Jack Gray and Marek Handzel

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VIEW FROM THE PMI

What is the purpose of our industry? Traditionally, it has been to ensure members of pension schemes are paid the right amount at the right time. However, the requirements have evolved over time and our role now has a broader purpose.

We must educate, engage and motivate members, as well as deliver the best possible retirement outcome. But should the inherent power we have also be used to make the world a better place? Is it incumbent on the collective of schemes, and those who run them, to use their purchasing power to save the planet?

This is not, despite its appearance, a facetious question. Trustees must set out how they considered ESG within their SIPs. Some trustee boards believe the protection of members' benefits is paramount and any actions taken must serve those members and, in doing so, forego exercising ESG principles in favour of returns.

The millennium brought the UN's Principles of Responsible Investment and its success saw the criteria extended beyond its original remit. It ignited the debate of SRI and now ESG.

Some will always believe that members' interests must come first, while others believe that our power needs to be used for good. To quote one of my colleagues, who is years from retirement, "what is the point in having a good retirement income, when I'll have to walk in a desert with a mask on because the water has gone and the air is too polluted?"

An interesting way to put it, I thought, given we are sold images of pensioners walking hand in hand along a glorious beach…

PMI president, Lesley Carline

Retirement Living Standards launched by PLSA to help savers

It has also launched a paper that aims to rebuild trust in the pensions industry, highlighting how this can be achieved

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

The Pensions and Lifetime Savings Association (PLSA) has launched its Retirement Living Standards to tackle the engagement challenge and help to build a nation of active savers.

Launched at the PLSA Annual Conference 2019, PLSA chair of the policy board, Emma Douglas, explained the PLSA's intention to make the standards a social norm. Quite like the five-a-day healthy eating rule, Douglas said, it is hoped that the initiative will make pension engagement commonplace among all types of savers.

The standards set out three key types of standard of living in retirement: minimum, moderate and comfortable. The standards set out living cost and expenditure figures needed in each category and they have separate sections for areas such as food expenditure, helping others, holidays and transport.

The industry body has published the standards on a specifically-designed website that is available to the public and industry to use and adopt into their businesses. At present, a total of 22 organisations are signed up to adopt the standards into their businesses. These include Aviva, RBS, L&G and PPI.

The PLSA, alongside involvement from the industry, hopes to achieve 90 per cent active savers by 2025 via engagement in the standards.

"We are looking to those parts of the industry who have direct contact with scheme members to adopt the standards to develop tools and customer journeys to take action," PLSA head of DC, master trusts and lifetime savings, Lizzy Holiday, concluded.

In addition, the PLSA has launched a new paper, *Building an environment of trust in pensions*, highlighting actions the industry can take to win back trust in the sector. The paper recommends that trust can be built by listening to savers, having honest conversations, increasing transparency and offering realistic expectations. It also states that savers should be treated as adults and not patronised, that the member experience should be considered and to trust savers so that they will trust the industry in turn. Being competent, delivering results and quickly righting wrongs is also suggested.

Launching the report, PLSA chair Richard Butcher said: "We all want better retirement incomes for all. And trust in the pensions and lifetime savings system is vital if we are to achieve that objective. Trust oils the wheels of the saving journey."

Written by Sarah Chandler and Laura Blows

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Thomas Cook pension scheme not expected to enter PPF

In other pension fund news, Heathrow's pension scheme swings into the red, and Asda's pension scheme completes a £3.8bn buyout

Editorial credit: mubus7 / Shutterstock.com

The Thomas Cook Pension Plan is not expected to enter the Pension Protection Fund (PPF) as it is estimated that it has enough assets to provide benefits to its members in excess of PPF levels, according to its trustee chair.

However, in a letter to Work and Pensions Select Committee chair, Frank Field, Southern Trustees chair of trustees, Steve Southern, said that recent calculations by the appointed scheme actuary estimated that the scheme did not have sufficient assets to provide members with their full benefits.

"The plan is currently expected to have sufficient assets to provide benefits in excess of PPF levels," Southern wrote. "This will be confirmed as part of the ongoing work of the trustees and the PPF.

"The plan's assets are not expected to be sufficient to secure all member benefits in full."

As agreed in its 2017 triennial actuarial valuation, the scheme was to receive annual contributions of £26m from its principal employer, Thomas Cook, until 2022 to repair its £105m funding deficit and support its long-term funding target.

Following this agreement, the trustees entered discussions with Thomas Cook over the firm's proposed restructuring. However, as time passed it became clear that the company was in financial trouble and the trustees indicated that they would be willing to consider deferring or reprofiling the deficit contributions.

However, the deferral or reprofiling of the contributions did not enter detailed discussions as the firm slipped into insolvency. Southern also stated that the trustees had been in regular communication with The Pensions Regulator throughout the process.

In other news, Heathrow Airport Holdings Limited's defined benefit pension schemes have swung from a £30m surplus to a £28m deficit in the past year. It's third quarter results report revealed that its scheme funding fell by £58m between September 2018 and September 2019.

Heathrow's DB schemes swung into deficit "primarily due to actuarial losses of £42m, attributable to a decrease in the net discount rate of 1 per cent over the nine months", according to the report. Asset value rose by £700m to £4,629m, however this was offset by a £760m increase in liabilities. Its report also revealed that the schemes were funded at 100.1 per cent, down from 100.7 per cent in December 2018.

The firm's largest DB scheme, the BAA Pension Scheme, remained in surplus, but it fell from £64m to £4m during the same period.

The BAA scheme is a funded scheme with both open and closed sections but was closed to employees who joined the firm after 15 June 2008. In the first nine months of 2019, Heathrow contributed £37m to its DB schemes, including £17m in deficit repair contributions. During the same period, Heathrow's shareholders received £300m in dividends, which the company said "reflects the continued strong performance of the business".

And finally, the Asda Group Pension Scheme has entered into a £3.8bn buy-in with Rothesay Life. According to Sky News, Asda's parent company, Walmart, signed the deal to offload the pension liabilities in preparation for a potential stock market floatation.

The agreement is expected to cover around 12,000 scheme members and follows a series of bulk annuity deals completed by Rothesay Life. The specialist insurer has completed deals worth more than £11bn in the past month, including with Telent and National Grid.

Written by Jack Gray

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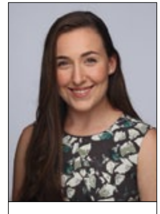
Appointments, mandates and moves

Vassos Vassou

Dalriada Trustees has appointed Vassos Vassou and Chris Roberts to its board of directors.
Between them, Vassou and Roberts bring over 40 years of pensions experience to the board, as heads of the London and Manchester offices respectively. They will continue to play a lead role in the development of the business strategy across both offices. Vassou joined Dalriada in 2016, having spent nearly 21 years at Capita and Willis Towers Watson. Roberts joined in 2011 after holding administration management positions at the Church of England and HSBC.
Dalriada Board chair, Tom Lukic, commented: "The appointment of Vassos and Chris reflects the valuable contributions both have made and the plans we have to further develop our business going forward. As the heads of our London and Manchester offices they have played a key role in helping us cement our position as one of the largest, multi-skilled professional trustee firms in the market and I am delighted to welcome both to the board."

National Employment Savings Trust (Nest) has named BNP Paribas Asset Management (BNPP AM) to manage its private credit mandate.
According to BNPP AM, the open-ended diversified private credit fund will initially consist of exposure to infrastructure debt, commercial real estate debt, European mid-market loans, UK SME loans and US mid-market loans. The fund will offer "active asset allocation in evergreen form", with principal repayments and interest reinvested to provide a total return for Nest's members.


Anna Darnley

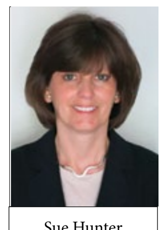
Smart Pension has appointed digital strategist Anna Darnley as a trustee.
The 26 year old joins Smart with two years of trustee experience at Accenture Retirement Savings Plan and takes the independent Smart Trustee Board of five up to 60 per cent female. She is a digital strategist with a special interest in artificial intelligence and blockchain. Smart said that its board now represents all generations of scheme savers.

Antonia Balaam

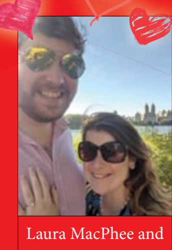
Aegon UK has appointed Antonia Balaam as client director for workplace.
She will focus on developing, broadening and strengthening key client relationships, while supporting the development of new business. Balaam is a qualified actuary, with 22 years of experience in the pensions industry, and most recently held positions at First Actuarial, Willis Towers Watson and Aon Hewitt. She joined the firm in October.

Britt Hoffmann-Jones

Professional trustee and governance services firm, PTL, has appointed Britt Hoffmann-Jones as its head of proposition development.
Hoffmann-Jones has re-joined the industry after taking a career break to start a family. She was previously head of UK defined contribution pensions at the River and Mercantile Group. She has a wealth of experience in advising both DB and DC schemes.


Sue Hunter

B&CE, provider of The People's Pension, has appointed Sue Hunter as its new chief financial officer. Hunter has spent most of her career at Legal & General, where she held a variety of finance director roles in the savings, corporate and business performance divisions. She is also a member of the Chartered Institute of Management Accountants. She joined B&CE on 12 November and took responsibility for the company's financial strategy.


Laura MacPhee and Matt Burrell

Laura MacPhee and Matt Burrell are delighted to announce their engagement. Matt got down on one knee in Central Park on 20 September 2019, while they were on holiday in New York. As both work in pensions, this is the only publication that made the shortlist for the announcement, so please humour them.
Laura and Matt first met in 2016 in a meeting at the PLSA about the pensions dashboard, a project that is very close to their hearts. At the time Matt worked for the PLSA, and Laura worked for USS. After months of pensions based friendship, they got together when they were seated next to each other at *Pensions Age*'s sister publication's event, the European Pensions Awards 2017, in the company of several members of the *Pensions Age* team.
They are planning a London-based wedding in November 2020.
The pair have been described as "everyone's favourite pensions power couple"*.
**By Matt.*

Running for cover

Martin Kellaway highlights the significant protections trustee insurance can cover

The role of a pension trustee today is more challenging and risky than it has ever been. A perfect storm of increasing and complex regulatory burden, the increasing scrutiny and requirements of The Pensions Regulator, and willingness of members to complain and hold you to account means that the job of being a trustee has never been more onerous.

Problems lie not just within day-to-day exposure, but also within risks emerging in the future: the operation of hindsight and the possibility of being held to account for something that the trustees never considered or were advised was an issue.

Thankfully, there are some protections in place. The indemnity clause from the sponsor, which gives trustees some comfort, as long as the sponsor exists and is willing to pay. An exoneration clause may excuse trustees from liability and the scheme itself may also indemnify. However, there are statutory exemptions. For example, neither clauses can be used to compensate for civil fines and penalties. And neither protection provides a comfortable place for the trustees to find themselves in.

This is where Pension Trustee Liability insurance (PTL) plays a vital role. An insurance policy should stand in front of the exoneration and indemnity clauses, thereby providing the first call for claims to protect scheme assets and the sponsor's balance sheet.

Even through trustees may use third-party administrators and advisers, they are still ultimately responsible for the running of their scheme. Insurance can therefore provide valuable cover when things go wrong, or where The Pensions Regulator launches an investigation.

The scope of cover is important. Some PTL policies provide very basic cover, excluding certain individuals or circumstances, and even adding auto-cancellation clauses in the event of a corporate event. Trustees need to ensure that their policies include cover for the following:-

• **Defence Costs.** Trustees need to demonstrate proper process and consideration has been given, irrespective of any substance to a claim. You will need to take legal and other advice. Defence costs are by far the largest part of losses covered under PTL policies.

• **Third-Party Pursuit Costs** are there to cover costs for when trustees need to pursue advisers or administrators who have failed.

• **Public Relations and Reputation** costs will help trustees manage a message to their membership and the media. Especially helpful for high-profile schemes/sponsors.

• **Court Application Costs** in the event that a court is needed to settle a matter or interpret documents.

• **The Pensions Regulator** (TPR) **Investigation** costs. You will need sufficient cover in place to respond to TPR enquiries and disclose documents, emails and advice. This is where costs can escalate very quickly.

• **Retirement of Trustees**. Cover for trustees who retire is provided for their lifetime.

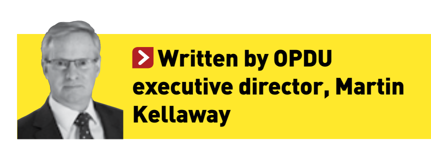
• **Civil Fines and Penalties** where insurable provides cover for items such as fines issued by TPR etc.

A good PTL policy should extend cover to include: families and estates of trustees; sponsor corporate trustees and directors; sponsoring employer for indemnified losses; the pension scheme in respect of exonerated losses and pensions employees of the sponsor.

Trustees should also ensure that they have a separate, PTL policy and not share a limit under another policy, such as a PTL extension to a corporate D&O policy, as the policy limit could be eroded by a D&O claim, leaving no cover available for the trustees

PTL policies are written on a claims-made basis and therefore cover all historic acts that emerge in the policy period. Run-off policies provide trustees with protection where a scheme winds up, with no assets left to reimburse a fine or claim, or a disinterested or non-existent sponsor. Cover can typically run from six years up to a lifetime.

To reiterate, it is not enough that trustees simply ask if they have insurance. They need to carefully assess any insurance that they have in place to ensure it is suitable and provides proper cover for them.



Written by OPDU executive director, Martin Kellaway

In association with

VIEW FROM THE AMNT

In the science fantasy satirical novel *The Hitchhikers Guide to the Galaxy* by Douglas Adams, a race of super-intelligent beings build a super computer called Deep Thought to answer the ultimate question of 'life, the universe and everything'. They are shocked when the computer comes up with the answer 42! When challenged, the computer responds by saying they didn't ask the right question.

Asking pertinent questions to obtain useful answers is an integral part of trustees' duties. Challenging preconceptions and the status quo leads to greater understanding and better outcomes for members.

Recently a friend took a dispute to the Pensions Ombudsman, based on the lack of clarity provided by pension fund information. The trustees had correctly followed the rules in the trust deed, but the information provided was of a general nature and not specific to the member. The ombudsman though, accepting this fact, ruled that the onus to find out detailed information was on the member and the only liability on the fund was to ensure correct information was provided when the correct question was asked. This ruling shows the importance of not only asking questions, but of asking the questions that will find the appropriate answer.

In the case of the ultimate question to the ultimate answer 42; that turned out to be 9 times 6; who'd have thought!

AMNT member Stephen Fallowell

Market commentary: Latest bump on volatile road

In late October, it was announced that the latest bump in the UK's volatile economic road will be a General Election on 12 December. The lack of reaction from the UK and global markets suggest that volatility and uncertainty are second nature, even in the case of an early general election.

However, with Brexit still undecided and the result of the election having huge influence on what future Brexit policy may look like, it's nearly impossible to predict what will happen post-election.

Saxo Markets FX sales trader, Oliver Konzeoue, describes the market reaction to the election announcement as "muted", but that general elections "carry a risk markets cannot ignore".

"GBP reacted positively, and the FTSE currently trades heavy – sterling's relative strength being one of the factors. The prospect of a snap election represents progress and it increases the chances of a Brexit deal being passed by 31 January," he adds.

"We all know election outcomes are unpredictable and therefore carry a risk markets cannot ignore."

Although the election may help the passing of a Brexit deal and therefore the UK market, some are concerned that if the election does not provide an outright winner with a majority then it will lead to further volatility and uncertainty.

Janus Henderson Investors multi-asset portfolio manager, Oliver Blackbourn, explains: "An election could be the much-needed unblocker for the clogged political drain that is Brexit.

"However, the result needs to be decisive in favour of the pro-leave Conservative Party or the anti-no-deal rainbow of opposition parties."

He also notes that the pound continues to be volatile and, despite the moves in sterling, gilt yields remain at the base rate of 0.75 per cent.

"Recent commentary from Monetary Policy Committee external members has focused on the downside risks to the economy, suggesting a greater likelihood of interest rate cuts," Blackbourn adds.

Franklin Templeton head of European fixed income, David Zahn says that the announcement of a General Election will create "a rollercoaster rise for UK assets" as investors monitor opinion polls on who may be victorious.

Zahn continues: "Gilts are likely to be especially volatile in our view. Whatever the election outcome, we expect a likely general shift higher in UK government bond yields, as the two main candidates to form a government have committed to higher government spending.

"The worst outcome for markets, in our view, would be a repeat of the status quo in which no party can command a majority in the House of Commons.

"We expect markets to remain very volatile over the six weeks until polling day. We think the ability to actively adjust portfolios quickly to react to changes in the market is likely to be important for investors."

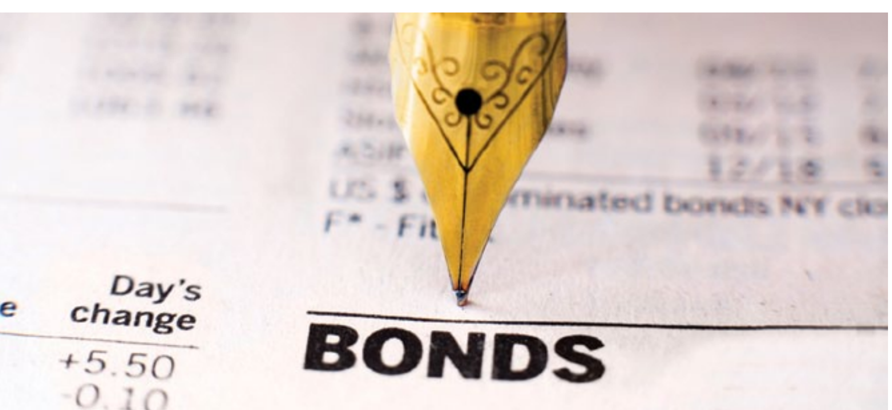
Although the announcement of an upcoming General Election did not appear to create a strong reaction from the economic markets, most commentators agree that the outcome of the election will have a huge bearing on the immediate future of the UK economy.

It appears that more uncertainty created by no clear winner would be the most detrimental outcome for the economy. Everything seems to be overshadowed by Brexit and only clear answers and policies may cease the volatility.

Written by Jack Gray

Making changes

Henry Odogwu reveals why climate change also matters for government bond investing



The global sovereign debt market is one of the largest asset classes in the world, and yet lags other asset classes when it comes to integrating climate change issues into investment processes. Sovereign debt investors are still exposed to a range of climate change risks that are not well understood or incorporated into the investment process. Part of the challenge has been the lack of sustainable investment products and viable climate data.

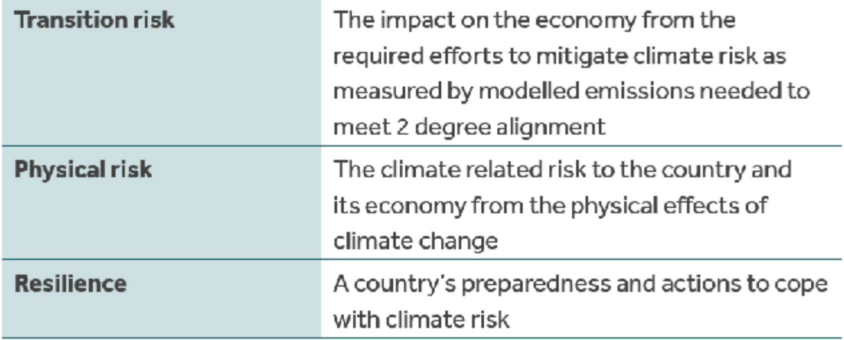
Climate change risk has long been a consideration for publicly-traded stocks. Today, investors can choose from a broad selection of equity products designed to avoid companies with high exposure to climate change risk: when it comes to government bonds, market participants have largely overlooked the potential impacts of climate risk.

Governments are exposed to both transition risk and physical risk related to climate change, and these risks are material and growing. Transition risk relates to the costs associated with countries transitioning to a greener economy. For example, growing concern over climate change – and the resultant increased regulation – has many countries developing plans to reduce carbon emissions. The UN estimates that such an undertaking would require investing about $1 trillion per year over 30 years, with this expenditure largely financed by governments.

Transition and physical risks have the potential to materially impact government debt, which is why it's important to consider climate risk alongside traditional risk measures when investing in sovereign bonds. To this end, FTSE Russell has developed a solution to serve as a sustainable alternative for passive government bond investors, the FTSE Climate Risk-Adjusted World Government Bond Index (Climate WGBI).

The Climate WGBI methodology conducts quantitative climate risk assessments across transition risk, physical risk and a country's resilience. The index scores countries across each of the pillars and a single combined score is derived for each country. The scores are then used to reweight the country's exposure in the index to provide higher exposures to countries that are better prepared for climate change risks and lower exposures to countries that are more threatened by climate change risks.

By incorporating these three climate risk pillars and weighting constituents accordingly, the Climate WGBI offers a solution for the growing number of investors who are recognising that climate risk considerations aren't just for equities – they also matter when investing in government bonds.



Transition risk	The impact on the economy from the required efforts to mitigate climate risk as measured by modelled emissions needed to meet 2 degree alignment
Physical risk	The climate related risk to the country and its economy from the physical effects of climate change
Resilience	A country's preparedness and actions to cope with climate risk

Written by FTSE Russell head of the asset owner group Europe, Henry Odogwu

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VIEW FROM THE PPI

The decisions people face when planning for and living through later life are becoming increasingly complex.

When making decisions about how to access their pension savings in a post-pension freedoms world they have to take into account a broad range of considerations, including household and family circumstances, expectations of retirement, desire to leave bequests, as well as a myriad of complex financial considerations.

Most people have not been exposed to these kinds of decisions during their working life, and many have difficulty understanding and making decisions about things like longevity, investment and inflation risk. These decisions don't get easier as people age. The risk of experiencing cognitive decline increases as people grow older, particularly from age 75 onwards.

While someone accessing their pension savings for the first time may have the financial capability to manage their own investments and withdrawal rates (although evidence suggests that many do not), this may not be the case as they reach older ages. As more people are moving into drawdown than ever before, there is likely to be a much greater need for support over the course of later life, rather than just at the point of or approaching retirement.

Without intervention, people in their 70s and 80s are vulnerable to making decisions that could lead to financial deprivation.

PPI senior policy researcher, Lauren Wilkinson

In my opinion

On the government not publishing a pensions dashboard timetable
"Why does the government insist on missing a trick like this? We clearly need a central, national, pensions 'account', that every individual could access, not only to monitor directly how their own retirement savings and planning is shaping up, but also genuinely compare all the vying 'offers' to manage their savings. This requires that the dashboard has details of the size of the state retirement pensions."
Work and Pensions Committee chair, Frank Field

On why the government should subsidise mothers' pensions when they take time out of work to care for children
"For all the strides we've made towards equality, social attitudes that push women to give up work to care for children and parents remain strong. As well as trying to give women and men more flexibility and choices, government policies should do more to help women with the financial implications of taking time out of work."
Social Market Foundation chief economist, Kathryn Petrie

On the ill-fated pensions bill
"Doing nothing in my view is not an option, and that's why we have consulted and that's why we have brought forward the bill. Now there are greater protections for members, which include new civil and criminal sanctions to punish bosses who wilfully or recklessly harm company pension schemes. The introduction of the dashboard will help people further reconnect with their pension pots by making it easier to see their pensions information in one place and we want people to be able to better plan for retirement, not just with confidence but knowing that their pension savings are protected."
Pensions Minister, Guy Opperman

On data in the pensions industry
"Everybody talks about it, everybody knows and thinks 'well data is dull, we've been through it, we've got common standards, we've got conditional standards, it's all hunky dory', but actually it's not. Data is simply not good enough. Some people actually fib about the state of their data quality, and others don't actually know what their data quality is."
Pensions Administration Standards Association president, Margaret Snowdon

On the desire to simplify pensions taxation
"There is widespread demand for reforms to simplify a tax regime that is now well past its sell-by date. It is clear that any reforms being considered by the Treasury must not be short-term tweaks for public sector employees only – reforms must be even handed and extend to resolving problems that impact on all wealth-generating sectors of our economy."
Association of Consulting Actuaries chair, Jenny Condron

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VIEW FROM THE SPP

The recently-concluded TPR consultation on the future of trusteeship and governance explored whether it should – in time – be mandatory for an accredited professional trustee to sit on every pension scheme trustee board.

This proposal looks to be driven by the higher expectations we often have of professional trustees, which will no doubt be reinforced by new standards published earlier this year, and by the expectation that professional trustees will pass on vital skills, knowledge and expertise to the other trustees.

All this may well be true in terms of many professional trustees, but is it right that appointing one should be mandatory? Even setting aside obvious concerns over capacity and financial resources, there are surely some broader issues to consider.

Would not such a move risk diminishing the role of the lay trustee – sending out the implicit message that professional trustees are somehow 'better' than lay trustees? Might this not result in lay trustees on a board being reluctant to challenge their professional counterparts? Over time could this even put prospective lay trustees off taking on the role?

And what of the many trustee boards that are already well run by a competent board of lay trustees, with no input from a professional trustee?

The value that a professional trustee can add will surely depend on the circumstances of a particular scheme. There is of course merit in trustees and sponsors assessing whether such an appointment might be in their scheme's best interests – but to make it mandatory may well be a step too far.

SPP legislation committee member, Shayala McRae

Soapbox: A pensions bill - oh no it isn't

Just last month there was hope once more that progress was set to be made again in the pensions industry.

Parliament, however, kicked that can down the road when it backed Prime Minister Boris Johnson's calls for an election. Now, long-awaited projects such as pensions dashboards and collective defined contribution (CDC) schemes are yet again, on the back burner, whilst the issue of, let's be honest, Brexit, is resolved.

It doesn't seem long ago that the industry was crying out for a break from the onslaught of governmental pension reform. Who can forget the pension freedoms – one of the biggest changes to face the sector in decades; the industry had no clue it was coming, and were given but a year to prepare.

But now, as we're about to enter panto season, the industry may be regretful of wishes to genies of the past (George Osborne, per chance) to 'let the changes bed in'. You could certainly say that Johnson is this year's villain, holding a Queen's Speech knowing that what he really wanted was an election. What was the point?

The proposals in the Pension Schemes Bill were widely welcomed by those in the industry. Many in the pensions sector have been involved with developing a pensions dashboard for several years now, and are awaiting the legislation to compel schemes to provide data for the dashboards.

Meanwhile, Royal Mail is eagerly awaiting legislation to allow it to run a CDC scheme, a solution that came from the end of its defined benefit scheme. It has the potential to revolutionise pension savings. Greater powers for The Pensions Regulator were also largely welcomed.

Sadly the Pension Schemes Bill, in its current skin, will go no further, as it will not get to the stage of receiving Royal Assent before the dissolution of parliament prior to the election. However, it is good news that Pensions Minister, Guy Opperman, has previously commented about the cross-party support that the bill had.

It hints that the much-anticipated legislation will become a reality one day, but at the moment, it's unclear just how long that delay will be. It was a shame, however, to hear that the government is not willing to commit to a published timetable for the rollout of the pensions dashboard, something the Work and Pensions Select Committee branded as "extremely disappointing". That it is; it could have served as the hope that the industry needs right now.

I sympathise greatly with those in the industry who are keen to see these reforms that aim to improve the experience of the member. For now, we will have to see how this panto plays out.

Written by Natalie Tuck

What to consider when transferring schemes

With trustee workloads ever-increasing, Roy Porter looks at the growing trend for consolidation within the DC market

The UK occupational defined contribution (DC) market is one of the least consolidated in the developed world, but things are changing. Single-employer DC trusts are in the spotlight.

There are 2,180 pension schemes in the UK. That ranks it behind Australia, with just 233, and far behind Mexico, with only 11 occupational pension schemes.

The Pensions Regulator (TPR) and The Department for Work and Pensions (DWP) are encouraging consolidation in the UK DC landscape, promoting fewer, higher quality, better regulated schemes.

Single-employer DC trusts are being pushed along by a unique range of factors, including greater costs.

Short service refunds were abolished just over four years ago. This prompted a rise in membership and a proliferation of small pots for many active DC pension schemes. However, for the larger number of smaller pensions schemes who offered this option, it can be costly and complicated to administer.

In the same year we saw the new 0.75 per cent charge cap for default funds. Larger schemes, like The People's Pension, have used their scale to make sure high-quality investment options remain available below this rate. Smaller schemes may have difficulty achieving this and, if they want active investment options, the charge cap poses significant challenges.

Other pressures come from The Pensions Regulator.

Its 2016 paper on 21st century trusteeship offered clarity on their expectations of pension scheme trustees. This includes their roles, board composition, risk management and a host of other issues.

This renewed focus makes it abundantly clear that the expected standard of governance is high.

The regulator has also pointed out to trustees its high expectations of both transparency, not least in the chair's annual statement, and good investment choices for members.

Moreover, DWP regulations have obliged trustees to strengthen their approach to environmental, social and governance (ESG) issues in their investment options.

Trustee boards are now required to consider ESG. And this means time and money spent on adopting new policies and working with investment managers to offer new options.

These are all material changes – requiring substantial amendments to working practices, policies, processes and the amount of time individual trustees spend on governing their schemes.

Trustees that signed up to the role with an expectation of a specific time commitment, will be interested that the regulator is now asking whether quarterly meetings are enough – and whether the board should meet every month instead?

This increased burden on trustee boards is laid bare by data from the regulator.

They have five key governance requirements – which range from independence to providing good value for members.

According to a May 2019 report, just 23 per cent of all pension schemes met two or more of these requirements.

This is perhaps unsurprising, given that the pensions market is one where the benefits of scale can be felt in governance, good value and the quality of investment options.

If the occupational DC pension market continues to consolidate it seems reasonable that trustee boards of single-employer DC schemes will look at master trusts as a possible consolidation option.

Master trusts operate under the same regulations and legislative regime as single-employer DC trusts, unlike contract based schemes, commonly referred to as group personal pensions. This means that the trustees have the same direct responsibility toward members' best interests.

Master trusts are just one of several available options, which is why we've created a 'key considerations guide', setting out what the journey could look like. You can get your copy from our website at www.thepeoplespension.co.uk/single-employer-trusts-PA.

If you're interested in learning more then why not get in touch? Contact us on 0333 230 1322 or at consolidation@thepeoplespension.co.uk.

Written by The People's Pension chief sales and marketing officer, Roy Porter

In association with the people's pension

iSource: The Pensions Regulator report, 'Defined Contribution trust-based pension schemes research', May 2019

VIEW FROM THE ACA

Our 2019 ACA *Pension Trends Survey* findings suggest employers were supportive of a number of the key measures in the Pensions Schemes Bill, which became a casualty of the election campaign.

Many of these measures have been well signposted by the government and enjoy a degree of cross-party support, which is welcome in an environment where political differences have generally been heightened. This bodes well even if the election has killed the bill at present.

However, our survey findings indicate that the government could have been bolder, probably with cross-party support, if it had added into the bill measures to build on the success to date of pension auto-enrolment (AE).

With evidence that fewer employees have ceased making pension contributions than was expected as minimum contributions were increased in 2018 and 2019, the bill should have included 'next steps' to build on those contribution levels, which are still far too low to deliver the levels of income needed.

Whilst smaller employers might need some help from government in supporting higher contributions, it would be wrong to halt the progress made, when much still remains to be done to increase pension savings. The next steps envisaged for AE would not require major amendments to the bill and could be added when it is re-introduced in some form to parliament post-election.

ACA chair, Jenny Condron

Diary: November 2019 and beyond

Project de-risk: The DB journey planning summit

15 November 2019
Waldorf Hilton, London

This inaugural DB journey planning summit, which comes from Just, in association with *Pensions Age,* will break the mould when it comes to helping schemes plan the journey to their endgame. It takes a different perspective, focusing on the practical and exploring the plethora of options available to schemes looking to de-risk, while helping them decipher what's the right route for them, and how they can reach their goals effectively.

For more information, visit:
pensionsage.com/justsummit

Eversheds Sutherland Annual Pensions Conference

4 December 2019
Church House, London

Eversheds Sutherland's 14th Annual Pensions Conference considers the many ways in which significant change is underway in how retirement benefits are structured, provided and developed – and how employers and trustees are encouraging financial inclusion and engagement. Speakers include Pensions Minister, Guy Opperman and The Pensions Regulator CEO, Charles Counsell.

For more information, visit:
eversheds-sutherland.com

Irish Pensions Awards 2019

20 November 2019
The Shelbourne Hotel, Dublin

Organised by *European Pensions* and now in their eighth successful year, the Irish Pensions Awards continue to go from strength to strength, giving well-deserved recognition to those pension funds, pension providers, advisers and pension professionals who strive to maintain the highest standards of excellence and professionalism in everything they do, despite the challenging economic and political landscape they find themselves operating in.

For more information, visit:
europeanpensions.net/irishawards

Pensions Age Awards 2020

27 February 2020
London Marriott Hotel, Grosvenor Square

The Pensions Age Awards aim to reward both the pension schemes and the pension providers across the UK that have proved themselves worthy of recognition in these increasingly-challenging economic times. The awards are open to any UK pension scheme or provider firm that serves pension schemes in the UK. The awards are now in their seventh successful year.

For more information, visit:
pensionsage.com/awards

Visit www.pensionsage.com for more diary listings

Month in numbers

79%

The proportion of participating University and College Union (UCU) members that voted in favour of industrial action over proposed changes to the Universities Superannuation Scheme. Members from 60 universities will take strike action between 25 November and 4 December. Universities have backed proposals to increase total contributions to 30.7 per cent, including 9.6 per cent of salary from employees, representing an increase of 0.8 per cent. UCU urged universities to respond "positively and quickly".

£30 billion

Over £30 billion has been flexibly withdrawn from pensions since the introduction of pension freedoms in 2015. HMRC figures show that £2.4 billion was withdrawn from pensions in the third quarter of 2019 by 327,000 individuals.

2023

The government will continue to uprate the state pension in five countries, Ireland, Switzerland, Norway, Iceland and Liechtenstein, in Europe beyond 2023 if there is a no-deal Brexit.

Record-breaking

Kai Hoffmann considers how this has been another record year in bulk annuities, with more to come in 2020

I remember where I was on the night of 23 June 2016.

And I remember sitting in a lawyer's office negotiating a pension risk transfer transaction the next morning.

Between writing this article and it being published, the implications of that date may have changed. What is certain is that the past three and a half years have seen significant political upheaval and economic uncertainty. And despite this, the UK buy-in and buyout market has reached unprecedented volumes.

It is testament to the resilience of the pension schemes and insurers active in this market that 2019 has eclipsed all previous years. Whether the final figure of bulk annuities this year ends up being in excess of £40 billion or £45 billion – it is more than the past two years combined.

This is not only good news for an increasing number of scheme members who benefit from the security afforded by the insurance regime. It is also good news for the UK economy, where Legal & General invests a material proportion of the premium we receive. This includes our £4 billion partnership with Oxford University developing homes for staff and students, as well as science and innovation districts around this great city.

Looking at the largest transactions in this market, it is telling that the list has had to be updated frequently since we announced our £4.6+ billion buyout for the Rolls-Royce UK Pension Fund on 6 June 2019. We kicked off a summer of 'jumbo' transactions. Of the 10 largest bulk annuities, six occurred between June and October this year.

While the large transactions attract headlines, we continue to serve the whole market. Earlier this year, we completed a buyout for below £2 million. And we have seen transactions across all sizes as hundreds of pension schemes reach a point where they can afford buy-ins and buyouts.

But even for schemes with lower funding levels, the market continues to develop. As many wait for further details on the regulation of new entrant pension consolidators, we have launched a number of solutions helping to bridge that affordability gap. We suggest schemes continue to discuss de-risking options with their advisers.

One longevity insurance (HSBC, £7 billion) has been announced at the time of writing. We are aware of further transactions in the market. This remains an important option for trustees as they de-risk. And it appears a good stepping stone for some schemes as an increasing number of longevity hedges have been converted to bulk annuities this year or are expected to do so in 2020.

Later that summer in 2016, I read an interesting report suggesting demand for bulk annuities of £350 billion over the following 10 years. Since the start of 2017, we have seen almost one quarter of that volume already. There is a strong pipeline going into 2020 and beyond as schemes position themselves to take the logical next (and often final) step on their de-risking path. If only politics were so straightforward!

Written by Legal & General director, UK pension risk transfer, Kai Hoffmann

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Understanding 'Generation DC'

David Whitehair explains how harnessing the power of emotions and their ethical concerns can encourage millennials to invest in their pensions

How can we persuade millennials to invest more in their pensions? Encouraging this age group, currently aged 22-38, has historically been difficult. But new research suggests that addressing their emotions and ethical concerns could be the key to unlocking greater contributions.

For many savers in what we call Generation DC, those who don't have defined benefit plans, current contribution levels are insufficient to reach the accepted target of two-thirds of income in retirement. This is despite the introduction of auto-pension enrolment and minimum contribution levels.

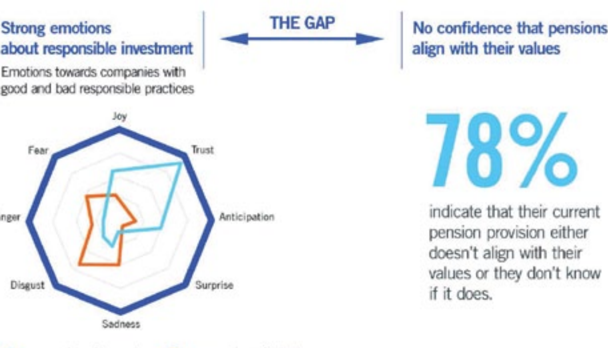
Responsible investing as a catalyst

Generation DC has strong feelings about responsible investment. In a UK survey of 2,700 employees commissioned by Franklin Templeton, a surprisingly high proportion – 45 per cent – said they would pay more into their pension plans if these incorporated responsible investment strategies; 70 per cent of these said they would contribute 1-3 per cent extra per month.

Generation DC ranked responsible investment second in importance in a list of attributes for their pension plan – ahead of fees and investment choice – with only the level of their employer's contribution seen as more important.

But there is a problem. Only 22 per cent of Generation DC felt their current pension reflected their values. This 'emotional experience gap' highlights the disparity between what Generation DC employees want from their pension scheme and what is currently on offer.

Those surveyed expressed particularly strong negative emotions when they felt that their pension savings were not contributing positively to society. But we did find clear alignment between the issues that Generation DC cares about and those that many in the fund-management industry focus on when they adopt responsible investment strategies, such as climate change, animal welfare and packaging.



View savers as people, not statistics

If the findings of the research were acted upon, our calculations show that Generation DC employees alone would be willing to pay £1.2 billion in additional contributions annually. This would represent an increase of close to 20 per cent on the amount currently contributed by all employees into workplace DC schemes.

To make this happen, Franklin Templeton believes we need to move past viewing DC savers as statistics and better understand them as people. We carried out this study with Adoreboard, a world leader in the use of artificial intelligence to measure emotional responses, because we recognise that emotions can drive decision making and actions.

The report shows the way forward: pension scheme operators, sponsors, advisors, investment managers and regulators should develop better ways to understand pension scheme members and their opinions, and respond to Generation DC's wishes for clearer information on where their money is invested and the impact it is having. There is a clear role for everyone involved, but it will require fresh thinking and a wide-ranging conversation.

The full report can be downloaded at franklintempleton.co.uk/generation-dc

Written by Franklin Templeton director of defined contribution strategy, David Whitehair

In association with

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How pension schemes are flexing ABS

Frank Meijer discusses the attractions of asset-backed securities

For those readers who are unfamiliar with this asset class, asset-backed securities – or ABS – are fixed-income investments secured with reserved asset pools, including car loans, credit card loans, residential mortgages, commercial mortgages and loans to corporates.

At over £1,100 billion, the European ABS market is similar in size to the European investment-grade corporate credit market. As well as being large it is also diverse, offering a broad range of potential allocations across countries and underlying sectors.

ABS portfolios offer institutional investors a structural spread-premium relative to traditional fixed income assets, with comparable levels of credit risk. One reason for the spread premium is that the European Central Bank has bought fewer ABS bonds than other fixed income assets, and so yields on ABS bonds have been much less suppressed. Insurance companies are also much less active in the ABS market due to solvency capital considerations, which makes the ABS market less crowded than traditional fixed income markets. Pension schemes searching for attractive sources of yield are able to benefit from this.

An additional attraction for pension schemes is that ABS has a low, or even negative, correlation with many traditional asset classes. ABS portfolios also offer exposure to direct consumer risk, which is complementary to sovereign and corporate exposure, both of which are typically well-represented within institutional portfolios.

There are various ways in which our UK pension clients have incorporated European ABS within their asset allocation. We summarise these in the table opposite.

Seeking a yield pick-up	Many pension schemes have been drawn to ABS because of the yield pick-up it offers over traditional credit and cash. UK credit yields have been compressed for a long time, while pension schemes have increased their fixed income allocations through LDI, buy-and-maintain and CDI strategies. This has left some clients looking elsewhere for fixed income investments that offer a similar risk profile as investment-grade credit. ABS is helping to meet this demand.
A temporary home before moving into illiquid assets	Many pension schemes are seeking to build allocations to illiquid asset classes, such as private debt and infrastructure, they often need a place to invest the capital before it is drawn-down. European ABS is a relatively liquid alternative fixed income strategy that compares favourably with other potential options such as equites (too volatile) and traditional fixed income (insufficient yield). In some cases clients have set a new strategic benchmark and want an immediate allocation to alternatives, a categorisation which includes European ABS.
Minimising interest-rate sensitivity	European ABS bonds are almost always floating rate, in contrast to the US, where most ABS bonds have fixed-rate coupons. This makes European ABS particularly attractive to clients who do not want to take on additional interest-rate risk.
Diversifying credit expo-sure	At times of stress similar asset classes tend to become highly correlated, including traditional credit markets. As global markets swing between 'risk-on' and 'risk-off', some of our clients have invested in our European ABS fund as a way to diversify their traditional credit exposure to less correlated assets.

For more information, please contact the institutional team of Kames Capital, which distributes Aegon Asset Management's strategies in the UK.

www.kamescapital.com/institutional

Written by Aegon Asset Management head of alternative fixed income, Frank Meijer

In association with

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Seagulls and horses

TORI Global pensions and investment specialist, Jon Dadswell, speaks to Jack Gray about his love for Harlequins, disco and having dinner with jockeys

What's your employment history (including jobs outside of pensions)?
I started my career with NatWest, working at the Wimbledon Park branch, which was great for the tennis come June/July time. I am proud to say I have worked for some of the best investment managers in the industry.

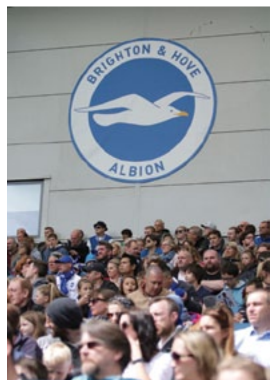
What's your favourite memory of working in the pensions sector?
I have fond memories of all the great pension fund clients I have worked with over the years.

If you did not work in pensions, what sector do you think you would be in instead?
I would have loved to have been a sports journalist.

What was your dream job as a child?
My dream job as a small child would have been to be a zookeeper.

What do you like to do in your spare time?
I love to watch Harlequins Rugby Club. My youngest daughter and I have season tickets. I also love watching my racehorse running anywhere in the country. I really enjoy seeing my daughter playing netball.

Do you have any hidden skills or talents?
I am proud to say I have run four marathons, three times in London and once in New York.



Is there a particular sport/team that you follow?
As well as supporting Harlequins, I have watched and supported Brighton and Hove Albion since being a small boy.

If you had to choose one favourite book, which would you recommend people read?
I love all books about sport and achievement. I was inspired by Matthew Syed's book *Bounce*, and at the moment I am reading *The Jumping Game* by Henrietta Knight – great if you love horse racing.

And what film/boxset should people see?
At the moment I am really enjoying watching *Succession*. It's a great series. An old film I really enjoy watching time and time again is *Trading Places* with Eddie Murphy.

Is there any particular music/band that you enjoy?
I am a bit of a soul and disco person, so enjoy all the favourites from the 70s and 80s.

Who would be your dream dinner party guests?
My dream dinner party guests are John Francome, AP McCoy and Lester Piggott – all legends. If I was allowed a fourth it would be Peter Kay.

Is there an inspirational quote/saying you particularly like?
Treat everyone as you would expect to be treated yourself. Always show respect and honesty.

Written by Jack Gray

DB Complete

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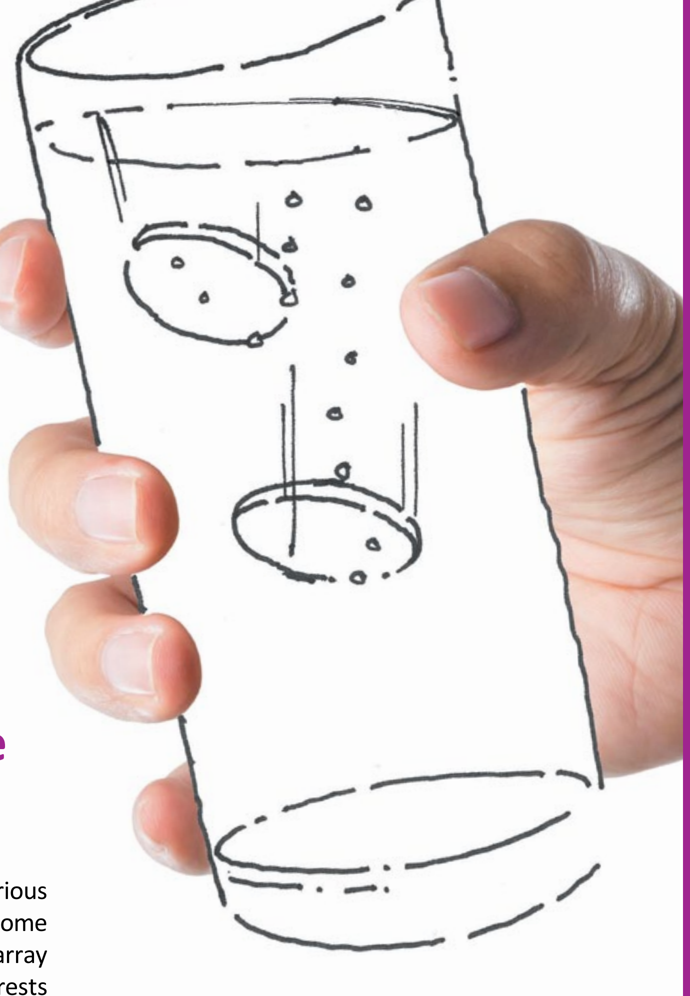

Effective relief from DB scheme management headaches

Running a Defined Benefit (DB) pension scheme is becoming a serious headache for non-professionals. In recent years, standards have become much more stringent, and this trend is only going to continue. An array of regulation is being introduced. These rules have savers' best interests at heart but implementing them can be complex.

The message from The Pensions Regulator is clear: **"If trustees cannot meet the standards we expect, we believe they should wind up and consolidate savers into a better run scheme."** David Fairs, Executive Director of Regulatory Policy, Analysis and Advice, The Pensions Regulator.

DB Complete is an award-winning Master Trust from TPT Retirement Solutions. We manage schemes for over 2,600 employers and over 350,000 members. Employers have been trusting us with their pensions for over 70 years and with assets exceeding £12 billion we are one of the leading providers of workplace pensions in the UK.

Save yourself the headache. Download our DB Complete guide to see how it could be the solution for your scheme www.tpt.org.uk/headache

The bulk annuity market changes up a gear

Guy Freeman looks at another record-breaking year for bulk annuities and what this means for schemes yet to turn to insurance

Every year it seems records are being broken in the bulk annuity market and 2019 has seen a string of very large deals. What could this mean for schemes that have not insured yet and how can they best prepare to approach the market when insuring becomes desirable?

2019 market update

Predictions for transaction volumes in 2019 are now at £40 billion, compared to the £24 billion completed last year and less than £14 billion in all previous years before that. This recognises increased demand from pension schemes and provides unambiguous proof that the appetite exists to transact at these volumes and sizes. So far, 2019 has seen:

- The largest buyout ever from Telent's £4.7 billion fund
- The largest buy-in with Rolls Royce's £4.6 billion
- The largest buy-in to include deferred members with Allied Domecq's £3.8 billion
- The largest-ever deficit contribution of £800 million from Walmart/Asda to complete their £3.8 billion buyout transaction.

Perhaps of greater significance for the future market are the large schemes transacting for the first time, for example the largest fund (National Grid at £20 billion of assets) and the largest UK company (BAT with a market capitalisation of over £60 billion) to have transacted to date. Why is this happening now?

Efficient risk management – There is a growing demand for outsourcing the sophisticated asset and risk management that is needed to pay pensions safely over decades. This is not only because of an emerging acceptance that insurers are simply more efficient and cost-effective than corporates at managing complex and long-dated asset-liability risks, but also the attraction of being able to communicate the simple message that the scheme has been being fully secured and transferred.

Solvency levels are higher – Whilst deficit contributions have helped, many funds have also seen asset-liability outperformance. When combined with a few years of falling costs for future longevity improvements and improved CPI hedging markets, solvency levels have reached their highest-ever levels for a sustained period. For overseas sponsors, the fall in sterling has also reduced the cost of a sterling deficit.

Regulatory pressure is increasing – With its 'clearer, quicker, tougher' mantra, its focus on contributions versus dividends and on investment risks for weak sponsors, The Pensions Regulator is applying more pressure on sponsors. Being forced to declare long-term funding aims might well trigger more companies to start to plan for a buyout, when combined with this increasing regulatory pressure.

What could this mean for the future?

All else being equal, schemes tend to see good pricing when insurers have an increased appetite and ability to transact. Appetite is driven by the availability of capital, which is currently good. Ability to transact is driven by availability of assets and human resources to price and process transactions. On the people side, insurers have been growing their teams but limited human resources mean they will continue to be selective about quoting. On the availability of assets for future deals, the recent announcements are stimulating an increased volume of enquiries about possible asset opportunities for Rothesay Life. This is an encouraging sign for 2020 pricing levels and bulk annuity volumes.

So, what should schemes be thinking about?

After a busy summer closing four large deals worth a total of £15 billion over two months, we can take stock and think about what made these schemes stand out. Apart from good preparation and planning, the key aspects from our perspective have been that:

- The company, trustees and their respective advisers work together effectively
- The advisers are experienced and regularly see transactions through to completion
- Early consideration is given to issues that might stall execution such as illiquid assets or complex benefits
- There is a price lock that matches assets held by the trustees with minimal caveats
- Contract negotiations recognise the needs and constraints of both parties

Good access to capital has helped us write multiple larger and longer duration transactions at competitive prices. Raising £1.1 billion in September means that Rothesay Life is well-primed for 2020 and has the appetite, resources and track record that trustees can rely on.

Written by Guy Freeman, business development, Rothesay Life

In association with

Rothesay life

Thank you

to all of our clients

Experts in pension fund insurance and buy-outs
Our focus on risk management means that after 12 years:

£50bn+
assets under management

£21.5bn
invested in the UK economy

3rd
largest UK annuity insurer

£2bn+
in pensions paid every year

800k+
individuals' pensions insured

£16bn+
new business in 2019

Risk Awards 2019 Winner
Rothesay Life
Insurer of the year

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Multi-asset credit: Time to diversify

Jack Gray investigates why pension schemes are moving away from fixed-income assets and becoming increasingly drawn to multi-asset credit investment strategies

Over the past decade, the popularity of multi-asset credit (MAC) investment strategies has surged as schemes look to create a more diverse, flexible and modern approach to pension investing.

Returns from fixed-income assets has declined as long-term government bond yields remain at low levels, resulting in pension schemes moving away from traditional fixed-income assets to a more diverse MAC approach.

Schemes have been seeking assets to close the funding gap and mitigate the increased regulatory pressure on trustees, while the uncertainty of the long-term prospects of UK interest rates and bond yields are pushing them towards a MAC approach.

MAC strategies typically target returns of between 5 per cent and 8 per cent and attempt to rotate between asset classes in order to maximise returns. They usually consist of allocations to assets with less sensitivity to interest rates, relying on MAC managers and market opportunities to receive positive outcomes from illiquid credit.

The flexibility of the investment approach allows schemes to be invested in a diverse range of credit strategies, reducing the risk that might be present in single asset class strategies.

Aviva Investors real assets CIO, Mark Versey, says that investors were increasingly looking for multi-asset portfolios with an outcome-orientated focus, "whether that be growth, long income, or predictable, inflation-matching cashflows".

He continues: "New entrants and rising allocations from existing investors increase the risk of overcrowding and of returns being squeezed in well-trodden areas of the market. Investors need to consider this when building strategies to ensure they achieve the best possible outcomes."

A recent Legal & General Investment Management survey found that demand for MAC strategies from defined contribution schemes had risen. It seems investors have found MACs more attractive as while one asset class may be underperforming, another will step up to fill the gap.

"Multi-asset funds or funds-of-funds that invest in open-ended property funds may have to suspend dealing if the property funds temporarily shut," explains AJ Bell head of active portfolios at investment platform, Ryan Hughes.

"As such, we could see multi-asset funds move towards closed-ended funds, such as investment trusts, for property exposure.

In a worst-case scenario, we could see them restricting their allocations to these illiquid assets to below 20 per cent, in turn reducing the diversification of the funds for investors."

Reduced fees have also increased demand for MAC strategies, with LCP's *Investment Management Fees Survey 2019* finding that the average asset management charge for a £50 million investment mandate fell by around 0.07 per cent between 2017 and 2019.

Its report states: "The average fee for an active global equity mandate of £50 million has fallen by 11 per cent since 2017. There have been notable fee reductions in multi-asset diversified growth funds, multi-asset credit, liability-driven investment strategies and passive global equity mandates.

"However, other fixed-income strategies have seen a rise in fee rates. It is difficult to give any particular explanation for these increases, but it could be due to pension fund demand for bespoke and more sophisticated fixed-income strategies."

Furthermore, it is not only prosperous returns and declining fees that are encouraging the use of MAC strategies. Their flexible nature can allow those with sustainable and responsible investment principles to invest in credit strategies that consider environmental, social and governance factors, while still attempting to maximise returns.

However, the Pensions and Lifetime Savings Association warned that the implementation of MAC strategies needs "careful consideration".

It advises: "If you are considering taking a different approach to how you allocate to credit, you must first define your goals. Think about the respective roles of liability matching and return generation that credit plays within your portfolio."

Written by Jack Gray

Harvest the potential of the credit markets.

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Investec Multi-Asset Credit Strategy

We believe our willingness to **dynamically allocate throughout the individual credit markets** sets us apart.

Through our expertise and experience, we seek to avoid the risks and take advantage of the opportunities in each market as they arise, **efficiently managing exposure** for the best outcomes.

The managers' objective? To provide a **global credit solution for pension funds**, seeking attractive, defensive, risk-adjusted returns and income generation characteristics, with lower drawdown and lower volatility.

This truly dynamic approach has resulted in annualised returns since inception of 7.1%[1], with attractively low volatility of 2.3%[2].

www.investecassetmanagement.com/MAC

Past performance is not a reliable indicator of future results, losses may be made.
Calendar year returns %[1] – 2019 YTD: 6.8; 2018: 1.1; 2017: 6.9; 2016: 11.4; 2015: NA

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More CHOICE for members more CERTAINTY for sponsors

Member options

Sponsors and trustees have an important role to play in deciding what options to make available to members and how much member support should be in place. Aon is well placed to help trustees and sponsors consider which member options solutions best meets their needs. We have a dedicated Member Options team comprising over 60 specialists, providing advice and support on the full range of member options, including flexible retirement and pension increase conversion exercises. With this specialist knowledge, we have advised on more exercises than any other consultancy in recent years.

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How far to go – *Tom Clarke asks how far away your scheme really is from being able to buy out members' benefits?* ***p44***

Know your options – *Aon senior partner and head of member options team, Benjamin Roe, speaks to Pensions Age about member option exercises* ***p47***

Member options focus:

A faster route to buyout

Aon senior consultant, Tom Clarke

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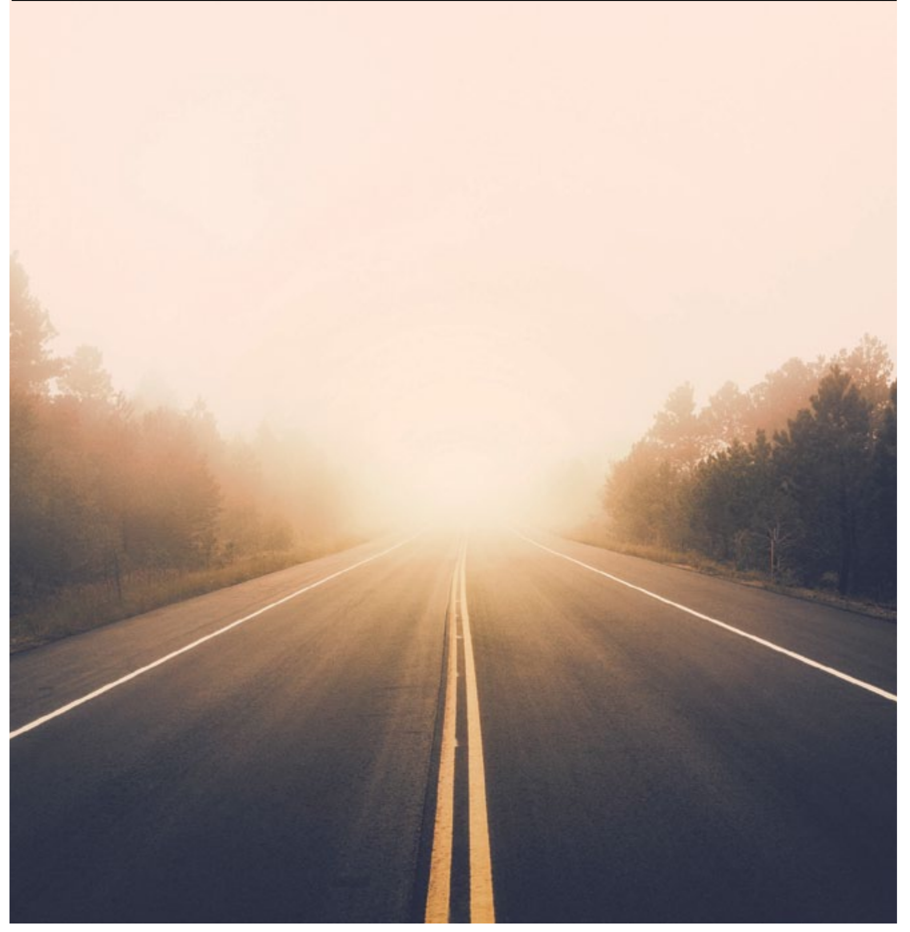


How far to go?

Tom Clarke asks how far away your scheme really is from being able to buy out members' benefits?

Time to buyout allowing for all proactive steps such as member options

Proportion of schemes

100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%

- 5 10 15 20 25 30

Years to buy-out

Over 90% of schemes could buy-out within 30 years

75% of schemes could buy-out within around 15 years

50% of schemes could buy-out within around 10 years

Despite current market volatility, record low yields and other pressing issues such as GMP equalisation, trustees and sponsors are talking more than ever about the endgame. Many schemes have a plan or a target date to get to buyout, but do schemes know how far away from buyout they really are? For most schemes, this will be a good news story as there are a number of reasons why buyout might be much closer than you think. Member options exercises and preparatory work taken ahead of approaching the insurance market can significantly shorten the timescales.

Aon has carried out research for all pension schemes with a FTSE 350 sponsor – schemes with liabilities in excess of £1 trillion – to understand what realistic timescales are.

What happens if I take no action?

The good news is that you can expect – on average – to make significant progress towards buyout without taking additional proactive steps. We have estimated the average time to buyout in this way to be around 20 years.

Aon research of schemes with FTSE350 sponsors

Taking proactive steps to reach buyout can halve the typical time taken from 20 years to 10 years.

One in five schemes could achieve buyout within five years following this more proactive approach.

For half of schemes, buyout in five to 15 years is realistic.

Deficit contributions are still being paid into most schemes and these will bridge much of the gap to being able to buyout. But they only go so far, and most schemes are not expecting contributions to continue beyond being fully funded at the three-yearly valuation. Most sponsors are likely to be unwilling to commit additional contributions beyond this point.

Investment returns are also expected to make a significant contribution. But can these be relied on? What is the impact of current record low yields? What happens if a recession hits? What happens if schemes de-risk their investment strategies further? The impact will vary significantly between schemes.

One other positive driver is that as schemes mature, buyout pricing becomes more attractive. This is primarily due to current pensioner members being much cheaper to insure than members who have not yet started to draw their benefits, especially where members exchange part of their pension for a tax-free lump sum upon retirement.

What action can my scheme take?

Our research shows that the typical scheme can expect to reduce its timescale to buyout from 20 years to 10 years through taking a number of proactive steps. One in five schemes could even achieve buyout within five years and a further 50 per cent in five to 15 years. These actions fall into two categories: member options and optimising the insurance transaction.

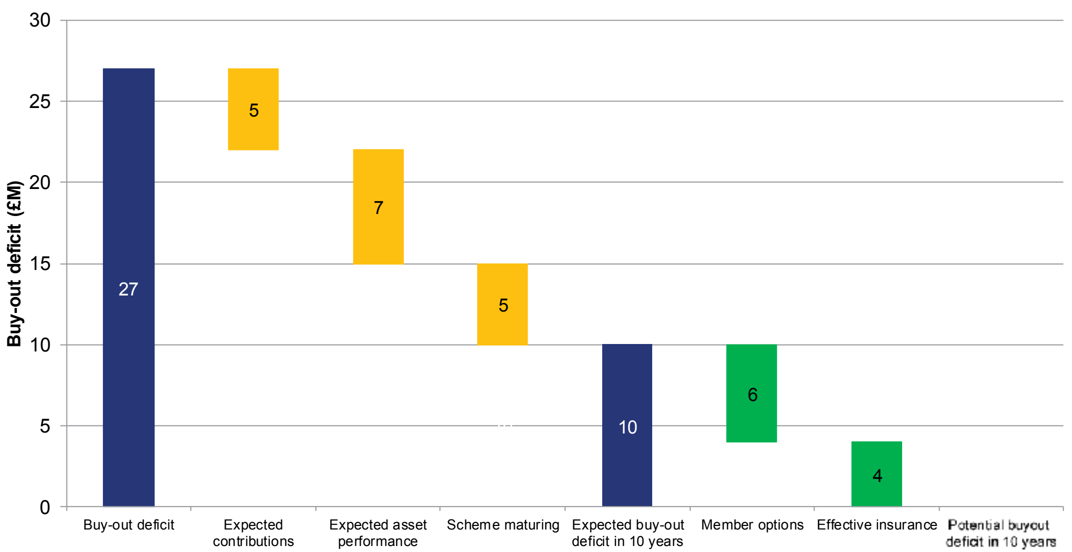
Member options

Transfers: The popularity of member options has risen significantly in recent years, with record numbers of members transferring their defined benefit pensions to defined contribution schemes. More and more schemes are going a step further and taking steps to facilitate this. In some cases the focus is on regular transfers (often at point of retirement). This typically involves taking steps to help members navigate the complex decision such as by sourcing a reputable IFA and enhancing the member journey through improved communications and online support. Increased transfers could reduce time to buyout by two years.

Bulk transfers: Other schemes are taking similar steps but as a bulk, one-off project such as an enhanced transfer value exercise. One-off exercises are usually particularly attractive as schemes approach buyout. Transfer terms are often more generous to members than the transfer terms which would be available from the insurer following the buyout but still leading to an insurance premium saving. This takes a future profit from the insurer and giving it to members now instead. In this way we often see these exercises

Where does your scheme fit in?

If you would like to understand how distant your scheme may be from buyout, the possible actions to take and how it compares to the schemes in our research, get in touch with Aon at **memberoptions@aon.com** for a free buyout timescale consultation.



as a win-win for transferring members, remaining members and sponsors. This step can bring buyout two to three years closer.

Pension Increase Exchange: Other than transfer values, the other main types of options are those that allow members to reshape their pension. The most common of these is a Pension Increase Exchange exercise (PIE) where members choose to give up future annual pension increases in return for a one-off increase to their pension. With many people preferring to spend more money in the earlier, more active years of retirement, this tends to be a popular option. Such options can look particularly attractive when viewed through the lens of getting to buyout due to insurers pricing inflation-linked pension increases more expensively than would typically be considered fair value. Some schemes may offer other ways for members to reshape their pensions, for example with the option of a bridging pension. This aims to make a member's total income before and after state pension age broadly equal. Implementing these kinds of options, both for current pensioners and as an additional option upon retirement, can reduce buyout timescales by more than two years.

Optimising the insurance transaction

There is also a huge range of actions that schemes can take in the settlement space to attract good buyout pricing.

Member benefits: It is important for schemes to understand early on which benefits are being insured. For example, understanding current discretionary practices (and considering if these should be insured) can have a material impact.

But perhaps the most material variable when it comes to understanding members' benefits is the level of actuarial factors, in particular commutation factors (the factors used to convert annual pensions into tax-free lump sums upon retirement). Insurers have their own sets of factors and typically set these at a level that is far more generous to members than those currently used by most schemes. This could present a windfall benefit improvement to future retirees compared to previous generations of retirees. For some this may be acceptable, but other schemes may prefer the insurer to set factors at a lower level – both for equal treatment of members and for reduced cost. While there is a limited range within which insurers will typically be happy to set their factors, this action could still bring buyout more than a year closer for the typical scheme.

Negotiation: Negotiation plays a key part. Deciding on your strategy for approaching the market (how many rounds of pricing?), maintaining flexibility and partnering with an adviser with experience of similar transactions are all key. Exploiting these competitive tensions in the buyout market could easily reduce buyout timescales by one to two years. In some cases, we have seen insurers reduce pricing by as much as 5 per cent overnight.

Insurer pricing is constantly changing due to supply and demand characteristics, market yields and asset availability. Being ready to transact at the optimal time also helps, with some schemes putting in place triggers to kick off the transaction once the insurance pricing reaches an acceptable level. This can mean schemes for which buyout is just beyond their reach (without additional contributions) can find themselves buying-out following a favourable change in yields.

Data and preparation: In an increasingly competitive buyout market, carrying out preparatory steps such as data cleansing, marital surveys and benefit audits can help schemes to stand out and attract the best pricing. It also avoids nasty surprises further down the line when insurers look into schemes in more detail as part of their due diligence. This can also bring buyout closer, in particular by increasing the attractiveness of your scheme compared to the other schemes obtaining insurance quotes.

Success story – PA Consulting
PA Consulting expected that their scheme would run on a self-sufficient basis for 10+ years. This was challenged by the Aon team, who showed that buyout was achievable in much shorter timescales with no further cash contributions. By combining a successful series of member option exercises and bulk annuities, all liabilities were secured, leaving the scheme with a small surplus.

What is right for my scheme?
The preferred approach will differ between schemes and not all schemes will wish to carry out all of the activities discussed here. Some sponsors and trustees will prefer a multi-year plan to get to buyout while others will prefer to hold out and consider issues such as member options once buyout is within touching distance.

This kind of planning is also relevant for funding and investment discussions between sponsors and trustees, with some schemes risking being overfunded once the scheme is buyout ready. A nice problem to have for some, but surely something most sponsors would prefer to avoid.

In summary, understanding how far away your scheme really is from being able to buyout members' benefits is the key to making the right decision for your members on funding, investment and the day-to-day running of your scheme.

Written by Aon senior consultant, Tom Clarke

In association with

Know your options

Aon senior partner and head of member options team, Benjamin Roe, speaks to *Pensions Age* about member option exercises

What options are available for schemes to offer their members, in order to help reduce the scheme's risk?
Options that could be offered to members typically fall into two categories. Firstly are those that make the scheme smaller and less risky by discharging assets and liabilities. The most common examples here would be DB to DC transfers or trivial commutation (cashing out small pension benefits).

Secondly, those that allow members to reshape the benefits provided within the scheme, for example pension increase exchange (PIE). This allows members the option to exchange future pension increases for a higher starting rate of pension, which does not increase in payment.

In all cases these options are presented as a member choice. Care is taken to ensure that the options are communicated clearly and concisely and member support is put in place to ensure members can make an informed decision.

The bulk annuity market has seen record-breaking growth over the past couple of years. Have the number of schemes offering members transfers and PIE increased similarly?
We have seen a large increase in the number of schemes that are running bulk incentive exercises and also proactively communicating options to members and providing members with access to independent financial advice as part of the ongoing running of the scheme.

The results of the Aon *2019 Global Pension Risk Survey* show that only 15 per cent of schemes say that they are unlikely to implement a flexible retirement option (communicating the transfer value option and providing support so members can make an informed decision at retirement) in the next 12-24 months. This has fallen significantly from 2013 when 74 per cent of respondents said that they were unlikely to implement this option.

While large bulk annuity transactions are visible and often make the press, ongoing member option activity is less likely to as many schemes see this as good governance in the ongoing running of the scheme.

What impact can implementing a member option exercise have on a scheme's journey to buyout? And are schemes aware of this impact?
One-off bulk member option exercises are usually particularly attractive as schemes approach buyout. Quite often you can find that as a scheme approaches buyout, the transfer terms on offer through the scheme are more generous to members than the transfer terms that would be available from the insurer following the buyout – but yet still leading to an insurance premium saving. So taking a future profit from the insurer and giving it to members now instead. In this way we often see these exercises as a win-win for transferring members, remaining members and sponsors.

We are seeing more and more interest from our clients in this area and it is becomingly increasingly common for member options to help to accelerate the journey to buyout. Recent large examples in the public domain include Rentokil and PA Consulting.

What advice would you give for schemes considering implementing a member option exercise?
The first step is to understand the various options that could be made available to members and working out the effect they could have on the current funding and investment strategy and journey to buyout.

Preparation is important; schemes need to make sure that the required data is available or understand if there are any workarounds for any missing information. Make sure that address data is up to date, especially for deferred members who may not be in regular contact with the scheme.

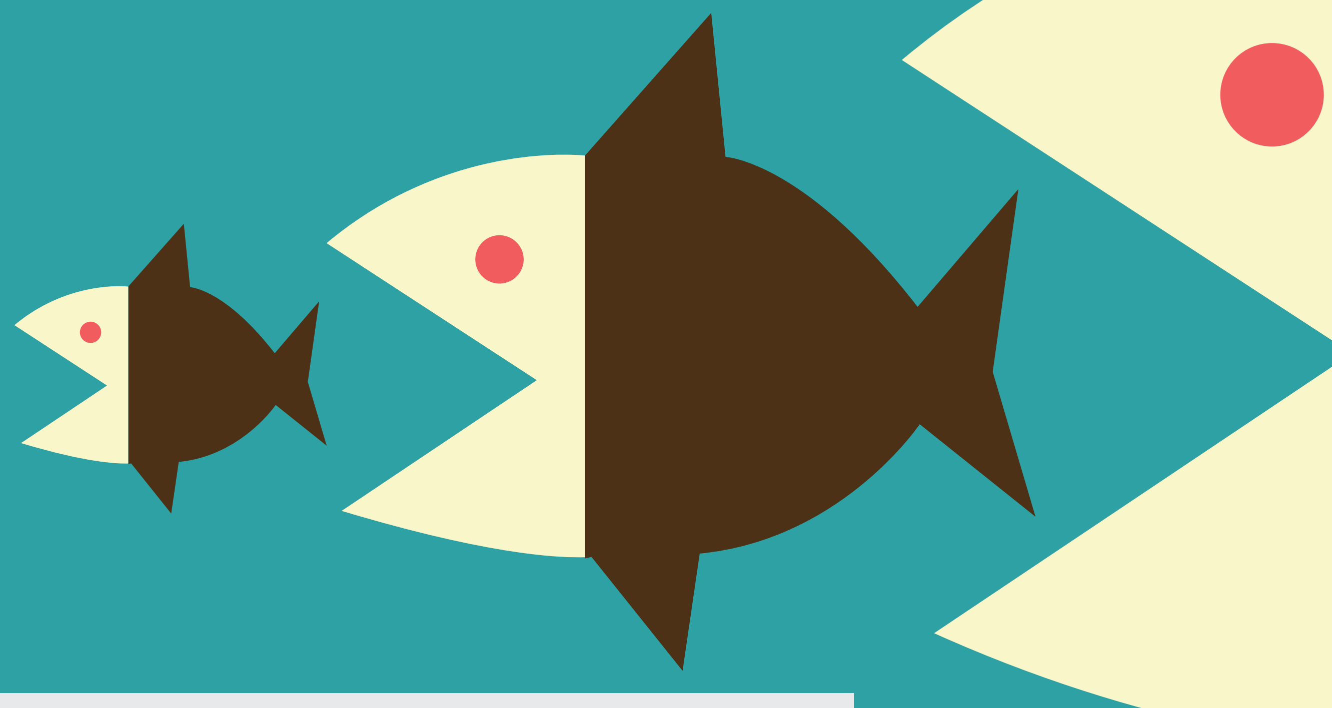
Member option programmes can be large complex projects with multiple stakeholders so make sure you have strong experienced project management in place.

And finally, always keep the focus on the member journey, how can you engage with members in the most appropriate way – and ultimately make sure that they can make informed decisions on their retirement benefits.

In association with

Size matters

Nick Reeve explores the relationship between the size of the DB scheme and the size of its sponsoring company



Summary

- A scheme's size relative to the sponsoring employer is a critical part of constructing a funding plan and identifying an endgame target.
- Close engagement with the sponsor is important regardless of size to ensure alignment of goals.
- Large schemes must be careful to construct contribution schedules and investment strategies that will not 'kill' the employer.
- Small schemes should keep an eye on the long term and obtain written funding agreements to avoid falling off the sponsor's radar during good periods.
- TPR is developing a two-tier approval system for signing off recovery plans – but big schemes are unlikely to make the cut for its planned 'fast track' option.

Eight of the UK's 100 largest listed companies have DB schemes bigger than the organisations themselves. Across the FTSE 100 index, DB liabilities are valued at more than 20 per cent of the index's total market cap.

In some cases – such as BT Group, IAG, and Centrica – the DB schemes dwarf their parent companies, with liabilities valued at more than twice the sponsor's market capitalisation (three times, in the case of BT Group). British Airways – now part of IAG – was once commonly referred to as a pension fund with an airline attached.

But how does a scheme's size affect its sponsoring employer? Is having a relatively large scheme always a bad thing?

The size of a DB scheme relative to its sponsor is a "crucial part of the puzzle" when constructing a journey plan, according to Redington investment consultant Mette Hansen. While there

Sponsor	*Assets (£bn)*	*Liabilities (£bn)*	*Market cap (£bn)*	*Liabilities as a % of market cap*
BT Group	53	59.9	19.9	301%
IAG	24.4	22.2	10.4	213%
Centrica	8.5	8.6	4.2	205%
J Sainsbury	10	9	4.6	196%
Royal Bank of Scotland	48.8	39.6	26.4	150%
RSA Insurance	7.8	7.5	5.4	139%
BAE Systems	21.2	24.8	18.2	136%
Lloyds Banking Group	42.2	41.1	40.9	100%

Sources: CapitalIQ, Bloomberg, Rhotic Media. Market cap as of 29/10/19

are many elements to consider when assessing a scheme's covenant, relative size can be a guide to how likely a scheme is to "kill the sponsor", as Hansen puts it.

"If the company is weak, and the trustees asking for money would kill the company, they have to manage the scheme with that in mind," she says. "They need a close relationship with the sponsor and to know what it is trying to achieve."

Big scheme, small sponsor

An outsized DB scheme is an obvious problem for finance directors, especially if it is underfunded. It can be a drain on cash and place a limit on business expansion, as well as bringing unwanted attention from The Pensions Regulator (TPR) – and in some cases, politicians.

TPR's recent drive to ensure employers do not prioritise shareholder dividend payments over deficit reduction contributions has also posed a potential investment problem to companies.

Kempen Capital Management's head of UK investment strategy, Nikesh Patel, says: "That much attention usually lends itself to the sponsor pushing for a more professional trustee board, as the outcome of discussions can make or break the business plan for years – even decades – to come. The scheme's performance relative to its deficit could swamp the activity of the business itself."

For this reason, there is less room for a "misstep in the funding journey", according to River & Mercantile Solutions' co-head, Ajeet Manjrekar. This needs to form an explicit part of the scheme's investment strategy, he adds.

On the plus side, Hansen points out that the sensitivity of the situation may make it easier for trustees to engage with the sponsor's board to come up with practical solutions to funding problems, "especially if both sides understand each other and there is a shared goal".

In May 2018, the BT Pension Scheme (BTPS) agreed a deficit reduction plan with BT Group worth £13 billion to address what was an £11 billion shortfall in the DB scheme. This consisted of £2.1 billion in cash contributions paid by June this year, plus a further £2 billion raised through the bond markets and annual payments of £900 million, lasting until March 2030.

As well as the contribution schedule, BTPS trustees also agreed to shut the DB section of the scheme and introduce a hybrid arrangement. They also amended the scheme's investment strategy, shifting 15 per cent from growth assets to lower-volatility investments.

At the time, BT chief financial officer Simon Lowth said the agreement would draw a line under "a key source of uncertainty for BT, the scheme members, and all our stakeholders, and allows us to move ahead with confidence as we deliver on our strategic initiatives such as investing in our network and improving customer experience".

The upfront contributions have already had an impact: in its annual report for the 12 months to 31 March 2019, BT reported a funding deficit of just under £6.9 billion.

Small scheme, big sponsor

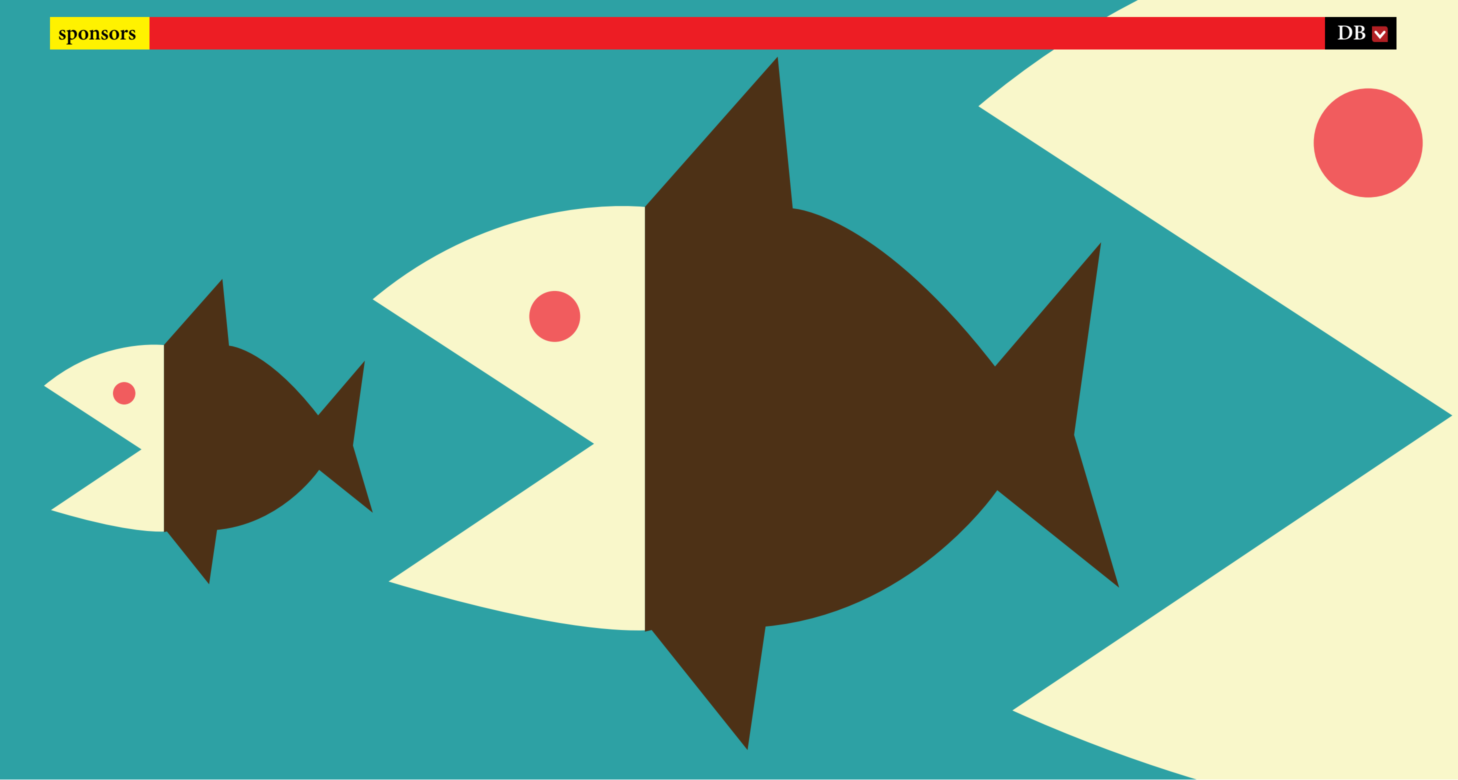
BT's position – and that of other companies whose DB liabilities outweigh their market capitalisation – is not the norm. There are many other companies with small schemes that do not cause their finance directors as many sleepless nights.

However, small schemes can have their own problems related to their size.

"A very small scheme in the context of a large employer is not usually given much priority, as it is not viewed as a significant business risk," says Patel. "They may struggle to get any serious attention or focus and be at risk of being pushed around in negotiations."

As Hansen explains, a small, well-run scheme can encounter engagement problems of a different nature.

"Sometimes trustees haven't thought about what happens when you're fully funded on a technical provisions basis," she says. Companies are not legally obliged to continue deficit reduction contributions once schemes are fully funded on a technical provisions basis,



even if it is not ready for buyout.

"It's a good problem to have, if engagement becomes harder because the scheme stops being a problem," Hansen says, "but it might be difficult to pinpoint an end target. Should you buy out or run off? Often trustees will want to do a buyout to wind up their fiduciary obligations. For very small schemes it's often not efficient to run off on your own."

Trustees should certainly not rest on their laurels in this situation, according to Manjrekar. While the employer may seem strong now, the picture could change dramatically over the life of the scheme – and trustees should factor this into their long-term thinking even when the funding position looks positive. For relatively small schemes, getting this in writing is vital.

"We believe that trustees need to work in partnership with the sponsoring employer to define and frame the long-term funding objective and endgame," Manjrekar says. "This should be coupled with a pre-agreement on financial support should the scheme get into difficulty.

"In doing so, trustees can therefore have greater confidence in the strength of covenant and may even target a higher level of return from the investment strategy accordingly."

New funding code

TPR is currently working on a new funding regime for schemes. Subject to legislation passing through parliament, it plans to set up a new two-tier approval system for DB recovery plans.

Speaking at the Pensions and Lifetime Savings Association (PLSA) conference in Manchester in October, TPR's executive director of regulatory policy, analysis and advice, David Fairs, told delegates that the regulator would introduce a 'fast track' process to reduce the regulatory burden on schemes and focus oversight efforts on more complex areas. He explained that TPR wanted schemes to reach a low level of dependency on their sponsoring employers by the time they reach maturity, or a cashflow-negative position.

Details of the new regime are still subject to consultation, but discussions of TPR's plans at the PLSA conference touched on how much of a factor size would be in ascertaining a scheme's eligibility for the fast-track route.

Hansen says: "We are supportive of the new regime, but fast track is meant to be for simple schemes. If you're not in the fast track it doesn't mean you're bad – it might just be that your situation is more complex and the right choices might be harder to figure out."

Over time, TPR will want more and more schemes to move to the fast track, Hansen adds, to help it identify where it needs to focus its efforts.

For Patel, the fast-track option will likely not apply to DB schemes larger than their sponsors. While small schemes may get the fast track, he warns that there will likely be more pressure on sponsors to close any funding gaps "faster and more aggressively".

Manjrekar concludes: "Ultimately, it is essential that the scheme and sponsoring employer are aligned on the long-term funding objectives of the scheme and its endgame. This reflects the balance in 'affordable and sustainable' contributions with targeting an appropriate investment return from the assets."

Written by Nick Reeve, a freelance journalist

Working better together

▶ *Pensions Age* looks for your tips as to how pension fund trustees/managers can ensure a harmonious relationship with their providers

At the heart of positive relationship management is good communication and a clear understanding of expectations, for both parties. I believe the best starting point is for pension fund trustees/managers to clearly define and agree their expectations at the beginning of any relationship with the service provider. This should encompass an agreement on service standards and ongoing service support. Questions like 'do we have a dedicated relationship manager' and 'how quickly will you respond to issues' can help build a framework around a set of expectations to help manage the relationship.

I also find that maintaining regular contact with service providers is key. We are all so busy in our day-to-day roles that when things are going smoothly with service providers, regular dialogue with them may sometimes drop off and things get missed. I think it's important that pension fund trustees/managers hold regular, structured meetings with their service providers. This strengthens the relationship in two ways. First it creates the conditions for both parties to continually keep up to date with each other's business, so services can be flexed when a change of circumstance arises, and help build on the partnership. Secondly, this helps the relationship when challenges arise.

CACEIS managing director, Pat Sharman

All parties in pension scheme trustee meetings need to be clear on what is expected of them and the risk of events that may prevent a pension scheme from achieving its objectives. One example is investment strategy: investment advisers and fiduciary managers need to be clear on the sizes of risks being taken. Another example is the recent risks to funding levels around an unfavourable Brexit that need to be clearly communicated. If the magnitude of risk of such an event is unbearable when communicated to trustees and sponsors, the investment strategy must clearly be further customised to a scheme's needs. Only when a strategy with appropriately sized risks is found, communicated and accepted by all parties does it become fit for purpose.

Another key ingredient of a harmonious relationship is that there must be give and take. The strongest relationships are those that are symmetric. If one party is given undue prominence then the whole relationship can suffer. For example, if the trustees' scheme actuary, investment adviser and covenant adviser are not in the room when discussing funding, covenant and investment issues, this can result in impossible objectives. If the investment adviser doesn't get to hear how the liability discount risk is set then it can result in investments that need to take unnecessary risk to meet the liabilities. Likewise if a scheme actuary doesn't get to hear a company's covenant strength, the entire scheme funding may be put at risk.

SEI Institutional Group client strategy director, Alistair Jones

We no longer live in a world of selling pre-packaged products and services to pension fund trustees. The world has moved on to a time where customisation and tailoring is key to ensuring a long-term successful partnership with providers.

For me there are three ways to do this successfully. First, by focusing on outcomes; ensuring the provider is aligned to your goals as trustees is key. This should be reflected in clear objectives, service agreements and key performance indicators. A good example relates to The Pensions Regulator's guidance regarding setting objectives for your investment adviser. Evaluating your providers against their own benchmark is akin to marking your own homework.

Secondly, collaboration delivers better solutions. Central to a harmonious relationship with providers is to work collaboratively on the design and implementation of fresh thinking. Finally, you need transparency in everything you do. Providers must be able to provide trustees with complete openness, whether performance attribution, full breakdown on ongoing costs, detailed risk assessment including environmental, social and governance considerations. This ensures that providers are fully accountable for the services they provide and supports effective trustee governance.

River and Mercantile Solutions co-head, Ajeet Manjrekar

It's important that providers have a clear understanding of their client's business needs and objectives in order for them to respond with tailored solutions. This understanding supports the delivery of a great service experience and strong engagement levels, which in turn support good members outcomes.

Standard Life head of strategy and development, Neil Hugh

Summary
• Financial services is one of the least-trusted industries by the public.
• High-profile scandals, such as Maxwell and Equitable Life in the past, and BHS and the NHS pensions today, give people a negative impression of pensions saving.
• Jargon, a lack of pension structure understanding and individuals suffering from mistakes made by their pensions provider can erode trust in the sector.
• This lack of trust may put people off saving for their retirement.
• ESG investment, new technologies and greater engagement with members is expected to increase trust in pension saving.

Do you trust me?

Laura Blows looks at the lack of public trust in pensions saving and the efforts that can be taken by the industry to remedy this

Do you trust me? An emphatic 'no' is the public's answer to those in the financial industry asking; pensions being no exception.

This widespread lack of trust is unfortunate, State Street Global Advisors head of pensions and retirement strategy, EMEA, Alistair Byrne, states, "given that there are so many well-run schemes providing good outcomes to their members".

The lack of trust may be more nuanced than first appears. For instance, while Nest research from October 2018 found a quarter of workers do not trust pension companies, 28 per cent said they did have trust in them.

Just's February 2018 report, *Rebuilding trust in long-term savings,* which conducted qualitative research with over-50s, found 35 out of 45 respondents say they mistrust pensions. However, when asked to rate separately how they felt about the state pension, defined benefit pensions and defined contribution pensions, the level of trust across the three varied considerably.

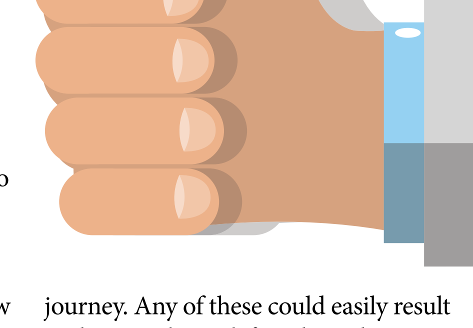
Launching the PLSA's *Building an environment of trust in pensions* report at the association's annual conference last month, PLSA chair Richard Butcher noted that its 2018 research found that two-thirds of pension savers do not trust the industry, rising to 80 per cent for baby boomers. "However," he says, "a 2018 FCA survey found *[pensions]* were the least complained-about financial sector, with approximately one complaint per 1,000 policies.

"So why aren't we trusted?"

Why indeed.

"Trust is hard won and easily lost," Columbia Threadneedle head of pensions and investment education, Chris Wagstaff, points out, "and so it's proved with the public's tarnished perception of the pensions industry.

"Despite the significant strides made to restore trust post-Maxwell and Equitable Life, the past decade has witnessed a whole host of contentious events that have further discredited pensions in the popular consciousness – regulatory failures contributing to the demise of the BHS, Carillion and British Steel pension schemes, financial advisers mis-selling to the deferred pensioners of these schemes, pension scammers riding roughshod over superficial prevention measures, providers having unjustifiably high and opaque pension charges and policymakers making pensions more complex than they need to be."



Reasons for mistrust

Respondents to Just's research recalled a litany of historical industry issues and broken promises that have shaken their faith in pensions.

"By far the most cited 'broken promise' of all was the Maxwell scandal, even though this happened more than 20 years ago. Some identified this as fraud and were aware that the 'rules had changed' as a result to stop this happening again – but were then confused about the BHS story and how this could still happen," it states.

For SEI's MD of defined contribution, Steve Charlton, rather than a lack of trust, the greater problem is that the public do not know how the industry works.

"Headlines like those associated with Maxwell and BHS were/are problems created at the sponsor level, made more complicated by the explanation for their cause being inaccessible to anyone but the most determined member of the public," he explains.

According to Redington head of DC and financial wellbeing, Lydia Fearn, because people don't relate or think about pensions on a regular basis, it can be easy for them to pick up on the bad news, rather than focus on why saving for their later life is important.

"We need positive news stories, case studies of people who have saved enough to allow them the freedom they desire *[at retirement]*," she adds.

But the problems keep hitting the headlines.

Sanlam Wealth Planning director, Michael Angus, highlights the current issue of some NHS pension savers exceeding the annual allowance, along with the poor pensions advice received by British Steel workers, and the Waspi campaign against the rise in women's state pension age, "which whilst having nothing to do with the industry itself will lead to more people mistrusting the sector".

"The developing pension court cases also continue to muddy the waters," Aon partner, Lynda Whitney, adds. "Trust can be lost because you give someone less money than they thought they should get, even when this is not a mistake, just see the ongoing commentary on RPI to CPI changes for specific DB schemes."

Trust can even be lost when giving more money, she warns. "We are going to have to communicate GMP rectification and GMP equalisation very carefully otherwise members can feel 'you have got this GMP thing wrong twice and now you expect me to trust you.'"

It is this fear of the future that adds to the lack of trust in pensions as a long-term saving product. There is concern that pensions legislation may change for the negative in the future, such as tax-free cash being reduced or taken away, Angus states.

Scandals past, present and potentially future may have increased the mistrust, but system complexity and goalposts that move over time adds to this mistrust, PSIG chair Margaret Snowdon agrees.

"People feel let down by the pensions industry and while a lot of it is deserved, there are many more examples of great service and great outcomes that just don't see the light of day," she adds.

There may be many good examples, but it is the mistakes the industry makes to individual pension schemes that are really remembered, Butcher states.

"Savers have very few contact points with us as an industry. If we make a mistake it may be the one transaction that the saver has with us for many years. One error by us, even a small one, can cause a significant sense of grievance with the saver," he explains.

The importance of trust

This breach of trust can have considerable consequences.

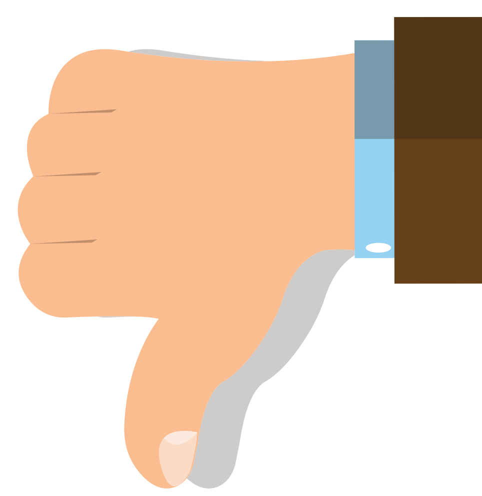
Butcher says: "Without trust there is a risk that members will opt out of saving. That members will pay inadequate contributions. There is the risk that they will not engage with us. Not talk to us so that they will lack the information they need to make the critical decisions they have to make during their savings journey. Any of these could easily result in the saver being left with inadequate retirement income and could result in an increase in pensioner poverty."

Not trusting the pensions industry may lead members to accidentally turn to "smooth-talking" scammers, Snowdon warns. "It is quite difficult to overcome the negative messages drip fed by the scammers. High charges with no transparency have been poisonous to the industry," she states.

Savers' lack of trust can also have ramifications for the industry itself. Turnover and profits for businesses in the sector may decline, as well as making it harder to recruit new staff, Angus says.

"A result could be that the government and FCA may make changes to the industry that may not be beneficial to the industry, such as more/stricter regulation and squeezing fees lower," he adds.

The Transparency Task Force, which has focused of improving trust in financial services, goes so far as to say the financial services sector is in the



'last chance saloon' in terms of changing public perception.

"It is becoming increasingly clear that there is a very real danger that the persistent drip, drip, drip, of adverse publicity caused by the persistent malpractice, malfeasance and misconduct by the 'mischievous minority' means that the public at large are getting dangerously close to 'the point of no return' whereby, regardless of what we subsequently do, the situation may not be salvageable," it warns.

But all is not lost yet.

Efforts made

Trust can be built/rebuilt in a number of ways, such as showing integrity and being transparent with actions.

Butcher recommends listening to the member to provide "valuable insight and understanding", being honest with them, so they can "find the truth in our words, especially if the truth is difficult", and "dumping the jargon".

Research from the Atlas Master Trust, published in September, found that 96 per cent of workers want their employers to be more forthright about saving levels and potential shortfalls.

It seems increasing engagement would be beneficial for both the member and the industry.

As Just's research states: "The more we can get people to think about their pensions, the more likely they are to take a more neutral, or even positive, stance *[with trusting the pensions industry]*."

However, Snowdon is reluctant to rely on 'engagement', as "I think we are kidding ourselves that people will become massively engaged with pensions if only we make it more interesting. Yes, up to a point, but if they trust us, engagement becomes less of an issue".

The growing importance of environmental, social and governance (ESG) issues within pension fund investment may drive savers' engagement. According to Angus, it "may help members better relate to their investments and may remove some of the perceived stigma of their investments benefitting 'fat cat' CEOs".

Nest's research backs this up, finding that hearing how their pension is invested responsibly led to higher levels of trust, interest and confidence among savers.

However, Snowdon worries that "ESG, while as a concept is good and will appeal to consumers today, could be the next scandal if it is not all it is cracked up to be".

Whitney agrees that ESG is not a cure all. "The problem is that members may not have the same view of what is good ESG behaviour. For example, what is the view on nuclear power generation – a carbon-light power source or a potential environment disaster?"

Along with ESG, technology is also expected to drive greater member engagement, and therefore trust.

"Technology will have a large part to play in this to make pensions more relatable, understandable and accessible," Angus says, through innovations such as robo-advice and the pensions dashboard.

However, according to Charlton, it is not building trust that is required, but instead the breaking down of barriers to understanding, to make it easy for members to become acquainted with pensions, the impact of saving and the benefits to their future selves by acting now.

Some pension schemes themselves are making efforts to improve engagement, understanding and trust in practical ways, such as providing clear communications, putting on presentations/workshops on the benefits of pensions and providing access to guidance and advice.

Building trust?

The pensions industry may have to live with the fallout of 'pension scandal' headlines, coupled with a lack of member understanding, but there is optimism that the efforts to engage with members and earn their trust will be effective.

According to Byrne, auto-enrolment may be key to providing people with pleasant experiences of pensions saving; this positive first-hand interaction being vital to increasing individuals' trust.

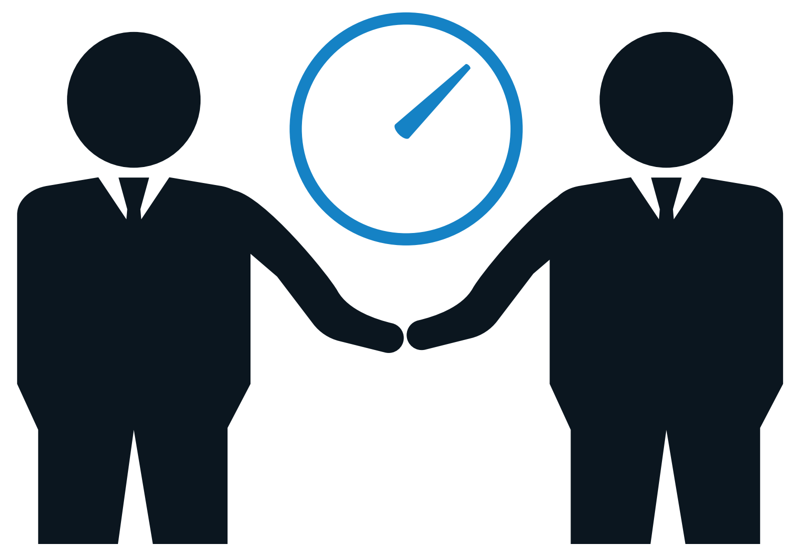
However, members' trust does not necessarily need to be with pensions or the industry itself, Whitney says, as long as people do trust the employer who is offering it or the government promoting workplace pension saving.

Either way, the main thing is that trust increases, so that one day soon, the answer to the pensions industry asking members 'do you trust me?' will be 'yes'.

Written by Laura Blows

A long-term affair with a key person

Paul Sturgess explores the risks of relying too much on the knowledge of long-standing team members



For those of you hoping this article's title might lead to stories of an illicit encounter, I apologise – my focus is to highlight the importance of scheme knowledge held by personnel at every level.

Pension schemes by their nature are complex, long-term affairs, taking account of the provenance of the sponsoring employer with the various twists and turns of corporate disposals/acquisitions, as well as the complex regulatory journey. This means understanding scheme requirements involves more than just a good understanding of tax and pension rules and regulations. It needs some historical context. I have often heard pensions professionals talk about schemes as though they are homogenous – after all a retirement is just a calculation operating under a common tax environment. This would be fine were it not for the fact that a tax regime is often the only thing individual schemes really have in common.

The issue however goes deeper, encompassing lower level operational resources where people undertake tasks to deliver specific objectives. The net result is that schemes are reliant on several subject matter experts (SMEs) to keep the machine turning. It is the risk of this reliance that trustees, sponsors and providers need to be alert to.

Any good risk management framework will feature key-person risk, but I would counsel against stopping there. Key-person risk does not necessarily sit solely with the obvious senior resources such as pension managers or directors, but flows to those sitting within providers and in-house functions, including roles relatively junior in nature. These are the people who know why a particular item of data or transaction was processed, in a particular way, on a particular day.

It is common these days to talk about the importance of data and our industry is beginning to wake up to this, but it is less common to hear focus on lower level processes and their data flows. Where processes are documented effectively at a detailed level, this isn't an issue, but how often is this the case? In fact, within large organisations, there will likely be instances where different teams of people do the same things in different ways.

A classic scenario is when a scheme changes administrator, or an employer gets subsumed into another corporate. These events lead to a changing of the guard and the risk of lost knowledge. Sometimes a new broom is what is required, but that broom is most effective if it knows which furniture to move – people still retain critical knowledge in their heads rather than it being documented. This doesn't mean they're trying to leverage their knowledge power – more often it's they're too busy doing their day jobs to take the time out to document it. After all, they know how to do it, so they think they do not need the benefit of the documented process.

Trustees and providers need to look beyond high-level, key-person risk and make sure their providers/teams understand the detailed level of exactly who the key person risk is centred around, understanding what procedures are documented and to close any gaps.

Now I hear you say 'this is just PASA on a mission to make sure the world recognises the importance of high-quality administration'. There may be some truth in that, but I am also highlighting this as someone who has seen these risks play out and have an understanding of the procedural and administrative infrastructure schemes and members depend on.

So unlike an illicit encounter – my advice is, document everything! Capture and share every bit of information about what that key person knows and how they do what they do – I promise it won't come back to haunt you!

Written by PASA's Membership and Funding Committee chair, Paul Sturgess

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How smarter ESG integration can preserve your free lunch – *The first generation of ESG strategies excluded whole sectors from investors' portfolios. Such approaches are still widely used, but investors may be underestimating their impact on portfolio diversification* ***p58***

A darker shade of green – *Lynn Strongin Dodds explores how ESG integration into pension fund portfolios is evolving* ***p60***

ESG focus:

Time for change

Legal & General Investment Management head of index equity and smart beta, David Barron, and index funds analyst, Jennifer Shering

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How smarter ESG integration can preserve your free lunch

The first generation of ESG strategies excluded whole sectors from investors' portfolios. Such approaches are still widely used, but investors may be underestimating their impact on portfolio diversification

We know some investors value the peace of mind that comes from owning lots of different assets in their portfolios, so their risks aren't too concentrated in any one area. They want diversification, in other words.

But equally we know that some investors want to reflect environmental, social, and governance (ESG) considerations in their portfolios. For some, that can mean excluding fossil fuels – typically meaning the entire energy sector – from their portfolios.

In a sense, these two desires – building a diversified portfolio and avoiding vast swathes of the economy – are mutually exclusive.

We wanted to investigate this apparent conflict in order to quantify more accurately the relationship between negative screens and portfolio diversification in equities. Put simply, are they friends or foes?

Sector inspector

As a starting point, we looked at the correlation of each sector in the MSCI World index to that parent index. This gave us a long-term picture of the diversification dividends yielded by each sector, as illustrated in Table 1.

We see here that some sectors have consistently been diversifiers. These include consumer staples (which include tobacco, of course), healthcare, and utilities.

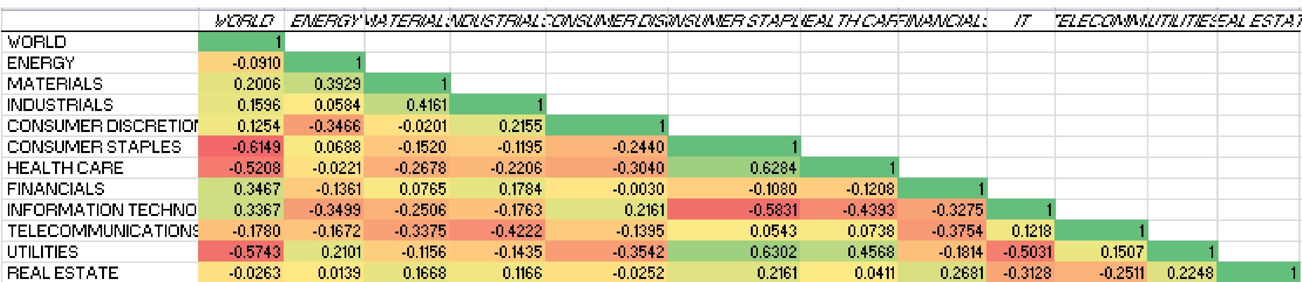
However, we must remember that correlations between sectors are dynamic, not static. For example, energy was a diversifier through the 2000s; technology and then financials have been highly correlated to the MSCI World index for long periods but this has changed at inflection points rather than staying fixed.

Correlations can switch unpredictably at key moments and so excluding sectors can deprive investors of diversifying assets unexpectedly or expose them to greater risk if the retained sectors converge in periods of market stress.

Weight watchers

This possibility prompts another question: when sectors are omitted from a market-cap portfolio, how is their index weight redistributed among the other sectors? This can obviously lead to unintended risk exposures if it concentrates a portfolio in sectors that are either more or less correlated to the index. In the former case, the portfolio could end up with a higher beta than desired; in the latter scenario, the portfolio may not offer the required market performance.

Table 1: Average five-year rolling correlations between MSCI World index sectors, 28.02.1995 to 28.06.2019



	WORLD	ENERGY	MATERIAL	NDUSTRIAL	CONSUMER DIS	NSUMER STAPL	EALTH CAR	FINANCIAL	IT	TELECOMM	UTILITIES	EAL ESTAT
WORLD	1											
ENERGY	-0.0910	1										
MATERIALS	0.2006	0.3929	1									
INDUSTRIALS	0.1596	0.0584	0.4161	1								
CONSUMER DISCRETIOI	0.1254	-0.3466	-0.0201	0.2155	1							
CONSUMER STAPLES	-0.6149	0.0688	-0.1520	-0.1195	-0.2440	1						
HEALTH CARE	-0.5208	-0.0221	-0.2678	-0.2206	-0.3040	0.6284	1					
FINANCIALS	0.3467	-0.1361	0.0765	0.1784	-0.0030	-0.1080	-0.1208	1				
INFORMATION TECHNO	0.3367	-0.3499	-0.2506	-0.1763	0.2161	-0.5831	-0.4393	-0.3275	1			
TELECOMMUNICATIONS	-0.1780	-0.1672	-0.3375	-0.4222	-0.1395	0.0543	0.0738	-0.3754	0.1218	1		
UTILITIES	-0.5743	0.2101	-0.1156	-0.1435	-0.3542	0.6302	0.4568	-0.1814	-0.5031	0.1507	1	
REAL ESTATE	-0.0263	0.0139	0.1668	0.1166	-0.0252	0.2161	0.0411	0.2681	-0.3128	-0.2511	0.2248	1

Source: LGIM, MSCI, Bloomberg

Table 2: Average sector overweights in MSCI World excluding Energy index (percentage points), 31.01.1995 to 28.06.2019

Sector	Overweight
Materials	0.53
Industrials	0.96
Consumer Discretionary	1.03
Consumer Staples	0.81
Healthcare	0.94
Financials	1.84
Information Technology	1.07
Telecoms	0.43
Utilities	0.36

Source: LGIM, MSCI, Bloomberg

As Table 2 displays, when energy is excluded the largest overweights have tended to be to consumer discretionary, financials, and technology.

Comparing this with Table 1, we see that the overall effect of rebalancing away from energy and into these three sectors – each of which has a relatively high correlation to the MSCI World index – is likely to be an equity portfolio with an above-average beta. The consistent diversifiers – consumer staples, healthcare, and utilities – receive more modest upgrades.

Again, though, we have to reiterate that these weights will vary through time – not always to the investor's advantage. The overweight to financials, for instance, reached its zenith just in time for the financial crisis.

Turning to the present day, the most significant overweight in the MSCI World excluding Energy index is now information technology at 0.98 percentage points. This additional exposure to tech stocks has important consequences for investors, not least for those who have already chosen to overweight technology elsewhere in their portfolios.

An additional point is that we have focused on global developed market-cap exposure here, which has well over 1,000 securities across more than 20 countries. For investors thinking about regional allocations, the impacts of reweighting can be even more pronounced. In the UK equity space, for example, three energy stocks – from just two issuers – make up over 15 per cent of the FTSE 100. Exclude these and the redistribution effect can lead to an overweight of almost four percentage points to financials within that adjusted index.

Matter of factor

We can also look at the factors – or risk premia – that the energy sector has contributed over time.

The decline in the oil price from 2014 clearly left energy heavily overweight the value factor, although this has moderated of late. This has led some to the erroneous presumption that such negative screens systematically underweight value. This is not the case. Excluding energy in recent years has certainly left portfolios underweight the value factor, but not so long ago quality and momentum were major forces in the energy index.

Investors may have been willing to forgo value exposure over the past few years as that factor has underperformed, but would they have been so happy to minimise the quality and momentum factors under previous market regimes?

Although there isn't a formally recognised dividend or income factor, we would also note that excluding energy – and tobacco – is likely to have impaired a portfolio's yield through this period.

Portfolio permutations

With all this in mind, traditional negative screens may be most appropriate for investors who are obliged to avoid certain sectors. But other investors may be able to preserve the diversification benefits from sectors like energy without sacrificing their ESG criteria by integrating those criteria into their investment process in more nuanced ways.

At Legal & General Investment Management, we believe ESG scoring gives us a framework for engaging the companies in which we invest and also allows us to tilt portfolios to reflect ESG criteria while maintaining diversification.

Written by Legal & General Investment Management head of index equity and smart beta, David Barron, and index funds analyst, Jennifer Shering

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A darker shade of green

Summary

- Regulation is driving DB schemes to incorporate ESG into their investment decision-making process.
- Creating a well-balanced portfolio is being hampered by the lack of consistent and poor quality of data.
- Investors still favour negative screening, which creates concentrated portfolios.
- Larger asset managers have their own intrinsic models and proprietary data to create more diversified ESG-friendly portfolios.

Lynn Strongin Dodds explores how ESG integration into pension fund portfolios is evolving

At first glance, environmental, social and governance investment (ESG) strategies seem to be at odds with building a well-diversified portfolio. Excluding large swathes of companies could tip the balance, for example, in favour of cleaner energy companies and against old-school manufacturing. However, a closer look reveals that increasingly defined benefit (DB) schemes are being more thoughtful in their portfolio construction. There is still work to be done but they are mining data, metrics and in some cases holding meaningful dialogues with management to create a more balanced investment strategy.

Regulation

One driver is a stronger regulatory impetus. As Legal & General Investment Management head of institutional clients, Mark Johnson, notes that under new disclosure rules in the UK, pension scheme trustees must bear the responsibility to weigh ESG and climate change risks more explicitly. They are obliged, as part of a scheme's Statements of Investment Principles (SIPs), to outline their approach to engagement and voting of their shares in companies. The schemes also have to explain how they incorporate financially material factors, including ESG and climate change considerations, in investment decision making. The rules are in line with the European Union Shareholder Directive II, which has the same aims of disclosure and engagement.

Challenges

However, despite the legislative push, the industry is still facing a number of challenges in terms of portfolio construction. The most notable is the lack of quality and reliable data available. There may be a treasure trove of information but it is still difficult to discern whether companies that claim to have strong ESG credentials actually deliver the goods. One problem is the various measurements being used. This can lead to one company reporting the carbon emissions of its entire business, while another may only disclose the carbon emissions for its headquarters but not for its other locations or operations.

This helps explains why the majority, three-quarters, of investors surveyed in a recent McKinsey study wanted more standardised sustainability reports and information that can be compared as easily as their financial disclosures. The theory is that greater uniformity would help investors streamline their research processes and enable them to allocate capital in a more efficient manner.

Complicating matters is the multiple iterations of ESG. "Everyone has their own definition of ESG and there is often a low correlation between the ratings of the same company," says Schroders head of systematic investments, Ashley Lester. "The scores are different because of the criteria that is being applied. For example, some may believe that nuclear waste is a more significant issue than carbon emissions. It is not a right or wrong way, but investors have to be clear how their fund managers define ESG."

While there is a plethora of external data providers and rating houses, the larger players typically have their own intrinsic models, frameworks and analysis. However, Lazard Asset Management co-head of sustainable investment and ESG, Jennifer Anderson, believes that the proverbial buck stops

with the portfolio manager. “In order to build a well- balanced portfolio, the portfolio manager needs to be forward thinking and to have proprietary research. They cannot rely exclusively on third-party providers.”

Negative screening

Another issue impacting portfolio construction is that investors are still wedded to negative screening. According to the McKinsey study, exclusion applies to two-thirds of sustainable investment across the global sustainable spectrum. This method not only creates concentrated portfolios but also neglects corporates that may not be up to ESG scratch today but have the potential to be better corporate citizens in the future.

Take BP. It would not be a natural constituent in many pure ESG funds or those that incorporate ESG metrics. However, the oil and gas giant is part of the portfolio at Majedie Asset Management because like its peers, it has and is planning to allocate greater resources to renewable energy projects “We do not separate ESG from financial performance and have a top-down and bottom-up approach based on our proprietary research that identifies the risks and opportunities for companies,” says Majedie’s head of responsible capitalism, Cindy Rose. “We also actively engage with companies such as BP to push them forward. For example, the transition to a more friendly carbon environment that meets the Paris accord will take time and as a result, we still need BP to provide energy.”

She adds: “However, there is a big opportunity because they have a massive amount of capex that they can use for renewable projects. We look at things such as what their strategy is, where they expect to be in 25 years and what green tech will be developed.”

Engagement is also a critical plank for LGIM, according to head of sustainability solutions, Caroline Ramscar. She points to the fund manager’s climate impact pledge, which was introduced two years ago. The fund manager assesses, as well as scores, over 80 of the world’s largest companies across six sectors identified as key to meeting global climate change goals. If, after working with the companies, they fail to deliver the goods and improve minimum standards, LGIM divests the stock from its Future World Range and, across its entire book, votes against the chair. “We look to use active ownership and if they do not improve their behaviour, we will divest them from our Future World funds,” she adds.

In general, LGIM has developed its own proprietary scoring model for the different ESG components. Ramscar notes there are 28 indicators, which for environment would for instance include a company’s carbon footprint, while for social issues, it could cover workforce and board diversity as well as investor rights and floating shares percentages.

UBS Asset Management, which has its own set of metrics, also adopts a more holistic view. “There needs to be a solid integration process starting from the financial analysts to the portfolio manager if you want to have strategies that are well diversified and aligned with traditional investments versus simply relying on third-party data,” says UBS Asset Management head of sustainable investment research and stewardship, Christopher Greenwald. “Third-party ratings are a starting point but not the answer. Our analysts will interpret the information and apply it to their investment cases to explain any sustainability risk they encounter.”

Greenwald also does not believe in excluding whole sectors. “Instead we reweight our holdings and encourage companies to go on the right path and change their behaviour,” he adds. “One of our most successful investment strategies (Long-Term Themes Fund) invests according to long-term themes such as energy efficiency, demographics and infrastructure and look for those that are addressing these issues in terms of clean energy and healthcare on a long-term basis.”

Factors

Another path taken by some fund managers is to treat ESG as another factor that sits alongside value, momentum, quality, size and low volatility. Schroders, for example, has created a sustainability factor that aims to translate social and environmental impacts into financial costs or benefits across investment strategies in a systematic and quantitative manner. “In a world of trade-offs, the question is how can I develop a more constructive and diversified portfolio,” says Lester. “By emphasising sustainability as a factor, rather than a set of exclusions, we can cram in as much factor exposure as possible, subject to the overall tracking error budget, and ensure that we have the right quantities and ratios of factor exposures in the portfolio.”

For now, creating more diversified portfolios is easier for some asset classes than others. Not surprisingly, as Anderson points out, ESG integration is the most straightforward but there is an increasing interest in ESG as it relates to fixed income. “Similar ESG criteria to those used in equities research can be applied to corporate bonds but the data may be not be available for the range of issuers in fixed income and or course there is no proxy voting,” she adds.

As with any investment, investors who want a diversified sustainable approach need to do their homework and look carefully under the proverbial portfolio bonnet to see how ESG is integrated, the methodology being applied and whether the holdings are evenly spread out across different sector.

Written by Lynn Strongin Dodds, a freelance journalist

In association with

Local responsibility

With new codes and principles being established to ensure that pension schemes are declaring their investment strategies, Jack Gray speaks to LPP deputy chief investment officer, Richard Tomlinson, about how Local Government Pension Scheme (LGPS) and public-sector scheme investment strategies differ from the norm

What kind of investment strategies are you seeing in the LGPS space?
There's a lot of debate on the active/passive divide. When I see a comment on the active versus passive debate, a lot of it seems to just say active managers haven't beaten the benchmark and therefore they haven't done very well. That may or may not be true, but that's quite a retail way of looking at the world. When I say retail, I mean private wealth, where you can pretty much do what you want with your own money. It then comes down to your own ethical preferences.

But in the institutional world – and it's getting more and more the case – you can't simply just buy whatever assets you want. You have ESG considerations. You have reputational risk issues. You have other constraints placed upon you.

Once you start layering in these additional constraints, the simplistic 'just buy global equities' isn't quite so simple anymore. This concept that there is just this market and you can hoover up doesn't quite fit anymore for many institutions.

The aim is building portfolios that are optimally positioned based on a scheme's investment beliefs, their constraints and being very cost efficient. If you can get the cost low enough in an active portfolio, the level of the risk exposure that you want in an ESG framework that makes sense to you and, critically, with low turnover. If the costs are low enough, that to me is a much better place to be than simply buying up passive equities.

On the passive equities argument, the minute you start deviating from a pure market cap benchmark, you're making an active investment decision. Even in buying a market cap weighted benchmark, you're making an active investment decision. Because, there are residual momentum components in there. If you think about it, which stocks have the highest market cap today? It's the stocks that have performed well in the last quarter or last momentum.

How about alternatives?
On the alternative side, or actually across the whole portfolio, it is very much looking at the split of return or excess return – or what I would call 'alpha' – split between the investor and the manager. If the manager's fee structure allows you to take an appropriate split of that value add, well, that's more acceptable. If the manager's fees are too high, whatever the value add or alpha is, then it doesn't make sense.

Even if a manager is adding huge amounts of value, if the fees are too high, there's not enough left once you adjust the risk for them or for the investor. Well, why would you do it? I find it hard to see how an average manager can deliver sufficient excess return for an investor net of the fees they're charging.

How does the long-term strategy differ for LGPS schemes?
With your average corporate pension scheme, most of them are in some kind of endgame or looking for some kind of endgame. If you think about the driver for a corporate DB, it's to provide the benefits and knock out the liabilities and minimise the earnings volatility of the corporate sponsor. So, your CFO or your CEO is saying 'I want to immunise my exposure to these liabilities'. Whereas the LGPS is a little different, because it's open to new members and accrual. It's a quasi-perpetual investor.

Then you layer in the fact that you're part of the fabric of society, because you're ultimately backstopped by the state and the taxpayer. You're not just this lone

private-sector operator, you are needing to think more holistically about your role.

I certainly think deeply about this, in terms of what to do with an investment portfolio. In terms of what you may call ESG – so whether it's climate change, whether it's housing, whether it's contributing to the local economy or whatever it'll be. You also have to consider LGPS schemes' roles in terms of capital markets, because I think large institutional investors have a responsibility to play in terms of the functioning of markets and the economy.

If you start thinking about what the role is in society in terms of the capital markets, you start thinking, 'as long-dated institutional investors, we have long-dated liabilities'. The liabilities often extend beyond 20 years. Long-dated institutional investors are able to buy assets and hold them for the long term, whereas some other investors can't. If assets are out of favour currently and are being sold down, whether they be equities or credit or property or whatever it'll be, they can be legitimately bought and held on to for the long term.

Long-dated investors are going to buy them because they think they have a long-term payoff for their fiduciary responsibility, which is the primary driver. But there is also this piece, which is 'what is the role of long-dated capital in the functioning of the economy and the capital markets'?

I do have a philosophical aversion in some ways to this spew that you hear some people putting forward that pension schemes should just be the dumb money and to just buy equity indices and should just buy passive investments, because pension funds are stupid and should leave the risk taking to those that should be doing it, like hedge funds. I would say the exact opposite that if you think about who should be able to take the long-term view, who should be able to invest for the long term in stable businesses, who should be able to provide the right sort of capital for genuinely strong, good companies or enterprises, shouldn't it be pension schemes?

The time horizon of most active trading books is much shorter. The asset management industry, people always joke that it gets shorter and shorter. You're now on a quarterly performance target for many asset managers. If people like us can't take that long-term perspective and invest in business because we think they've got long-term prospects, well, who can?

What are the typical questions you receive from LGPS members?

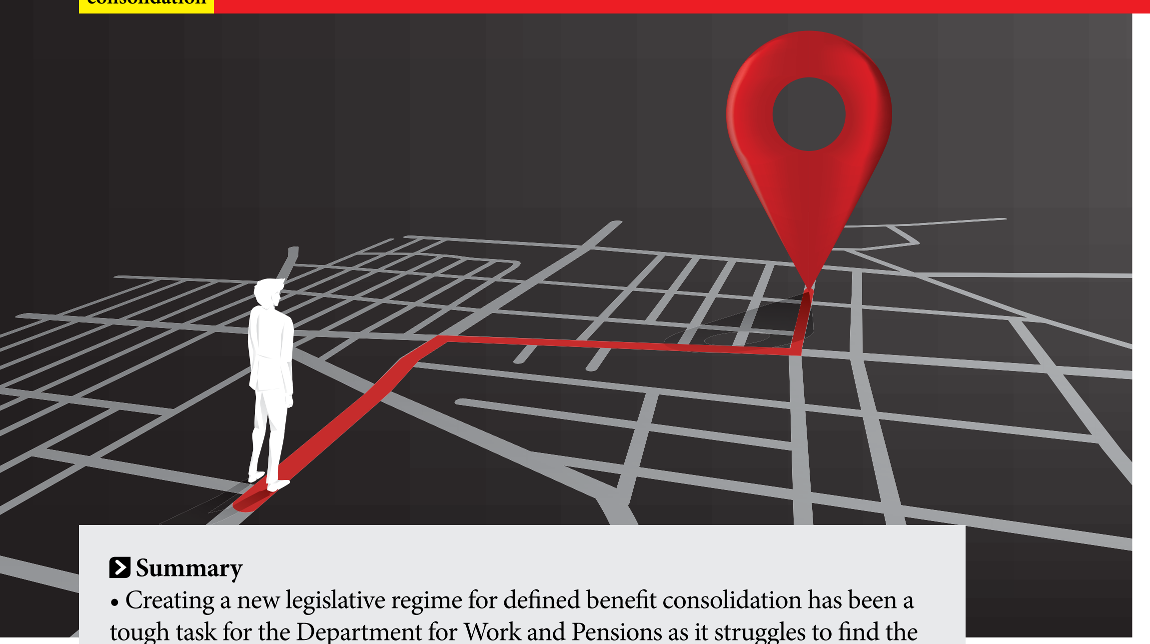
You tend to find that member questions broadly fall into two camps. One is very administration focused. 'Can I get my statement online? Can you make it easier for me to access this piece of information or that information? Can you make the wait time on the calls two minutes less?' Or that type of transactional query.

But from the investment side, the queries tend to focus on ESG/responsible investment type queries, climate change. You'll get very direct questions on 'what is the scheme's policy on this element of climate change? What are you doing for members on – are you thinking about this risk factor from that area? What are you doing on fossil fuels?' Those types of things come in from members.

Are there any lessons we can learn from other nations' investment practices?

Certainly one model that we can point to is the Maple model, the Canadian model. So looking at what the Canadians have achieved in the past 30 years with their pension structures and how they've approached things and looking at some of the tenets of success. What drove success for them? Professionalisation, increased levels of delegation, getting the right people in the businesses, strong governance and sensible investment beliefs.

Written by Jack Gray



Summary
• Creating a new legislative regime for defined benefit consolidation has been a tough task for the Department for Work and Pensions as it struggles to find the 'sweet spot'.
• The Pensions SuperFund expects TPR's pre-authorisation regime to be ready "by the end of November" and the DWP consultation response "by year end".
• Lack of endorsement from the government runs the risk of negatively impacting the commercial consolidators' future pipeline.
• Concerns over how it will work alongside the bulk annuity market may have added to the delays.

Finding the consolidation sweet spot

The omission of defined benefit consolidation legislation from the upcoming Pension Schemes Bill is a bump in the road for the two main commercial consolidators, but time must be taken to balance member security, employer affordability and investor profitability

When rumours trickled out over the summer that defined benefit consolidation was not going to be part of the upcoming Pension Schemes Bill, many thought it was another example of government kicking an initiative into the long grass.

However, given the complex and non-uniform nature of commercial consolidators, the government was quick to reassure the industry that this was not the case.

Last month, the Department for Work and Pensions (DWP) DB consolidation lead, Des Healy, said that the government was yet to find the 'sweet spot' on legislation for the superfunds, unable to find the balance between 'member security, employer affordability and investor profitability'.

So, with The Pensions SuperFund (PSF) and Clara Pensions waiting in the wings, and the former with two seed deals already in place, what will happen next?

The sweet spot

Balancing the new legislation on the three pillars mentioned by Healy is no small feat, and Baker McKenzie pensions partner, Jonathan Sharp, believes gaining the member trust must come first.

"There needs to be a level of trust for pension schemes to be willing to transfer their members to the superfund, and for the confidence of members themselves, that the superfund will be able to deliver the promised benefits," he says.

There is industry-wide consensus that an updated operating framework is needed to be put in place, and the fact that commercial consolidators are able to operate under the current legislation has caused worry in some factions, particularly given the delays.

Commenting in the weeks leading up to the Queen's Speech, Work and Pensions Committee chair, Frank Field, said he had written to Pensions Minister Guy Opperman to ask if it would be included, saying that more workers could be 'robbed' from their entitlement if it wasn't.

However, both of the consolidators have been keen to stress their willingness to work with the regulator and the DWP in order to ensure members come first.

PSF managing director for deal origination, Peter Cazalet, says: "The PSF can already transact under the existing legislation and it should, and will, voluntarily submit potential transfers for The Pensions Regulator's (TPR) clearance/pre-authorisation.

"The lack of clarity around the regulatory regime for consolidation requires us to work very closely with TPR to ensure that clearance, and a future pre-authorisation regime, is as comprehensive as possible."

Despite this, Royal London director of policy, Steve Webb, believes that the government delay in introducing updated legislation was less to do with member security, and more to do with Treasury concerns that the consolidators would "compete unfairly" with bulk annuity insurers.

"The regulation of pension superfunds has been left in regulatory limbo. It is one of the biggest failings of UK pension policy that the department with lead responsibility for pensions can be thwarted in bringing forward sensible reforms by an over-mighty Treasury that has no vision for pensions," he says.

While Sharp doesn't immediately agree, he believes that legislators have had to give extra thought to how the new consolidators will act alongside bulk annuity insurers.

"One interpretation of the fact that superfund legislation wasn't included in the pensions bill is that it was seen as too controversial to receive smooth passage through parliament, and that it could be portrayed by some as a poor man's buyout," he explains.

However, the regulator and the DWP are adamant that it is the pure complexity of the process that has caused the updated legislation to be left out of the Pension Schemes Bill.

TPR had previously told *Pensions Age* that it hoped to have the superfund assessment completed by the end of the year, however, the signs are that it may take longer.

In an update, the regulator told *Pensions Age*: "Until the assessment framework is finalised, we are in no position to assess the funds and any associated transactions.

"In any transaction, we expect all proposals to have the full support of the scheme trustees and provide better outcomes for members. We are working extremely closely with the emerging superfunds throughout, who are aware of the complexity around the process."

According to PSF, the regulator will advise on an "interim pre-authorisation regime" towards the end of November 2019, while the DWP intends to respond to its December 2018 consultation "by the end of the year".

"Clearance of the seed deal is expected shortly after that," Cazalet adds.

With the lack of government endorsement however, will the omission of updated legislation from the Pension Schemes Bill damage the consolidators commercially?

Will trustees still be attracted to consolidators?

While Sharp doesn't believe that the latest setback will stop the industry from taking off, it has at least slowed down the process.

"The lack of legislation means there isn't the same level of endorsement for superfunds by the government, and so the development of the industry and attraction for new entrants may be slower than would otherwise be the case, as there's uncertainty about exactly how the superfund regime will operate," he says.

Despite this, Cazalet believes the schemes that want to make it happen are willing to wait: "The pension funds we are discussing consolidation with are prepared to lay the groundwork for consolidation in expectation of that regime, which will provide a cost-effective alternative to insurance buyout."

The Pensions SuperFund has two seed deals awaiting clearance from the regulator. The first, a flexible apportionment arrangement was presented to TPR in May, while the second, a scheme-to-scheme merger, has also been agreed, according to the group.

"Behind these there are a substantial number of schemes in the pipeline where the PSF is in discussions with trustees, sponsors and advisers," he adds.

Clara Pensions has previously said that they have a number of schemes interested in their version on consolidation, but that the schemes would rather see the first deals hit the market before they make the move.

According to Sharp, getting the requirements for superfunds to operate wrong by making them too stringent, would be more damaging than the current delay.

"If the requirements are too stringent then the market won't take off, for instance if the pricing for superfund entry is similar to an insurance buyout," he says.

"Commercial providers will only enter the market if they can make a profit from running the superfund. However, the two points are linked as the greater the solvency requirements the harder it may be for a provider to extract profit from the superfund.

"On that analysis it suggests it might be difficult to predict exactly how the regime will operate once it has been through parliament."

Cazalet and PSF understand that it is not going to be a walk in the park. Steps such as the data quality audit, asset portfolio assessment and contractual benefit definition all take time, but the longer the government takes to establish a stable framework for the super schemes, the more damaging it could be for the industry.

Written by David Andrews, a freelance journalist

Bright ideas

Maggie Williams looks at the many ways a scheme can streamline its processes

Summary
- The range of consolidation options for trustees is widening, including better regulation of master trusts and 'superfunds'.
- There are also many ways that schemes can drive efficiencies without consolidation, including investment pooling.
- Consolidating trustee boards and use of sole trustees can also help to streamline governance.

As governance burdens on trustees increase and the cost of running a pension scheme heads in the same direction, all schemes will be looking for more streamlined and cost-effective ways of working.

For some, that will mean consolidation. Speaking at the PLSA's Annual Conference, Department for Work and Pensions (DWP) defined benefit consolidation lead, Des Healy, re-iterated the government's support for consolidation, whether through master trusts (DB and DC) or commercial consolidator 'superfunds' for DB schemes.

However, there will still be trustee boards that don't want to merge with other schemes and are currently unable to buyout, but still need to find efficiencies that ensure their scheme remains sustainable and well run for the long term.

Investment pooling

One well-established option is to pool investment management. Local authority pension schemes have been compelled to carry out investment pooling as part of the radical reworking of their sector – could the same approach work for private sector DB and DC schemes? River and Mercantile head of DC solutions, Niall Alexander, sees fiduciary management as the closest equivalent. "This is the most common method of pooling, which enables schemes to improve the efficiency of their investment returns net of all fees. The LGPS approach uses a similar model."

Willis Towers Watson senior director, Gareth Strange, says that the scale of assets under management at a fiduciary manager should mean savings on asset management fees. "With significantly higher assets under management, fiduciary managers are able to buy assets at significantly lower cost than individual schemes," he says. He adds that fiduciary management also delivers other efficiency advantages such as access to greater innovation and a nimbleness to respond to market changes that standalone trustee boards would be unable to achieve.

However, although it reduces the governance burden for trustees and enables managers to negotiate lower fund management fees, fiduciary management may not always reduce overall costs for a scheme once the fiduciary manager's own fees have been taken into account.

Investment platforms are another option for improving investment efficiency. "Investment platforms have traditionally been thought of in the DC world, where you can achieve buying scale at an individual level. But we are starting to see them being used for DB plans as well," says LCP partner, Jeremy Dell. "Schemes can't pool assets with another scheme unless they merge or use a fiduciary manager, but they can achieve a similar effect using a platform. It offers access to funds and fund management that schemes wouldn't otherwise be able to use."

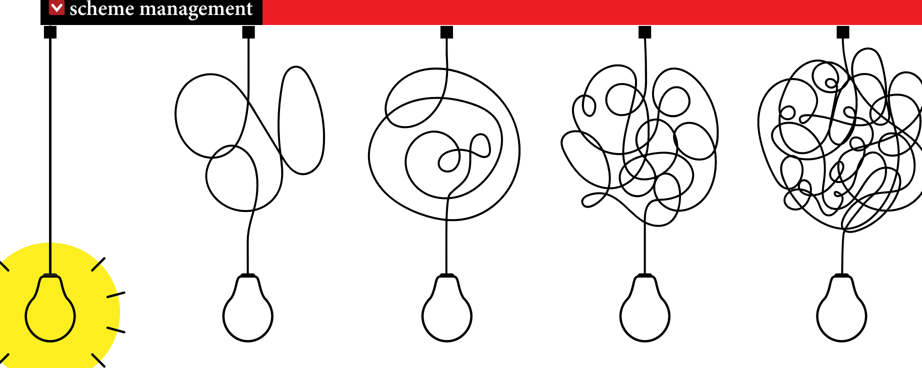
Administration efficiencies

While there are established strategies that enable trustees to benefit from efficiencies of management in their investment strategy, pooling other aspects of pension schemes such as administration, is much harder to achieve. "Each scheme has its own set of rules and benefits, so the efficiencies of pooling administration without consolidating are less clear," says Alexander. Unless benefits are harmonised across schemes – a controversial and costly exercise – there is little potential for pooling administration. "Harmonising benefits might lower costs in the long term, but the communications, actuarial fees and other potential heartache involved in the process mean there is little advantage to doing this," says Strange. He adds that, even after harmonisation, the reduction in ongoing administration cost is likely to be minimal.

While pooling administration will not be a workable option for most schemes, new technologies offer a raft of other ways to drive efficiencies. Alexander cites tasks, such as maintaining accurate member records and delivering good quality communications, that can be improved substantially through good use of technology.

"Offering DB members access to online quotations is another major way of improving administration efficiency," says Strange. "Most administrators offer a fixed-fee service and then charge per additional activity. As the volume of requests for quotations has increased, so has the additional activity costs for schemes. However, if quotations can be carried out online without the need for extra work by the administrator, those fees will disappear – and the time demands on schemes will also reduce."

Administration is just one way in which technology can drive efficiencies for schemes. It also has a part to play in improving actuarial processes. "Much actuarial work is now commoditised and firms that have invested in technology



are able to deliver services at a lower cost. Schemes don't expect to spend a fortune on actuarial valuations any more as so much of the process is now automated," says Dell. "Across the board there is value-add from using technology, as well as improvements to efficiency for schemes."

Consolidating advisers

Strange argues that using a single consultancy for administration, actuarial and investment services can also bring efficiencies. "Using a single provider can reduce friction and costs," he says. "There's more efficient use of data between systems and the same consultant's investment, actuarial and administration provision should all link up effectively to bring the scheme's strategy together."

"Consolidating advisers and investment managers across schemes means bigger volumes and that drives fees down," agrees Dell. Strange adds that using a single provider for all consultancy services brings efficiency benefits both within a single scheme, and across multiple schemes run by the same sponsor if all consultancy services are run by the same provider.

Consolidating trustee boards

Dell also sees potential efficiencies in consolidating multiple schemes that have the same sponsor. "We see a strong drive from sponsors running many schemes to merge them together, and offering trustees incentives to do so," he says. Dell adds that as schemes become better funded, it becomes easier to achieve this.

While some sponsors might stop short of a full merger of their schemes, Dell says that many are also exploring the idea of a common trustee board across multiple plans. "While the traditional trustee board model has worked well in the past, companies are now struggling with the governance burdens trusteeship demands – and these are increasing further. Sponsors are looking at more streamlined governance and starting to explore consolidated trustee boards for defined benefit," Dell says.

Aon head of DC consulting, Sophia Singleton says that she is seeing a similar trend amongst DC schemes. "There has been substantial regulatory change in recent years and much more is required of DC trustees now. Schemes are asking whether separate boards are driving better value, or whether they are just a governance burden. For many employers with multiple DC schemes, rationalising and consolidating trustee boards is a very sensible move."

Sole trusteeship

Scheme sponsors are also exploring sole trusteeship as a way of improving efficiency. This replaces the trustee board with a single trustee responsible for all governance. "Companies that are struggling to find member-nominated trustees that are still in the business may be looking at more streamlined governance and heading to sole trusteeship," says Dell.

Sole trustees are typically independent professional trustees who will act as a trustee for a number of different schemes. As such, they may also be able to bring economies of scale for all the schemes that they work with. "If a sole trustee works for a professional trustee group, they can hire consultants or fund managers consistently across their whole trustee book and drive further efficiencies through commonality of advisers," Dell adds.

Master trusts

Auto-enrolment raised the profile of DC master trusts and has driven rapid growth for a handful of well-established schemes. That growth means that they now operate on a much larger scale than many standalone trust-based schemes, with the associated efficiencies that brings. As a result, Singleton says an increasing number of DC schemes are now exploring the option of moving their members into a master trust. "Trustees struggle with the time required for DC governance, especially if they are responsible for a DB scheme as well. When they start to look for efficiencies from outsourcing administration, governance and investment – that's really a master trust. There are other reasons to move too, such as better use of technology, future-proofing and scale."

While DB master trusts have been active in the market for many years, there has been very little take up and activity in this area, particularly in comparison to DC arrangements. But with plans in the DWP's pipeline to set up an accreditation regime for DB master trusts, and enable trustees to find a meaningful comparison between a scheme's current situation and how it would fare within a master trust, this could also provide a more wide-ranging choice for DB trustees in the future.

The next year looks set to see the consolidation sector become more structured, with clearer regulation and more choices available to DB schemes in particular. But if master trusts and commercial consolidators don't suit the needs of every scheme there are still plenty of structural changes and outsourcing options available to enable all trustees to improve scheme efficiency.

Written by Maggie Williams, a freelance journalist

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To buy-in or not to buy-in? *– Jos Vermeulen compares a partial buy-in with an insurer to a self-managed de-risking approach* ***p70***

Considering the consequences *– The past year has seen record-breaking activity in the bulk annuity market, including a number of huge buy-in deals. David Adams looks at the reasons why trustees might consider using a buy-in and the consequences that decision might have on scheme investment portfolios and funding plans* ***p72***

De-risking focus:

The impact of buy-ins

Insight Investment head of solution design, Jos Vermeulen

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To buy-in or not to buy-in?

Jos Vermeulen compares a partial buy-in with an insurer to a self-managed de-risking approach

A broader de-risking assessment

Today, many private defined benefit (DB) pension schemes are targeting a buyout as their endgame. However, most schemes cannot afford the cost of undertaking a full buyout in the near term. Therefore, they may ask themselves whether they should conduct a partial buy-in for a portion of their liabilities or simply evolve their current de-risking strategies, taking a self-managed de-risking approach.

To help schemes make an objective comparison of different de-risking options, we examine:

1. Value for money
2. Impact on the overall portfolio
3. Flexibility to deal with the unpredictable

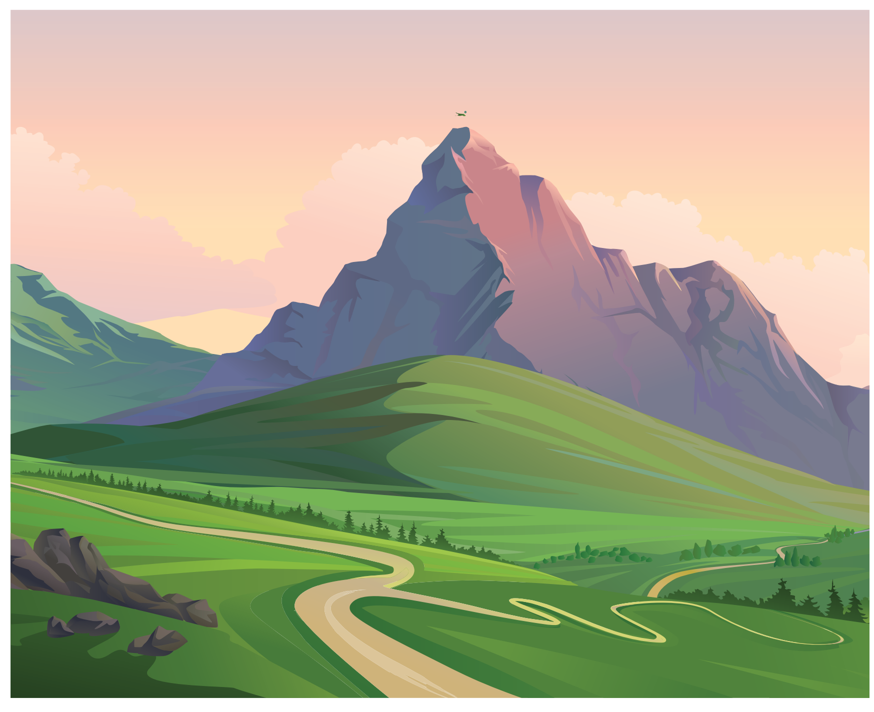
Value for money

A major driver of the increasing demand for buy-ins is the seemingly competitive pricing from insurers. Typically, buy-in contracts are priced on a 'gilts plus' basis, making them look attractive when compared to the cost of matching pension liabilities with government bonds. However, investors should not focus on price alone, but focus on what they receive for this price.

A self-managed de-risking approach is able to replicate many of the characteristics of an insurance buy-in, including longevity hedging, but at a lower cost due to the allowance in insurers' pricing for capital and profit margin considerations, and more stringent investment restrictions.

Historically, we estimate that the difference has been up to 15 per cent when considering the whole scheme membership. In the case of a typical pensioner-only transaction, the difference has been 5-10 per cent, equating to a saving of £25-50 million, assuming a buy-in of £500 million.[1]

Also, because a buy-in is unlikely to cover non-pensioners, while the value of retained liabilities may fall, the risks (for example, the sensitivity to interest rates and inflation) will fall by less. Therefore, under an insurance buy-in, schemes may transfer disproportionally more assets than risks to the insurer.



Impact on the overall portfolio

An insurance buy-in offers security and cashflow matching in respect of a portion of the liabilities, but schemes should consider the broader impact on the overall portfolio. In particular, how does a buy-in impact the expected return needed on the remaining assets and/or the scheme's ability to hedge its liabilities, and the expected time to reach the targeted buyout?

1. Impact on the target return required from remaining assets

If a scheme is underfunded, the nominal level of deficit will vary following the buy-in, depending on the valuation basis relative to the buy-in basis. The disclosed deficit may even fall. Crucially, however, a buy-in leaves fewer 'free' assets to

[1] Insight calculations, 2019. Given current Solvency II regulation, we estimate that a pension scheme could achieve a net asset yield of circa 100 basis points more than an equivalent insurer. Around two-thirds of this difference is due to the pension scheme's greater investment freedom, with the remainder reflecting the insurer's cost of capital. We assume that, on average, pensioner liabilities have a duration of 10-15 years.

Figure 1: An insurance pensioner buy-in can increase the target return needed from your assets

Pre buy-in

Collateral
Free assets
Buy-in
Deficit

Post buy-in

Target return = Gilts + X% pa

Target return = Gilts + Y% pa (Y>X)

For illustrative purposes only

make up any funding level deficit. This increases the target return needed from the remaining assets, everything else being equal.

2. Impact on the scheme's ability to hedge its liabilities

In order to maintain a given hedge ratio, a proportion of the remaining assets must be allocated to collateral, further pushing up the required target return on the 'free' assets. This would incur additional costs and could result in potentially selling assets at an inopportune time. Alternatively, schemes could decide to accept a lower hedge ratio.

3. Impact on the time to achieve a full buyout

The pursuit of higher target returns following a buy-in increases the chance of defaults, negative returns and forced-selling risk, especially during times of market stress. Ultimately, it potentially reduces the chance of the scheme being able to afford a buyout at the target date. The alternative, maintaining a lower hedge ratio, could lead to an increase in liability-mismatch risk.

Flexibility to deal with the unpredictable

Up to the point of a full buyout, regardless of the adopted de-risking method, there will always be risks affecting the assets or the liabilities that cannot be predicted or hedged. Examples could be poor short-term returns, transfer values forcing payments earlier than expected, or changes in legislation causing changes to benefits.

Conclusion

We suggest that schemes look beyond buy-in prices alone and assess the impact at the total-scheme level, considering a wider range of factors, such as value for money, impact on the total portfolio and flexibility to deal with unpredictable events. We believe that this will help them reach their endgame with more certainty. When considering these wider criteria, we believe a self-managed de-risking approach offers a more efficient route to a buyout for many schemes than an insurance buy-in.

Conventional insurance buy-in: A scheme transfers some of its assets to an insurance company, which in return covers the cost of the pension payments for some of the scheme membership, usually the pensioners.
Self-managed de-risking approach: A scheme aims to replicate the key characteristics of an insurance approach – such as hedging longevity risks and generating cashflows to match outgoing payments – directly and more broadly across the whole portfolio.

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Summary
• Bulk annuity de-risking transactions have reached record levels in 2019, including very large buy-in deals, alongside buyouts.
• A buy-in requires very careful planning, particularly in relation to the impact it may have on the scheme's overall investment portfolio and strategy.
• A buy-in should be planned in relation to the scheme's longer-term funding plan, including future de-risking exercises.

Considering the consequences

The past year has seen record-breaking activity in the bulk annuity market, including a number of huge buy-in deals. David Adams looks at the reasons why pension scheme trustees might consider using a buy-in and the consequences that decision might have on scheme investment portfolios and funding plans

Bulk annuities are very much in fashion: buyout and buy-in transactions worth more than £30 billion in total were announced during the first nine months of 2019, well ahead of the £24.2 billion seen during the whole of 2018 and dwarfing the £12 billion total for 2017, according to LCP.

As well as eye-catching buyouts, 2019 has seen some very large buy-ins, including a £3.8 billion deal between the Asda Group Pension Scheme and Rothesay Life; and a £3.8 billion buy-in the same insurer is delivering for the Allied Domecq scheme. The latter deal was announced the same week that Rothesay unveiled the largest-ever UK buyout, a £4.7 billion transaction with telecommunications company Telent, which will eventually be completed as a buyout in 2022 but begins with a buy-in.

Other buy-ins announced during the year included the British American Tobacco UK Pension Fund insuring £3.4 billion of liabilities with Pension Insurance Corporation (PIC); and a Rothesay Life £520 million buy-in for the Cadbury Mondelez Pension Fund. Meanwhile, LCP has reported strong demand for its streamlined buy-in/buyout services for smaller pension schemes.

The logic behind a buyout is pretty straightforward, but the case for a buy-in is not always so clear cut. It may form a stepping stone to a buyout, but for some schemes, says PIC chief origination officer, Jay Shah, a buy-in is the next logical step in a de-risking journey that begins as a scheme moves towards holding more long-term, fixed income assets, rather than risk-seeking, high return assets. "The more de-risked a scheme already is, the greater proportion of its assets that are already held in fixed income, the more likely it is to move to buy-in," he says.

As an investment, the buy-in policy can offer greater security than fixed income assets because it provides cashflow – often better cashflow than provided by the gilts being used to purchase the buy-in – while protecting the scheme against longevity and negative inflation risks.

"For most of my clients, the decision starts with longevity risk," says PwC head of pension risk transfer, Ben Stone. "They've got interest rate and inflation hedging, but longevity risk can blow them off course."

"By using a buy-in you generate investment headroom; and it leads to greater security and less volatility," says Aon senior partner and head of the risk settlement group, Martin Bird.

But although a buy-in is notionally an investment, it is also a permanent arrangement. "Gilts you can sell, but a buy-in is for life," says Shah.

Pensions and Lifetime Savings

Association (PLSA) DB policy lead, Tiffany Tsang, stresses the importance of trustees considering the wider consequences of a buy-in. "What impact does it have on your remaining assets?" she asks.

LCP partner, Charlie Finch, says his team always asks trustees considering a de-risking transaction exactly which assets will be used to fund it. "You need to make sure you have enough collateral, liquid assets, to maintain the hedging you need," he says.

"To what extent is this going to limit flexibility?" asks Barnett Waddingham head of bulk annuity consulting, Gavin Markham. "Might it inhibit my ability to hedge? If I'm spending a good chunk of my assets, do I have sufficient liquidity to meet further needs going forward?"

Indeed, as Stone puts it: "If you give away your gilts to pay for the buy-in, you may find that the numbers don't add up and you have to exchange more of your return-seeking assets for more gilts you can use to hedge."

There is a risk that a buy-in may make a buyout more difficult, warns Insight Investments head of solutions design, Jos Vermeulen.

"When we've looked at the impact of a buy-in on portfolios we have found that, in a majority of cases, buy-ins make it more difficult to get to buyout," he says. "The reason is what it can do to the risk and return of the remaining portfolio. You're left with some risky liabilities and fewer assets to deal with that risky liability.

"A buy-in ties up a lot of capital in a very illiquid asset and if transfer values move, or equity markets fall, you have very little scope to change things. In many cases it will extend the time it takes you to get to buyout."

There is also a need to ensure that the mix of liabilities the scheme will be asking an insurer to take on in a future buyout will appeal to the insurer's risk appetite.

"Smaller schemes are more constrained in terms of how many times they can slice and dice liabilities," says Markham. "You don't want to be going to the market with slices of liabilities that are too small."

Bird stresses the need to balance numbers of pensioner members and deferred members within the group of members to which the buy-in applies. "If you leave yourself a block of risk that is very deferred-heavy that's going to be a lot less attractive to the market," he warns.

Each insurer will have a different appetite for different types of risk, so solution might be to work with a number of different insurers to de-risk different groups of liabilities. However, this could create additional complexity and communication challenges if the scheme then moves to a full buyout later on.

Some trustees may conclude, when considering the impact of a buy-in on investment and funding strategies, that there is a case for proceeding straight to a buyout.

"Insurers' prices are very competitive at the moment, so more schemes find themselves thinking about full scheme buyouts sooner than they had anticipated would be the case," says Bird. "Once you get within a few per cent of being able to afford it, maybe there are levers that can be pulled. Maybe the sponsor can draw on a war chest."

But, says Vermeulen, trustees also need to consider the impact of the buy-in on the scheme sponsor, in part because there is a risk the process will actually push the date of a buyout further into the future. "If you want to solve *[the de-risking problem]* in the same amount of time you need to take on more risk; if you're not taking on more risk you're pushing the buyout further into the future," he says. "You're relying on the sponsor covenant for longer, which means you're taking on more risk.

"If you're going to do a buyout in the next few years, then you can understand why a scheme would be doing buy-in: they're not taking much risk and they're well-funded," he continues. "But if you're looking to do buyout in five to 10 years' time, a buy-in is probably not the best use of your capital."

On the other hand, external events may change the situation, such as a sponsor preparing for a major acquisition, or itself being acquired by another company. Such changes may encourage the sponsor to increase available funding for the scheme with a view to moving to a buyout.

That means it may be sensible for a scheme to put in the groundwork needed for a buyout, suggests Rothesay Life co-head of business development, Sammy Cooper-Smith. "There's no harm in pension schemes starting that process now: cleaning data, checking records are correct and so on," he says. "We have seen examples where something has changed and a scheme is suddenly in a position where they can afford to do a buyout. If you find yourself in that position, you will be pleased you are ready."

Whether – or whenever – an individual scheme is ready to go through a buy-in or a buyout, the market for de-risking transactions has acquired a powerful momentum. But even when the price starts to look very appealing, the decision as to whether to buy-in or buyout must be based above all on a clear assessment what it will mean for the members' long-term interests.

"You need to look at the before and after positions of doing the transaction and ask what impacts it has on your future returns and on your risk profile, to establish whether doing this is taking the scheme towards your objectives," says Markham. "It's a decision that needs to be strategically correct."

Written by David Adams, a freelance journalist

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A big fish in a big pond

Telent and Rothesay Life recently concluded the largest bulk annuity deal in UK history, completing a full buyout with the GEC 1972 scheme worth £4.7 billion, in September 2019. Jack Gray speaks to Telent pensions director, Pete Harris, its CIO, Alan Goodman, and Rothesay Life co-head of business development, Sammy Cooper-Smith, about how this unique deal was completed

This year has been a record year for bulk annuity transactions, with the value of deals expected to exceed £35 billion by the end December. The largest of these was the £4.7 billion buyout of the Telent GEC 1972 scheme by Rothesay Life. It secures benefits of all of its 39,000 members, including 11,000 deferred members, and will see the transfer of assets from the scheme to Rothesay Life.

What was the scheme motivation for the buyout?
Pete Harris: Since 2005 the pension scheme has been much bigger than the company. When the £4.7 billion buyout occurred, Telent turned over around £500 million. So, if either Telent or the scheme had fallen over, it would have pulled the other one down. For a number of years now we have been actively targeting being able to buy out, to remove the risk from our pensioners and to remove this major financial burden from the company.

What made it an attractive scheme to complete this deal with Rothesay Life?
Sammy Cooper-Smith: I think there were a few factors. Obviously one, as a business we target larger transactions, so just the overall scale of the transaction made it more attractive than many others to us, just because it enables you to get a large amount of liability written in one go. The scheme was clearly very well funded, we didn't know how well funded until we'd actually started to price it, but all the indications were that this was a very likely candidate.

I think the thing to say that was most attractive for us was having had a group of trustees, and you had a corporate sponsor who could not have been clearer to us what their motivation was. There are always ifs and buts and doubts when someone approaches you on a transaction of this size, but I can't remember a time where those ifs and buts and doubts on our side were as small as they were on this transaction.

Alan Goodman: There was clear motivation from both sides, from all three sides; Rothesay's side, the trustee side and company side.

The trustee of the scheme had managed to eliminate most of funding deficit in around a decade. How was this achieved?
Harris: Fundamentally, the way it was achieved was through investing in governance. In around 2009 we recruited a new CIO, we appointed a new investment adviser in Redington and we beefed up the power on our investment committee. The simple answer to that

question is governance. The core of the investment strategy was fundamentally to hedge out the risks that we didn't believe we'd be rewarded for. Then to target a level of risk that we were happy with that we thought could get us to our targets.

Goodman: We'd looked at this situation 10 years, or 12, 13 years ago even, and said 'okay, well what's the sensible long-term strategy to minimise the potential downside risk to the funding level and therefore, minimise the level of support that we need from the sponsor?' Hedging rates of inflation has been something that the scheme has done 100 per cent for over a decade now.

We were an early adopter of those LDI strategies and an early adopter of focusing on downside risk, which meant that an exposure to more credit linked strategies, lower risk stable return strategies and away from growth markets of equities and investments like that.

Cooper-Smith: Another thing that made this scheme very attractive to us was the fact that it owned a number of limited-price index (LPI) swaps.

Goodman: Yes, roughly half of the inflation hedging was done through LPI swaps rather than through investment gilds or traditional inflation swaps. It was done many, many years ago, when availability of the instruments was a lot more pleasant than it is today. Our ability to manage the inflation exposure on a collar basis rather than just having to continue with the LPI swaps.

How long has this deal been in the works? Can you describe the process that the two firms have been on to reach this deal?

Harris: Fundamentally we got to the point more or less this time last year of concluding that it was worth exploring whether there was a deal to be done in the market. We weren't sure we were there, but we were getting indications we were close enough. We then deliberately took a measured approach, whereby we were very careful about selecting our advisers.

We did want to get out and talk to the insurers very early; we formally met Rothesay at a meeting in January. We'd appointed our advisers by March and then it was from March for the rest of the year basically that we did the heavy lifting on doing the deal.

Is that a typical length of time?

Cooper-Smith: Certainly no, this wasn't typical. As has become clear to everybody, this year was a phenomenally busy year, so briefing the market knowing that this process was coming, making sure that we had resources to one side, that was something that wasn't a common feature of the marketplace.

When we first started having the conversations and putting together the quotation of this process, we had no idea what the rest of the year was going to look like.

We really pushed ahead in order to be able to really focus on this scheme ahead of anything else in the marketplace, because it represented such a key opportunity. Many times, people just very dogmatically stick to a specific timeline. This process was much faster than most and when you consider the size of the transaction.

Goodman: Improving our data and keeping our data in a sensible stable shape over the past 10 years has been critical for us. But it wasn't that much effort going into it to getting ourselves ready.

I think that's really a credit to the way that the administration side and our administrators have run the scheme over time. We had Q4 of last year to really establish some interaction between the company and the trustee, to make sure that we were on the same page with our objectives. Which is if a deal is affordable then it's in both the company's and the trustees' interest to do a deal and get over the line.

What kind of impact do you see this having on the members?

Harris: It is interesting, because it's one of those things that we have thought a lot about. Every interaction we've had with Rothesay has been extremely professional and then it just comes down to it being an absolute no-brainer. When you get a member in front of you and you say 'right, we've got this huge scheme, if anything goes wrong Telent are tiny and can't fill the hole.'

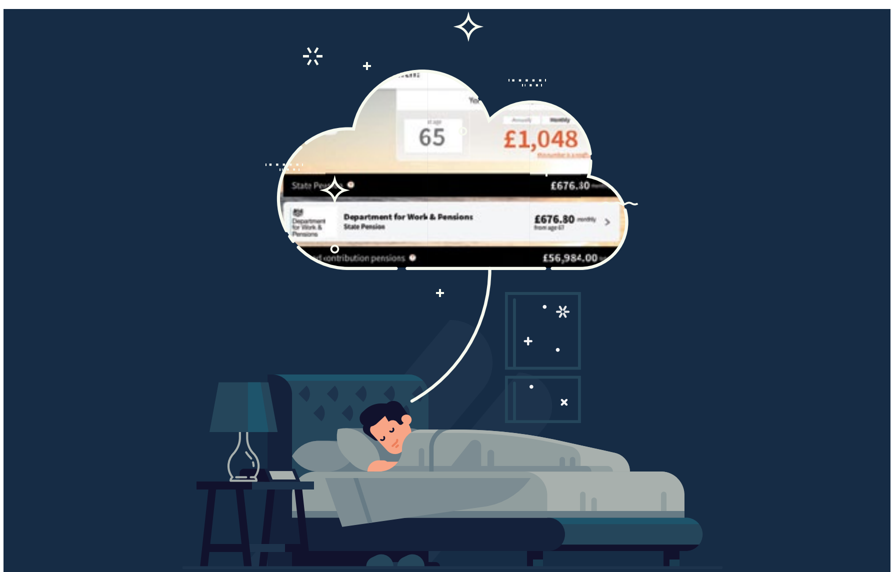
Then you've got The Pensions Regulator that's got very limited powers and then you've got the Pension Protection Fund that doesn't pay full benefits. You compare that to Rothesay, to have the regulatory capital required to have and their policy is to hold more than that.

Cooper-Smith: Where the trustee and the corporate set out a very clear target and interact directly with us, it makes a big difference.

Written by Jack Gray

A dream come true

Sara Benwell explores how to make the dream of pensions dashboards a reality



Summary
- Pensions dashboards see yet another delay due to the general election.
- However, schemes still need to crack on with preparing their data.
- Challenges to overcome include digitalisation and data cleansing.
- Two further hurdles are data security and settling the question of one dashboard versus many.

The pensions industry has been calling for government regulation on pensions dashboards for some time now, and finally after myriad delays, the Pension Schemes Bill was introduced into the House of Lords. Unfortunately, there was a twist in the tale as just two weeks later a general election was announced and the bill was dropped.

Despite this, experts are convinced that the bill will once again be on table when we have a new government.

"The General Election means that the present government's pensions bill will go no further. But most of the measures, such as support for a pensions dashboard… have broad cross-party support. This means that a new government, of any complexion, is likely to bring forward pretty much the same legislation, albeit much delayed," Royal London director of policy, Steve Webb, says.

While this is surely a cause for celebration, there are still several hurdles to be overcome, before the dashboard(s) becomes a reality. And the industry must continue to prepare for when legislation is eventually introduced.

Getting legislation right

Assuming that the Pension Schemes Bill is reintroduced by the next government, there are still questions around what the new laws will look like and what will be expected of pension schemes and providers.

Compulsion is critical, particularly if we want to have a dashboard that shows people a holistic view of all their pensions savings. Many have also argued that it is crucial that the state pension is included, something the government has not yet promised will happen.

Altus head of retirement strategy, Jon Dean, says: "If pension schemes are not forced to provide data to pension dashboards, we believe that many will choose not to, leaving individuals with an incomplete picture of their entitlements. If it's incomplete, this is likely to be an expensive but unsuccessful project."

Royal London pension specialist, Helen Morrissey, adds: "Care must also be taken to ensure all providers are willing and able to supply their data and the government must commit to supplying state pension data on the dashboard without users having to go off to another site. The whole point of the dashboard is that it should be a one-stop shop – if people need to go elsewhere to gather further information then it defeats the object."

Dealing with data

Perhaps the biggest challenge to be overcome is that of data. Part of the problem is that the data standards for the dashboard have not yet been released, so schemes are finding it hard to prepare.

Standard Life head of global savings policy, Jamie Jenkins, explains: "The biggest challenge will not be the technology itself. The real obstacle will be the provision of accurate data from schemes, especially when it has been stored in a paper format for many years."

Of course, some schemes will find it easier to provide data than others. DB schemes, and in particular, those that are closed or have relied on paper records, are likely to have the most difficulty. There may also be some difficulty for DC schemes, where trades don't reconcile immediately.

Cosan Consulting director, Ian Bloxham, says: "The ideal world would

be one with a dashboard linking together all forms of an individual's pensions from multiple sources, with 'dynamic' views of retirement, transfer and death values. This will therefore rely on a base level of calculation automation for all schemes and members. This is probably a harder nut to crack, especially for smaller schemes on legacy technology.

"Most admin operations will automate the volume calculations but have workarounds in place for categories of members and/or calculation types where the casework is low. This could lead to a double standard within schemes where certain members can view retirement benefits online but others can't because the calculation is manual."

While the regulatory expectation may be that all schemes, even those in the DB world, have accurate and up-to-date records, there is substantial evidence that this is not always the case. This means that many plans may have an uphill journey in getting their scheme data clean and ready, in a digital format.

ITM director, Matt Dodds, explains: "At the moment, the best thing for schemes and providers to do is get their data as clean as possible and keep it clean – whilst this seems obvious, only at the latest PLSA annual conference did we hear that most schemes do not have data that is fit for dashboards. And the regulator has recently issued hundreds of schemes with warnings due to non-compliance with record-keeping guidance."

Smart Pension director of policy and communications, Darren Philp, adds: "For some it will be as simple as writing an additional section of code. It's probably two weeks' work for a provider with its own API. For others with legacy issues, it will be a much bigger, longer-term undertaking that will involve dusting down paper records, or investing in more dynamic, proprietary technology. This kind of digital transformation would require enormous investment and inevitable cultural change, so it won't happen overnight."

Legal & General Investment Management head of product policy strategy, Colin Clarke, concludes: "Schemes and providers should start reviewing this as soon as possible, as well as IT infrastructure and associated processes. Third-party administrators should also be engaged early to ensure they are prepared.

"At a high level, schemes should focus on the basic principle of the dashboard – to ensure a successful match with the member's personal details and to play back information, such as the fund's current value, on request in real time. The Pensions Regulator has recently stepped up activity to make sure schemes have high-quality data and this will become even more important when the dashboard is rolled out."

Security and compliance

As well as data quality, on the dashboard design side there are also serious concerns about how data will be kept secure and what it will be used for. Issues to be overcome include how dashboard providers will verify identity and how schemes will provide the data in a safe and secure manner.

Dodds says: "Whilst data is critical it is not the only consideration – simultaneously the industry delivery group will also be working on defining the way dashboards will verify identity, how data will be made available as well as lots of stakeholder and consumer engagement. There is a challenge around compliance regime too. If data standards are set, how do schemes confirm their compliance with them? Will they need to actively confirm this, or will it be assumed?"

There are also still some technical hurdles to be overcome in terms of physical dashboard provision. For instance, questions remain about whether there will be one sole independent and non-commercial dashboard provided by the Money and Pensions Service or whether it will be more like open banking where providers can build their own dashboards.

Opinion is divided on which approach is best. Consumers have indicated that they would prefer a dashboard to be government run. A consumer survey by Ipsos Mori found that 42 per cent of people said they would trust a government-backed model, compared to 22 per cent who would trust a private pensions company or a company set up specifically to run a dashboard.

Of course, providers are keen to build their own dashboards, ostensibly for engagement purposes. However there are concerns about what the commercialisation of the dashboards projects could mean.

Cosan Consulting director and actuary, John Reeve, says: "The main issue for me is the way in which the data is used. If the data is used to drive profits within the financial services industry then trust will very quickly be lost, and engagement will fall. I have to believe that we are entering a new world where the data will be used to help ensure that individuals have a better financial future and that this drives value and hence profits. Abuse of this data for corporate gain will create a world too horrible to contemplate."

The eventual route may well depend on who wins the general election. Webb concludes: "If we were to have a change of government, the main differences would be that a Labour government would be less keen on multiple pension dashboards and would prefer a single one hosted by a public body.

"The delay to the legislation means that the legal framework for the pensions dashboard will be further delayed, but the industry needs to crack on in the meantime with getting systems and data in place ready to go live as soon as possible".

Written by Sara Benwell, a freelance journalist

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The power to pivot – *Tim Banks explores how fiduciary management can provide pension schemes with the flexibility they need during their journey plan* ***p80***

Going on a journey – *Pete Carvill explores the journey of selecting a fiduciary manager* ***p82***

Fiduciary management focus:

Lightening the load

Mercer principal, Tim Banks

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The power to pivot

Tim Banks explores how fiduciary management can provide pension schemes with the flexibility they need during their journey plan

These are demanding times for pension scheme trustees and sponsoring companies. Regulatory demands are increasing and requirements are ever-more complex.

Britain has about 5,500 defined benefit (DB) schemes – a large number by international standards. Regulators are asking trustees and sponsors to consider ways to improve efficiency.

Consolidation – what form and how to get there – is on the minds of decision makers. But consolidation is often presented as a hard choice between keeping things as they are and arriving at a buyout. This sees the consolidation journey as a two-stage process: set a strategy to invest in higher return assets and then switch into safer assets when you are close to full funding.

Whatever the ultimate objectives of a scheme are, it may take 5, 10, 15 years or more to get there. That's a long time in which plenty can happen – as we know from our personal lives. Fiduciary management offers a flexible alternative to the all-or-nothing consolidation narrative.

Combining traditional advice on strategy with a mandate to implement can be a powerful combination. It also treats the scheme's journey as a gradual one with several different stages and mindsets and the need to respond when circumstances change.

We see more and more trustees turning to fiduciary management to give them the flexibility and expertise they need. The number of schemes to adopt this approach had increased from about 60 in 2008 to almost 900 in late 2018.

An important feature of fiduciary management is the ability to pivot when things change. Instead of setting a strategy and reviewing options occasionally under a traditional advisory model, the scheme entrusts industry experts to manage proactively and respond to changes.

Politics, regulation and markets always have the potential to throw up the unexpected but in a 24-hour world where established ideas are under fire and pensions are increasingly political, events are arguably moving faster and becoming less predictable.

For example, in the run up to the Brexit vote in June 2016 it was clear that if there was a leave vote the pound would suffer and that if there was a vote to remain there would be little effect on sterling.

How many schemes run on traditional lines were able to put in place currency hedges to help protect

against the pound's sharp decline after the referendum result? A good fiduciary manager would not have had any special knowledge but it would have had the responsibility and flexibility to make that pivot after analysing the likely scenarios.

More recently the government announced it would make changes to the Retail Price Index (RPI) over the next decade to align the measure of inflation with the Consumer Price Index, which usually runs about a percentage point lower than RPI. This change has implications for the valuation of schemes' assets and liabilities linked to RPI.

Again, an expert fiduciary manager would have acted promptly to identify which clients' liabilities had big exposures to RPI and put in place de-risking triggers to help preserve the value of members' pensions. As with the Brexit example it's the mandate to monitor and that ability to pivot that enables fiduciary managers to do this.

Under a traditional advisory arrangement there would have been less flexibility and ability to react than under fiduciary management. That shouldn't be surprising. It's simply not reasonable to expect busy scheme trustees to have the time and insight to spot these kinds of dangers and opportunities to lock in value.

Trustees are facing increasing demands and their jobs aren't getting any easier. The regulator wants schemes to show evidence of journey planning towards an intended destination and a strategy linked to a long-term funding target. Expect the regulator to ask trustees for more evidence to demonstrate how the investment strategy speaks to the funding target, including an audit trail.

We still come across large schemes with no journey plan but even the better-prepared schemes may struggle to adapt to the additional demands coming down the track. It's very difficult for trustees to react quickly in a coordinated fashion when circumstances change – or even to stay abreast of developments.

On that journey from where we are now to buyout or self-sufficiency, markets, ideas, and options can alter with an impact on the funding plan and investment strategy. Most of this discussion focuses on assets – but liabilities can be unpredictable too. A stark example is the government's introduction of freedom of choice, which has triggered £30 billion of withdrawals in little more than four years.

Overlay these changes and disruptions with the different stages in that journey of five, 10, 15 or more years and you have a complex set of dynamics that the traditional model, with its three-year reviews, can struggle to track. Professional managers whose job is to keep up with developments in real time can have that ability to pivot and proactively manage liabilities and assets.

There has been a lot of discussion in the market recently about cashflow-driven investment (CDI). Like fiduciary management, CDI isn't new. It means managing like an insurer and is consistent with getting to the journey destination, whether that is self-sufficiency or a buyout.

About 10 per cent of our client schemes in fiduciary management are managed according to CDI and all of them are gliding towards that basis. The flexibility of fiduciary management is much better suited to managing assets proactively against liabilities for a successful CDI strategy.

Consolidation is a big move, and for scheme sponsors and trustees, fiduciary management can act as a first step in the world of consolidation. We recently lost our fourth client to a buyout but of course it wasn't really a loss – the client got to their destination and our job was done.

Fiduciary management won't be for everyone. There's a cost involved, of course, and many schemes may prefer to stay with their current arrangements. But as I write we are heading for an unpredictable general election that could produce wildly different outcomes and Brexit is still unresolved.

It doesn't feel like the world is going to get any more predictable soon and pension schemes will continue to face demands and changes. In that environment the power to pivot could prove vital.

Written by Mercer principal, Tim Banks

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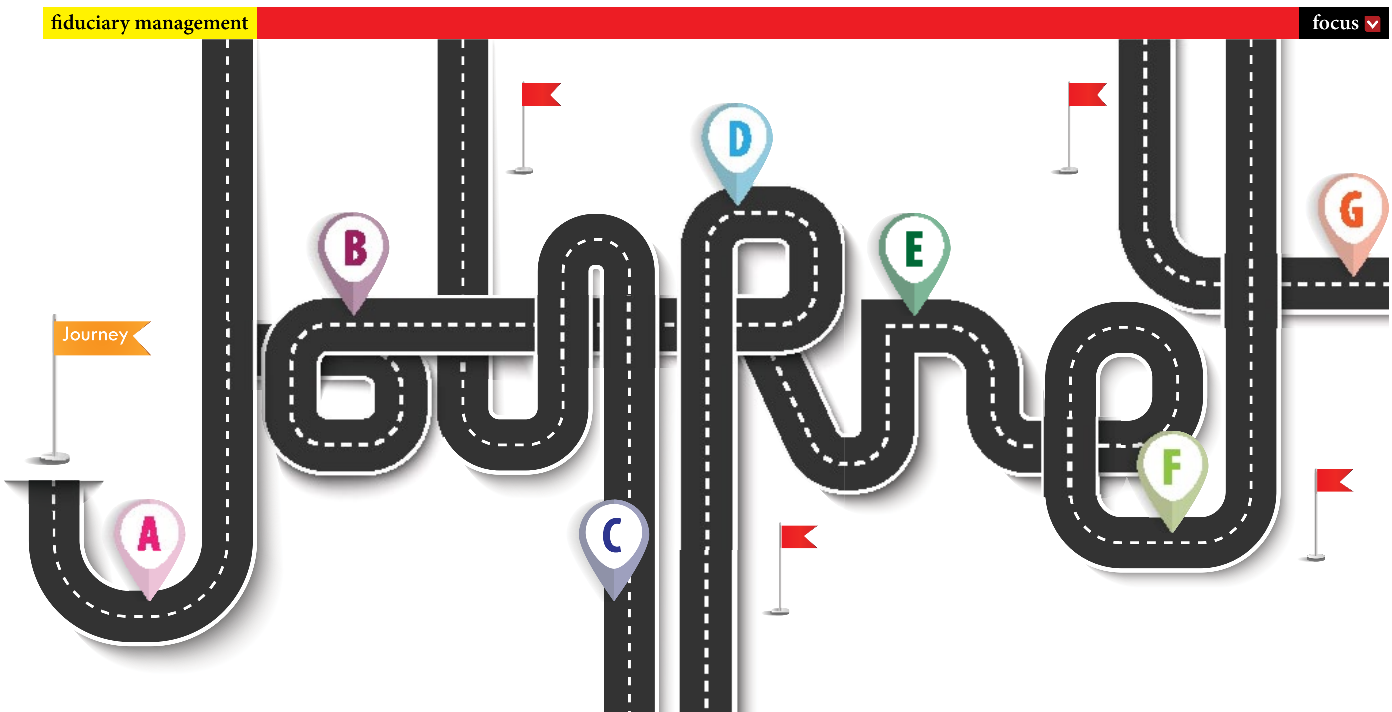


Summary
- In mid-2019, it was decreed that fiduciary management services now have to go out to tender.
- As part of the tendering process, trustees should plan ahead, and look at the capabilities of the fiduciary manager and their track record.

Going on a journey

Pete Carvill explores the journey of selecting a fiduciary manager

As the year closes and the cold, dark nights come in, it is the opportune moment to look back on one driving issue in the fiduciary management space: the Competition and Market Authority's (CMA) June publication of its final remedies.

There has been something of a long and winding road to get to this point, but it is instructive to take a step back and look briefly at the role of a fiduciary manager. Ernst & Young has a good, if slightly wordy, definition of what one is and does.

According to the organisation, fiduciary management is "[…] an investment governance solution that involves the trustees delegating certain elements of the investment process to an investment expert – the fiduciary manager".

The fiduciary manager, says Ernst & Young, "[…] can be expected to employ the best practices in pension scheme investment management. This means managing the pension assets relative to the liabilities, employing techniques such as hedging interest and inflation risks, maximising investment diversification and de-risking as market conditions allow."

Trustees approach fiduciary managers for a number of reasons. BlackRock head of UK fiduciary, Sion Cole, says that there are three types of clients. "One, they're underfunded, which is a common driver. Two, they are in a better position and it's about investing in something that delivers cashflows. And, three, there are those that are looking to transfer to an insurer," he explains.

The CMA's work in this area began in September 2017, following a referral from the Financial Conduct Authority. This led to a December 2018 report finding an adverse effect on competition in the fiduciary management and investment consultancy markets. The report made clear a number of changes, with a December 2019 date for implementation.

The key changes

The key change being implemented revolves around tendering. The Pensions Regulator outlines it this way: "From 10 December 2019, trustees will be required to run a competitive tender exercise for any agreement with a fiduciary manager provider that would result in 20 per cent or more of scheme assets being delegated. Trustees who appointed a provider prior to 10 June 2019 without conducting a competitive tender process will be required to conduct a competitive tender process within five years after the first appointment of a fiduciary management services provider. Where the five-year period expires before, on or within two years of 10 June 2019, trustees must

complete a competitive tender no later than 9 June 2021."

Pensions Age approached a number of people in the market. The responses were broadly supportive of the work being done. CEM Benchmarking principal, John Simmonds, says that everything put forward "made sense". He adds: "There were inherent conflicts in the system and far too many consultants were leading clients down a path that resulted in the consultants becoming the fiduciary managers. We needed to change that and introduce some proper competition into the industry. But it is difficult to force an organisation to go through a tender and have regulatory oversight that makes it a truly competitive process."

Mercer UK head of fiduciary management, Ben Gunnee, went further. He says: "The regulators wanted to see that performances are transparent, so trustees can compare one fiduciary manager with another on things like fees and past performance. Some produce fees in differing ways, whereas some had bundled fees, and so it often wasn't clear or easy to make comparisons. The overall report and its aims were pretty sensible."

Of those interviewed, there were comments that making funds go to tender would mean increased competition in a market long dominated by a handful of big players. This, it was said, would not only bring smaller players in and give them a chance to show their value, but would encourage trustees to see that they have more choice.

"It gives trustees the opportunity to go back and think about their investment philosophy, and to re-think about what they are trying to achieve from an investment risk perspective," Ernst & Young director Rikhav Shah says.

Bringing in fiduciary management

There are a number of things that trustees should do when looking to bring in a fiduciary manager. Broadly speaking, there are three areas. These are the objectives of a scheme, the capabilities of the fiduciary manager, and their track record.

The most important step comes at the beginning when trustees should look at and define what it is that they want to achieve. Simmonds says: "If you're a DB scheme and you're looking at an exit strategy, you should be considering what your path to buyout is. And what you need there is for your fiduciary manager to help you make better decisions, particularly around things such as funding and timing."

Gunnee goes further, saying: "Fiduciary management 101 was something that people either took, or didn't. It's rapidly evolved into a solutions business, even if that's a terminology that's somewhat overused. Good fiduciary managers can do different things, depending on the client. Whereas some clients give autonomy around things such as asset allocation decisions, hedging, and de-risking, some delegate some of these. It's been an evolution of the market."

This planning should go back further than implementation, according to Cole. He says that many trustees make the mistake of not sharing their information upfront and will ask instead for the fiduciary manager's best portfolio. "That's akin," he says, "to asking a builder to build a house. You might get a mansion, a two-up-two-down, or a tent. The question has been answered, but in a different way because not enough information has been shared upfront. If you do that here, you'll get a range of solutions but they won't meet your needs."

Next to consider is the capabilities of the fiduciary manager. Gunnee says that trustees should look at the portfolio management capacity and assess whether the fiduciary manager's is strong enough to meet their needs. Many of these organisations, he says, only have 10 people working there. "Given that you need experience in many, many areas, that number is not going to cut it."

Aon's head of investment for UK and Ireland, Tim Giles, offers a more-granular vision. He says that trustees and schemes should be asking themselves if the fiduciary manager is someone that they can work with, and for some time. "Will they be able to evolve?" he says. "Most of the discussions in this area are around DB schemes, but how will that change around areas such as de-risking? You may want people, in the long-term, who have that capability."

The third area is around the preparations that should be made by trustees, which is considering the track record of the fiduciary manager. Giles says that trustees should not look only at what has been done, but how they have done it, and the composition of the portfolio. "You want to see that the firm's track record is consistent with the process to give you the right returns for your scenario. There's no point in having great returns from the previous year if too much risk is being carried."

Growth market

Despite a reported dip as people waited to see what the CMA came back with – "the number of mandates has been slow this year as trustees have waited to find out what's going on", Gunnee says – the market remains a growth one. This is largely due to complexity of what's going on beneath the surface when it comes to DB scheme investment. Cole says: "The entire UK DB landscape has assets of around £1.6-1.7 trillion. It's not a market that's growing significantly. But there's a lot of activity – big movements from assets to growth to defensive positions, and things like alternative assets. When you bring that together, it's a complex position and it's driving the market."

Written by Pete Carvill, a freelance journalist

In association with

Looking around for inspiration

Pensions Age asks which other industries have developments that may be of use to the pensions sector

Social media

Facebook, Twitter, Instagram, YouTube and others have increased the sharing of information and experiences between people beyond all recognition – and ultimately this leads to cultural change. If pensions became a hot topic on social media platforms, that could significantly change current pensions savings and spending patterns – for good or for ill.

Aon partner and head of UK retirement policy, Matthew Arends

Medical sector

Clearly medical advances that improve longevity will have an impact on how long pensions schemes will have to pay out pensions. In the DB landscape this will have an impact on funding levels and in DC it will mean pots of money that have been accumulated by individuals will need to last longer.

SEI managing director of defined contribution, Steve Charlton

Advancing medical knowledge and technology will increase longevity overall, but we will also see factors such as NHS adoption speed and budgets either accelerating or decreasing this trend. In addition to material medical improvements, the accessibility of health data is actually allowing us to paint a better picture of what the true mortality picture is, adding an additional layer of information.

Redington chief technology officer, Adam Jones

Organisations such as the NHS are starting to use the power of their data, for example, to predict which individuals are less likely to turn up for a doctor's appointment and to send tailored reminder messages. In the pensions industry, we can use our big data to help members with their next best action; to design tailored campaigns to increase contributions or the take up of matching contributions, and use our understanding of past behavioural patterns to understand what type of communication will be most effective in the future.

Legal & General Investment Management head of defined contribution, Emma Douglas

Automotive industry

The automotive industry is going through radical change as it migrates from human-controlled driving, through assisted driving and eventually to fully computer-controlled driving. This is a bellwether for the development of technology to reduce human effort and reduce human-induced risk. The pensions industry should watch these developments closely because the same type of approach might be applicable to pensions – particularly to help DC savers to make complex investment and disinvestment decisions.

Aon partner and head of UK retirement policy, Matthew Arends

Supermarkets

Supermarkets go to extreme efforts to collect data on customers, such as loyalty cards and store cards etc, to be able to understand what type of customer you are and in turn to personalise the promotions they send you. However, while we know vast amounts of information about members of pensions schemes, we are only scratching the surface of personalising our messages.

SEI managing director of defined contribution, Steve Charlton

Artificial intelligence

We have seen massive improvements within asset management in the use of data science and machine learning in how firms are assessing market risk and opportunity. I expect us to see similar techniques being deployed further up the value chain in time, in order to add further value to the way we do investment research and also for the optimisation of portfolio allocation.

Redington chief technology officer, Adam Jones

We need to consider the policy implications of new technologies, such as artificial intelligence (AI) and the internet of things (IoT). Policymakers should be considering now how best to ensure that such services are well thought through, well governed and entirely secure, so as not to open up additional avenues for criminals to extort people out of their life savings. For example, if people start to conduct their financial affairs through smart speakers, then we need to ensure that the same security is deployed for other things they might do by voice command, such as turning the lights on or boiling the kettle. Otherwise, it's a bit like having a deadlock on the front door but leaving the back door open.

Standard Life head of global savings policy, Jamie Jenkins

Quantum computing

An area we should be keeping an eye on is quantum computing – speeding up the power of complex calculations. For example, an actuarial calculation could be carried out in a fraction of a second instead of the hours it might take now.

SEI managing director of defined contribution, Steve Charlton

Banking

Open banking facilitates access to banking data, but we need a similar approach in pensions and investments. There are industry-led initiatives, such as TISA's Open Asset Management and also the pensions dashboard, which may bring this about. If we can achieve this though, we could be looking at similar third-party engagement in the pensions ecosystem as we have seen with comparison sites in insurance and banking and budgeting apps in personal finance.

Redington chief technology officer, Adam Jones

In personal finance we have seen how the 'challenger banks' and others have delivered fully personalised information in a clear and easy-to-use format, making it easier for individuals to make changes with just one click. Micro-savings (rounding up the pennies), has brought saving closer to spending and helped individuals to see both sides of their finances in one place. The more we can bring pensions into the context of everyday finance, the better.

Legal & General Investment Management head of defined contribution, Emma Douglas

Gaming

It's worth considering the gaming/esports developers. Those with children will know that video games today can be compared to the Rubik's cubes of the past. Children are engaged in these activities and are the pension scheme members of tomorrow, and as a result they will have an expectation we need to live up to.

SEI managing director of defined contribution, Steve Charlton

Paying the rent

Andrew Williams considers the opportunities for pension funds to invest in social and private-rented housing

Summary
• Observers point out that the global appetite towards residential investment is growing rapidly and that there is a rapid acceleration in understanding and demand amongst UK investors.
• Pension funds' interest has been matched by a growth in the number of funds available in which to invest.
• Industry insiders point out that the private rented sector can offer a steady real-income-generating investment.

In the ongoing quest for steady returns, many pension funds are showing increasing interest in investing in social housing and private-rented housing. So, what have been the main recent trends and developments in pension schemes' investment in this market? Has there been an increase in UK pension fund interest in this area over the past few years? What are the main motivations and risks? And in what ways might pension schemes access this asset class?

Significant advancement

As Aberdeen Standard Investments' global head of investment research, Andrew Allen, explains, since the turn of the century, we have seen a rapid emergence of interest in residential generally - a trend he observes appears to reflect the 'underlying fundamentals, progression of management techniques and professionalisation and understanding of the sector.'

"One might suggest that the huge expansion of buy-to-let amongst private investors perhaps expanded the consciousness of the sector amongst investors generally," he says.

According to him, this growth includes a significant advancement of lending to social housing providers, and a nascent advancement of equity investment alongside such entities, as well as a rapid phase of growth, and arguably maturity, in the UK student hall sector (where Allen reports private-sector investment from pension funds and others is now commonplace) and early stages of progression of mainstream private-rented housing, albeit "perhaps curtailed by the lack of established and stabilised investment product to invest into".

"We find it fascinating to see the differences in international perspectives in this regard. Whilst a typical US pension plan might allocate perhaps 20-25 per cent of its real estate portfolio to residential we see UK plans typically allocating between 0-10 per cent. Our experience, and recent survey evidence, of global appetite towards residential is growing rapidly. Amongst UK investors we see a rapid acceleration in understanding and demand," says Allen.

Secure income

Pensions for Purpose's founder, and MJ Hudson Allenbridge's senior adviser, Karen Shackleton, agrees that there has been growing interest in residential property as an asset class amongst pension funds, attracted by the relatively secure income stream and growth potential. In her view, this has coincided with a growing interest in impact investment, which she describes as a desire to try and deliver both positive financial returns and positive outcomes for society or the environment.

"This means that any asset class that can deliver to those twin objectives will be of potential interest to a pension fund, and residential property can do that. Pension funds' interest has been matched by a growth in the number of funds available in which to invest. Ten years ago, it was difficult for a large institutional investor to deploy capital in affordable housing. Now there are a number of funds raising capital, from large, global fund managers to niche, impact specialists," she says.

"UK pension funds have, for a number of years, been looking for alternative secure income asset classes which can act as a substitute for low-yielding gilts. This has probably been the main driver towards affordable and social housing. However, pension funds need to consider issues such as liquidity, scalability, track record, impact measurement and regulatory change to housing allowances before investing," she adds.

Elsewhere, Redington head of manager research, Nick Samuels, argues that the private-rented sector offers a steady real income-generating investment at a time when traditional equity and bond markets are looking expensive and offering relatively low income returns. In order to access the space, he reveals that many pension funds are joining forces in order to allocate money – and cites the example of seven local authority pension funds, which recently clubbed together to invest £200 million in a private-rented sector fund.

"The decision to join forces was prompted by plans to merge the investments of the UK's 91 local government pension funds (LGPS) into eight pools. Going forward, the government is hopeful that pooling will encourage more money into the sector and enable local government funds to make bigger private-rented sector investments," he says.

"Interest in social housing is also starting to increase. Investments not only provide attractive, secure inflation linked income, it also clearly makes a sustainable and distinct difference to communities across the UK. Meeting a social need in the UK housing sector is clearly appealing," he adds.

Attractive proposition

Elsewhere, M&G Investment director of fixed income, John Atkin, points out that recent regulation in the banking markets means that, from a capital perspective, it is difficult for banks to lend for long time periods, as they used to previously – but that pension funds have stepped in to meet this requirement.

"Housing associations like to have long-term financing in place for a number of reasons and they tend to plan new developments with a long time horizon. Pension schemes too have an increasing desire for long-dated assets as it enables them to hedge out their liabilities and they like the certainty of well regulated markets," he says.

"It is therefore fair to say that there has been increased interest from both sides, borrowers and lenders, in finding appropriate finance solutions," he adds.

According to Atkin, pension schemes can buy the debt of social housing associations in the public bond market or they can lend to them on a private and bi-lateral basis. Typically, he observes that most pension schemes would use an external credit manager to do this as the risks can be complex and need to be fully understood. A scheme would also "ideally seek assurance that either of these options offer good value versus other similar investment propositions, so a breadth of perspective is important".

"As pension schemes continue on their de-risking path it is likely that they will continue to have need for reliable, well-regulated cashflows, which they should buy as and when they exhibit good value. It is of course impossible to know what legal or regulatory changes may have on such a supply and demand dynamic, but for whichever entity becomes responsible for actually paying pensions, this is a potentially interesting lending market," he says.

Moving forward, M&G's associate director of corporate affairs, Rebecca Grundy, believes that a key challenge now is to ensure that PRS accommodation is of a high quality – particularly since, if the accommodation is right, renters will reward landlords with long tenures.

"On average most would expect to change accommodation only twice in a decade, which is music to the ears of institutional investors, such as pension funds and insurers, who need the income security of long-term tenants," she says.

"Through their investment in commercial real estate, pension funds are accustomed to investing extra in durable, quality buildings and facilities in order to make this happen. We definitely think this is a growth area and could be particularly interesting for LGPS in the future given that housing is in the infrastructure 'bucket,'" she adds.

Ultimately, Samuels argues that, for investors with long-term liabilities such as pension funds, both private-rented sector and social housing offer a very attractive proposition, with the yield offered by the private-rented sector currently "'very attractive compared to UK gilt rates, which have fallen and have remained consistently low over the past 10 years".

"The appetite of investors is expected to remain strong and grow over the coming years. Not only does the sector offer institutions a compelling combination of reliable income growth and robust capital values, returns have shown low correlations with those from other asset classes, making it an ideal component within a UK diversified portfolio," he says.

"Whilst the sector is still in its infancy, greater investment will come once pension funds are convinced that it can deliver an acceptable net return, without relying on unrealistic capital value increases."

Written by Andrew Williams, a freelance journalist

In association with

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

Sustainability roundtable

CHAIR

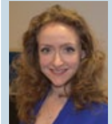
Chair for the day: Andrew Cole, Trustee Executive, BESTrustees

Andrew has over 15 years' pension experience of both DB and DC schemes, managing one scheme through five valuation cycles. For the past seven years he has also chaired the investment sub-committee of a £650 million portfolio. Andrew joined BESTrustees in April 2019. Previously, Andrew spent over 35 years working in global financial markets, working for both American and European investment banks, where he held a number of senior roles in capital markets. Andrew has extensive liability and investment management experience.

PANEL

Henry Boucher, Partner & Deputy CIO, Sarasin & Partners

Henry is chairman of the Sarasin & Partners investment strategy group, deputy chief investment officer and fund manager of the specialist thematic food and agriculture opportunities strategy. He started his career in fund management in 1983. Specialising in multi-asset and global-equity fund management, he has managed a wide variety of funds, including unit trusts, pension funds, life funds and charity endowments. He is also a fellow of the Chartered Institute of Securities and Investment.

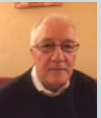


Caroline Escott, Policy Lead: Investment and Stewardship, PLSA

Caroline works on a number of institutional investment and corporate governance issues at the PLSA. She is also responsible for co-ordinating the PLSA's work on diversity and inclusion. Before joining the PLSA, Caroline was senior policy adviser at the Personal Investment Management and Financial Advice Association (PIMFA) and was head of government relations at the UK Sustainable Investment and Finance Association (UKSIF). She has also held roles providing financial policy analysis to members of parliament.

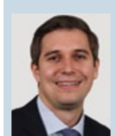
Mike Fox, Head of UK Sustainable Investments, Royal London Asset Management (RLAM)

Mike is head of sustainable investments and fund manager of the sustainable leaders, world and diversified trusts. He has managed the sustainable leaders since November 2003. Mike had worked as a deputy fund manager at the Co-operative employee pension fund for two years and as an investment analyst covering the utility, support services and media sectors. Mike originally trained and qualified as a chartered accountant with Ernst & Young in Manchester. He is a specialist in sustainable investing.



John Graham, Company-Nominated Pension Scheme Trustee, Royal British Legion

John was previously finance director and deputy director general of the Royal British Legion (RBL). After retirement, he was appointed as company-nominated pension scheme trustee on the £100 million DB scheme. John has been involved with pensions as a trustee or as the employer representative for over 20 years in both the charity and the corporate sector. As finance director, he closed the NSPCC DB scheme to future membership and again as finance director closed the RBL DB scheme to future accrual.



Lloyd McAllister, Responsible Investment Analyst, Newton Investment Management

Lloyd's role at Newton includes conducting research and company engagement on environmental, social and governance issues. Previously he worked at KPMG, where he qualified as a chartered accountant and worked within the sustainability consulting team. Lloyd is a member the Climate Disclosure Standards Board's technical working group and the Institute of Chartered Accountants of Scotland's sustainability panel. He is also the treasurer of a small UK charity.

Anita McBain, Head of Responsible Investment & ESG, M&G Investments

Anita joined the corporate finance and stewardship team in April 2018 and assumed the title of head of responsible investment and ESG in September 2018. Anita provides ESG support across equities and fixed income, working with the equity and credit analysts and portfolio managers on ESG research, thematic research and ESG engagement. Anita regularly speaks at conferences on topics such as climate risk, company ESG disclosure and sustainability topics.

Yo Takatsuki, Head of ESG Research and Active Ownership, AXA Investment Managers (AXA IM)

Yo leads AXA IM's in-depth global sustainability thematic research and its engagement programme with investee companies. He is an expert on the healthcare sector. He has sat on the expert review committee of the access to medicines index since 2017. Prior to AXA IM, Yo spent seven years working as director, governance and sustainable investment at BMO Global Asset Management where he led the ESG engagement overlay service.

In association with

Sustainability roundtable

Sustainability in today's pension world

Our panel looks at how well sustainability is being embedded in UK pensions investment today

Chair: What does sustainability mean in the pensions world today?

McBain: Sustainability essentially comes down to the long-term resilience of companies in the face of environmental and social challenges. This provides a framework for asset managers and asset owners to understand the long-term risks and opportunities for their investments, and represents a powerful tool for engagement with companies on key sustainability issues – from how their business will be affected by climate change to how well managed their supply chain is, for example.

As a starting point we can look at how our investee companies have disclosed on various issues, allowing us to see the degree to which they understand the risks and opportunities facing their business. Ultimately this is a way for us to mitigate risk, by asking how resilient these companies are and whether they can demonstrate to us that they have put the right measures in place. And where they haven't, we can engage with them to set out our expectations to encourage positive change.

This also comes down to the board, how it considers the financial and non-financial factors affecting the business, how it ties this in with executive remuneration, whether the board can demonstrate command of the subject and whether they have considered the material risks and opportunities. For 30 years, M&G Investments has actively engaged with our investee companies on governance.

McAllister: We start by saying to our clients: What are you trying to achieve when you're looking at ESG or sustainability? ESG integration, for example, is not about trying to improve environmental or social outcomes; it is about using ESG as an alternative way to improve risk-adjusted returns over, say, a three to five-year period. That's one approach to this that a lot of clients want, and that approach has been in play for 20 -30 years.

However, there are still some big societal issues out there, climate change for example, and there is appetite for an approach that says we need two objectives for the fund – one to get better risk-adjusted returns, and the other to improve long-term environmental and social outcomes.

So, for our ESG-integrated funds we have one objective, while for our sustainable funds we have two. That's where we start the conversation – by asking what the pension fund or the client wants. That way you're clear on what you want to achieve.

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Sustainability roundtable

One of the ways we have seen trustees and schemes have that lightbulb moment in terms of getting into ESG and realising the positive impact it can have on the investment returns (which is a really powerful argument) is by talking to them about the impact of the 'G' and using that as a way in.

By that I mean explaining: does it not make sense that a company which is well governed, has a diverse board, has a clear split between its chair and CEO, is better able to take account of all the long-term strategic risks and opportunities facing its business, including the 'E' and the 'S' ones? And that this approach will probably make them perform better and have a positive impact on their risk-adjusted returns?

The other thing that is coming up more and more as a reason as to why schemes are looking at ESG investment is thinking about member engagement and thinking about how you make pension savings real to members – there is a powerful argument there.

For example, if you talk about what someone's savings are doing in terms of the impact they are having on issues they care about – be that climate change or the gender pay gap or whatever else it may be – that can encourage them to engage with their savings more broadly and hopefully encourage them to think about what kind of contribution they want to make, whether or not they should be in the default fund and so on. That's a positive development too.

Boucher: To the question of what sustainability/ESG means today, the 'G' should have always been there because shareowners, company owners, should always look after their companies.

The 'S' has been around for a very long time in terms of social responsibility right back to the Quakers and Methodists in the 19th century.

But the thing that has really changed today is around the environment and environmental sustainability, and the reason that is so important for pension funds is that it's an intergenerational issue.

Greta Thunberg is out there protesting, and kids are going on strike because climate change really means something for their future. So, pension funds, which are, after all, looking after savings on a very long-term basis for their members – DB or DC - need to consider this long-term change. Pension funds today must wake up to the intergenerational issues that are out there. That's the big shift. As Caroline *[Escott]* was saying, it's a journey, but it's a fast-accelerating journey.

Chair: Is this more an issue for DC schemes rather than DB? Most DB schemes are now closed, therefore one would tend to think that their members are older.

Boucher: It is an issue for everyone. Even DB schemes that are closed might still have 30+ year liabilities. In 30 years, if we carry on as we are, climate change is going to make a huge difference.

Therefore, all trustees must do something, and they must try and pick apart what all these different factors are, and not get too hung up on the ethics or some other bits, because the language is so confusing. They must focus on what is really going to make a big difference to their pension.

Fox: I agree there is a lot of confusion in the pensions industry about what all these terms mean – impact investing, responsible investing, ESG, sustainable investing, CSR – there are many different terms out there.

I don't think, however, that today you

Chair: What's the trustee's perspective?

Graham: From my own trustee perspective, there are several issues that we're battling with. I'm involved with the British Lung Foundation and we have been out of tobacco for as long as we were formed. Our managers monitor our fund's performance against an equivalent with tobacco and we have years when we're down and we have years when we're up, and over the past 10 years we have been about level.

The phrases I like to hear are things like 'mitigation of risk', because I got interested in ESG when the voices in the industry started saying that ESG could have a fiscal/financial impact. That's when the accountant in me woke up and I knew I had to get interested.

I'm happy to be here today because there are a number of threads to this and, to find a way forward as trustees, we need to pull together the arguments and understand where we want to go.

Chair: Do pension schemes fully understand ESG?

Escott: The pensions industry is going on a journey and there are some schemes that have been getting to grips with ESG for a long time, and there are others for whom the new regulations have meant they've had to get up to speed extremely quickly.

can get an optimal investment outcome without considering ESG investment decision making, and that is something that has changed in 20 years.

Twenty years ago, there was no ESG in the ether. Companies polluted; pension funds got abused – that was life. There was no political consequence to it, there was no regulatory consequence to it, consumers weren't that bothered about it.

That has completely changed, and if you're an environmentally poor, socially irresponsible, badly-governed company, you're not going to be a good investment. Whether you come at it from a sustainable perspective, or morally or philosophically; or whether you think it's about fiduciary duty, the fact is you have choices now.

Do you invest in the companies that are creating environmental or social issues, or do you invest in the companies that are solving them? Do you want to invest in companies that lead their industries in ESG management, or do you want to invest in the laggards? I would argue that choosing the positive option on both of those is just good investment and if people choose to badge it in a certain way, so be it.

I also think we are starting to see the penny drop that maybe this is the best way to invest – even if it wasn't 20 years ago, now maybe it is.

Takatsuki: We have been focusing on ESG for quite some time – it is resource-intensive, and you need commitment from senior management to do this properly. You also need external datasets and you need excellent people to do it.

Also, one-size-fits-all doesn't work -– asset classes have their own nuances as to how you apply ESG.

In our conversations with UK schemes, cashflow-driven investing (CDI) is a big discussion area for us; that's where we're seeing the biggest interest. So, in that specific asset class, what are we communicating to our clients?

The first thing is you want to avoid tail-risks, so for credit segregated mandates we will ask: what are the types of tail-risks that you would be looking to avoid?

On the ESG side, it's sometimes obvious – coal, for example, is no longer in our view a long-term viable energy source globally. There may be ups and downs over time but as a firm, not just for our SRI strategies but across our entire investments, we have decided to exclude coal producers. Then there are other issues on which we believe it's important to make a stance – tobacco, for example, has been one of those.

Beyond that, it is up to us to make sure we do our research well, and make sure that we have the right IT systems in place. It's one thing having experts but industrialising it to the point where the decisions can be made by the fund managers on their front-end systems is key.

For us to be able to display that to our clients has been a huge plus. Every asset manager is telling UK schemes that they do responsible investing and some are doing it, but for us to show that we are a leader in responsible investing, we have to show evidence of what we're doing and how that actually relates to investment outcomes for our clients.

ESG and emerging markets

Chair: Are the arguments around ESG different if you are looking at emerging markets?

Takatsuki: Some of the biggest idiosyncrasies we see within the debate about climate change are in relation to the emerging markets, as environmental damage is often most visible in parts of the emerging markets.

As a result, we're starting to see large national governments in emerging markets take some of the most ambitious steps in this area. In China we're seeing the biggest rollouts of renewable energy – there's more renewable energy capacity in China than there is across most of Europe. It's that level of implementation that's happened in a very short time.

If you look at India, it is a very coal-fired dependent economy, but their national goals around climate change are quite remarkable – they're the only state in the world for which the long-term national climate change goals are actually aligned with the one and a half degree initiative.

So, you're starting to see some of the most ambitious projects coming from the emerging markets whereas in other countries like Australia or Germany, for example, internal political interest is often stopping major changes happen.

It's easy to paint a picture that the developed world is leading the way on this, with the emerging markets lagging, but it's a far more complicated picture than that and that dynamic has happened over a very short period.

McBain: We have a team looking at trends in emerging markets and we're seeing a lot of the emerging markets/ developing economies starting to leapfrog into new technologies such as solar, renewable and hydro energy, for example. We think this is very

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encouraging and demonstrates that there are opportunities as part of transition to a low-carbon economy.

What isn't so encouraging is the situation in Brazil concerning general deforestation and the Amazon fires. This is a big problem, and we carried out a deep analysis on our portfolios to understand the exposure of all of our securities to soft commodities that can be traced back to Brazil – as well as Indonesia and Malaysia – including exposure to palm oil, soy and cattle.

Following on from that research, we're now carrying out an engagement piece with some of the companies that are linked to commodity-driven deforestation. There has been a lot of input from our investment teams with this in conjunction with our ESG team – as investors we have to look at our portfolios through these different lenses to properly understand all of the risks and opportunities they are facing.

In a similar vein, the carbon tools that we now use allow us to look at our portfolios and assess their exposure to fossil fuels, for example, to understand all of the risks associated with that – including the physical and transition risks of climate change – as well as the opportunities, i.e. in green technology.

Regulation

Chair: Should one of the drivers to change be regulation?

Boucher: Regulation is going to happen but not necessarily to the pension funds – it's going to happen to companies that generate plastics, for example. Some companies are suddenly going to have to focus on the end of life of their product. So, the circular economy, as that starts to become reality, is the place where the regulation will take place. Where the pension funds will suffer is from the poor returns as the result of that regulation.

Escott: The Principles for Responsible Investment (PRI) have an initiative called the Inevitable Policy Response – this makes the case that there will be a plethora of new regulations as governments try to adapt to climate change and make sure that companies and industries are doing what they should be doing for the long term.

What I thought was interesting about a very high-profile pension scheme's recent decision to divest from tobacco was that it wasn't about the moral or ethical case, it was more for the reason that tobacco as an industry internationally was going to be under increased regulatory pressure and they wanted to escape that industry before regulations had a knock-on impact on investment returns in the long term.

Should regulation be driving this? There are certain countries where we are seeing investors step into the breach where regulators and policymakers have taken a step back. You see that quite clearly in the US.

But there is also a danger in regulations being too far in advance of the industry and that can cause a lot of pain; I think at the moment in the UK the regulations have been very helpful and I don't think that they are too far ahead of pension schemes and the rest of the investment chain. We've got the pace of change about right on that front.

McAllister: What I find is that, when you start talking to investors about ESG in ethical or moral terms, you lose the conversation immediately, whereas when you talk about ESG in terms of externalities, its potential to become internalised into profit and loss accounts, you get more positive feedback. Also, as soon as you start talking about these solutions potentially being cheaper (for example, renewable energy being already cheaper in a lot of places), then there is more interest.

A lot of these solutions should be cheaper in the long run; the early innovations will cost a bit more, but once they get scale, they will be cheaper. That will cause problems – energy costs will come right down; energy is priced on the margin or the cost of energy, which means it's going to be very difficult for investors to recoup their investments in the long run. That's a genuine problem in the energy market – how are investors going to get repaid where the margin on the cost of energy is basically zero? That's going to totally change the energy market. It is going to be great for consumers.

Takatsuki: When you look at this market, it started as a values-led initiative – individuals or charitable entities had specific values that needed reflection in investments in a very niche area. But since the 80s, it grew a little bit more mainstream. The big change though was when that conversation around ESG turned from a *values*-led debate into *value*-led one.

Debate became one of how we drive investment returns on a risk-adjusted basis across asset classes for pension funds and insurance companies and their beneficiaries through incorporating ESG considerations. This value-led debate is where most of the industry is focused.

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Interestingly though, for us when we look at it globally, we see that the argument is starting to shift again. So, the values are starting to become much more of a consideration. Pension funds, wealth managers and insurance companies all want to start to have a specific corporate identity that reflects either their employee base or their underlying beneficiaries.

Our parent company, AXA, for example, believes addressing climate change is one of the biggest drivers of their future success. They believe that a 4-degree world is not insurable.

So, that's starting to provoke discussion and interaction with our prospective and existing client base.

Fox: I don't think that in the wholesale/financial advisory market, when you focus on morals, you lose the argument. In my experience individuals, particularly young people, don't believe that investment is an amoral exercise. They find it a moral and philosophical oddity that their savings are put into things that are creating climate change, unhealthiness, all these other kinds of things.

But I would argue that in the institutional market, the issue of financial return is front and centre. If I go along to the pension fund trustee and just say, "this is the right thing to do", quite rightly they will ask what's the financial return attached to it.

But I still come back to the point that to me there is no difference anymore between ESG and financial performance. They are one and the same.

I've spent most of my career being told there is no role for ESG in investment decision making, but that predicated from a very simple point: what is the financial consequence of being an environmentally-poor, socially-irresponsible, badly-governed company?

My simple point is the consequences of that will be huge now, and if that doesn't get you hooked, the opportunity to provide solutions to the environmental and social issues, is equally as huge. So, you can skew your opportunity on upside, and you can maximise your risk mitigation.

In my experiences of meeting a lot of people, that is the penny that has not yet dropped – that you can only meet your fiduciary duty by doing this.

McAllister: I would say that you can be an environmentally irresponsible and socially irresponsible company that's poorly run for a pretty long time and still make good money. But I totally agree that eventually it does catch up with you, and that's when time horizons and timeframes come into play – eventually it comes back to bite you, but it's a question of time.

Chair: Do you think that because there is a big buzz around ESG at the moment, that time horizon is shortening? Do you see opportunities to invest in different industries, in different companies? It's relatively easy to see the negative, i.e. we should not invest in tobacco; we should not invest in carbon industries, or whatever else it might be. But do you see something else happening on the other side?

McAllister: Yes, for every problem there's a solution. There has been an exclusions industry for decades. That's not new. But what sustainability is saying today is that for every brown building, there is a green option alternative, and you can move your investments in that direction.

For things like education, there is huge growth in online education and particularly in emerging markets. So, there are all these other investment opportunities that are arising that are perfectly aligned to sustainable investing, and they're just a better growth alternative to the existing companies. It is massively important to focus on the opportunity side rather than just the exclusion stuff.

Graham: But are there also going to be investment opportunities in the old industries? One of the problems you had with tobacco was people were surprised at how long a tail it has; carbon industries might have an equally long tail because as much as we'd all like to buy electric cars, most of us still drive petrol cars.

Fox: Yes, the nature of the market is things always get over extended, but the fundamentals of businesses are like gravity, and you can only deny them for a period of time before they hit.

For example, carbon-based fuels will always have a role, those shares can be too cheap. But when your fundamental business model is impaired by there being an environmentally better and cheaper option, that's when you're swimming against the tide.

That's why energy transition doesn't go away as an issue because whether Shell is cheaper or more expensive, there is effectively a better way of getting energy from the sun that is cheaper and more environmentally friendly.

Takatsuki: I completely agree. Where capital is being allocated by senior executives of companies is a great forward indicator of where companies are transforming. We generally see most industries allocating capital to the areas

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which are considered transitioning or green.

They realise either they are faced with regulatory challenges that they have to pay for, or they understand that consumer habits are changing, or they just simply understand that the underlying business realities within the company and its situations have to transform over time.

That's been an area of great conversation for us with the companies in our engagement and our research – how those decisions are being made; what level of expertise senior execs and boards have to make those decisions; is it valid or are they just jumping on the bandwagon?

We've got to understand that as investors we are really just taking that secondary position – asking is it valid or not.

Boucher: There is risk in assuming that there is an investment positive equal to the negative lost by acting more sustainably. If you take Shell, for example, back in June they announced their CapEx plans for the next five years – they're spending about $30 billion a year, a huge sum of money. Sadly, only $2 billion is going into renewables.

It's not because they don't get it; they simply cannot replace the incredibly lucrative profits they make out of extracting carbon fuels with something more environmentally friendly. The business model for the energy market today is still heavily tilted towards combustion and the generation of CO2.

Governments around the world still subsidise combustion fuels in many cases, so for Shell, yes, they face this issue but there isn't a strong enough requirement for change and there isn't a straight one-for-one switch from a negative to a positive available. They simply cannot swap that CapEx and make as much money. In fact, they make almost no money out of their renewables. They have been trying for over a decade and they're not really making any meaningful change to a new, sustainable business model.

The elephant in the room is this conflict of interest for the management teams. On the one hand they are being told to give the shareholders the returns and the cashflows and the dividends, on the other hand, the reality is they can't easily change what they do.

This is a massive challenge and pension trustees do need to be aware that a lot of environmentally unsustainable businesses, like coal, oil and gas, carry a high risk of lower future investment returns.

McAllister: That's where I do see that regulation has to come in and solve the problems, because I just see oil and gas companies as being the middlemen between governments giving out licences to drill and consumers demanding their products.

So, unless the rules of the game change, they're just going to carry on doing this and there's going to be strong demand for their products for a fair while. It is difficult for them to transition their business models and still give investors the returns they need.

Takatsuki: You will continue to have oil as long as people still demand it because most of the oil is pumped by emerging market governments such as Saudi Arabia and Venezuela. They will pump until the last drop and whether the international oil companies play a role in that is almost a secondary argument.

Fox: But these are challenging industries, even looking only at the financials. Ignoring the sustainability issues for a moment, you could argue that there's an impediment to delivering optimal returns by investing in these industries.

Then the fact that they're becoming arguably environmentally less relevant because of the alternatives means there is a double whammy reason for not investing.

Fixed income and ESG

Chair: We have talked about the equity market, but given that pension schemes also heavily invest in fixed income, are you applying the same rules to the fixed income market?

One of the challenges that I see is, if you look at green bonds for example, it is a tiny market that is dollar and euro based – it's not a sterling-based market. So, are you seeing the appropriate instruments out there to meet pension funds' fixed-income ESG needs?

Fox: Most people's starting point in the area of ESG has been in relation to equities, but that's come a long way and there's a growing understanding in the corporate world that there is a pool of capital out there that is looking for projects with some kind of ESG benefit to them, and green bonds are one manifestation of that.

But that's the tip of the iceberg – there is a lot kicking around that doesn't come with a green bond badge that has these characteristics. So, ESG in the area of fixed income will progress quite rapidly.

Also, if you're interested in impact investing, debt could be a more powerful place to do it than equity.

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Takatsuki: For insurance asset managers, fixed income continues to be one of the, if not the, most important asset allocations.

We have done equity and corporate bonds as the vanguard of our ESG integration first and foremost. If we couldn't get those right, we don't believe we would have had the chance to be looking at the other asset classes.

So, we have poured enormous amounts of effort into getting these areas right. We have taken a slightly different approach with each, which you need to do, but the core fundamentals and the tools available to the fund manager largely remain the same.

It's about winning hearts and minds as much as the techniques available. For people in our position, half of it is about the journey of trying to get colleagues to understand where ESG fits in with existing investment approaches, and once that battle has been won the rest is quite straightforward.

McBain: My team works very closely with both our equities and our fixed-income investment teams. We are fortunate in that we can leverage off all of the engagement that we have with our equity investee companies, where we might have a big shareholding and also hold the debt.

As both a large equity and debt holder of companies, we have good access to management, and to make sure we effectively take advantage of this we have developed a proprietary ESG framework, including a databank of ESG questions that are aligned with specific sectors and themes. This has done a lot to equip our analysts, irrespective of their asset class or sector specialities, with the right toolkit and framework to allow them to more effectively engage with companies on material ESG risks and opportunities.

Also, increasingly, we are being asked by our clients if we are investing in the 'problem or the solution'. We need to be able to demonstrate to our clients that we have a grip on these issues, and that we are asking investee companies the right questions to effectively understand, for example, a company's pathway to transitioning to a low-carbon economy. Our ESG framework definitely helps to facilitate this.

Beyond that engagement piece, though, we are looking at the full gambit of sustainability-focused bonds, from SDG bonds and social impact bonds to transition bonds and climate bonds.

We have also looked at syndicated loan facilities and bonds that have a step-up coupon, if they fall down on their ESG criteria, the coupon steps up – and we have had issuers come to us and ask if we could advise them on their green bond framework.

Chair: So, we're seeing lots of innovation in this sector.

McBain: Yes, and we are also looking to elicit the same criteria from our credit issuers as we do from our equity investee companies.

For example, if a company comes to market with an SDG bond, we want to understand the baseline criteria upon which that company is issuing this bond, such that we can measure the necessary KPIs to assess performance in line with the targets it has set.

We ask these companies, in the same way that we ask our equity investee companies, for clear oversight from the board on any new issuance.

That's where aligning our equity and our fixed income teams, collaborating across our asset classes, brings a lot of credibility and rigour to the process.

Escott: Two points from the asset owners' perspective. First, when I speak to schemes and when we look at what kind of ESG topics schemes want to hear about, more and more often they're interested in gilts, and they are wondering how an ESG rating can be applied to a particular country or market economy that they are invested in.

The second thing is that a lot of the regulation is now focusing on ESG beyond equities. If you look at the Stewardship Code, for instance, it is very likely that it will be applicable to asset owners or asset managers in terms of their fixed income and other asset classes as well.

So, they're already on that journey and the PLSA, as well as lots of others in the industry, are asking for references to fixed income, private equity and so on to be made much more explicit throughout the code.

McBain: I would augment that further and say that, where we have talked about evidencing our stewardship processes very much on the equity side, we must now also do so for fixed income, in view of the changes to the Stewardship Code.

The role of the trustee in ESG

Chair: A view from the trustee on all of this?

Graham: From where I'm sitting, it has been an interesting debate and I take the point that there is a difference between talking about ESG and implementing ESG. What I am doing as a buyer is listening to the people that

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are doing the work and implementing it, because when we come forward to look at a particular fund, we use our investment analyst to give us a rating, an ESG rating. What I am sensing is, as a buyer, I am becoming increasingly dependent upon that assessment, and the work that goes on behind is almost so complex I don't want to go there, so I'm going to rely upon that number.

We as the users should be asking the questions, but I am very aware of the complex processes that are going on beneath.

McBain: There are definitely questions that trustees can ask to elicit the information that they need.

Also, in addition to the evidence process, if we own a large percentage of the market we need to be able to demonstrate our strategy and process for identifying those companies that we want to be engaging with, and the purpose and outcomes of those engagements.

Graham: People tend to hide behind the ESG label but there are a number of questions we ought to be asking about it.

Escott: Yes, it's about asking questions and it's about asking the right questions. You need to be able to put the asset managers on the spot, make sure they aren't just trotting out the same old case studies, saying 'yes, we are involved in X and Y collaborative engagement' but without digging down any deeper than that. You also need to choose the issues that you want the case studies on and that you want the answers on. There's lots of guidance out there to help schemes do that.

In fact, the PLSA recently published a guide on this topic, which is half practical case studies and questions to ask asset managers and consultants to keep them on their toes.

Chair: But one of the challenges for a trustee is that everybody is very convincing. How do we as trustees differentiate between those that are doing ESG well and have been for years, and those that are just jumping on the bandwagon?

Fox: You are right that it is challenging – I think ESG integration in the asset management industry in two or three years' time may be an example of overpromising and underdelivering. In fact, I should be absolutely delighted everybody is talking about ESG, but because it has become such a bandwagon it worries me. Moreover, the barriers to integrating ESG into fund management are not operational – you can hire as many people as you like – they're cultural.

The reality is that some fund managers don't truly buy into it and you've got to smoke those people out. A great question to ask for example could be: How would your fund be different if you didn't integrate ESG? I suspect that, out of 10 fund managers you ask, eight would squirm.

And it's not an impossible task. Trustees have become quite sophisticated at smoking out poor bond managers or equity managers now. This is just another skill they are going to have to learn and, what is in their favour is that this is not too technical an area. It's not too complicated. It's based on some very simple principles.

Takatsuki: Trustees also need to smoke out whether a firm's senior management actually buys into the importance of ESG too, because that's a real tell-tale sign of a good ESG manager. If you can have the top-level management meaningfully buy into this, that is key.

I have seen so many different firms over the years where that continues to still be an unanswered question – what is this whole ESG thing and why are we even bothering to do it?

Fox: True ESG integration into investment processes is the best kept secret of our industry. What is at the core of this is something fantastic for asset owners and asset managers.

But it is hard to do, which is why the industry can't just flick a switch and find that everybody is onside. But in the end, we will get there and frankly, the next generation of people doing my job will think this is the only way that money should be invested.

In five to 10 years' time, we'll be in a massively better position, but the concern today is that it's just over-egged.

Challenges going forward

Chair: What are the challenges standing in the way of the industry moving forward on this?

McBain: One challenge we face is that a lot of the data on which we are trying to base our financial decisions is very static, it is backward looking, and in many cases it's lagging.

As asset managers, we are trying to identify data that is forward looking, dynamic, and interactive – that is the challenge. When we analyse the data, we draw out the relevance to the investment process and have developed a simple, repeatable process to break ESG risks and issues down into their units of meaning. Where data can be found and processed to generate knowledge, we are hunting it down and building tools to extract meaning. And, as an active manager, we engage with our investee companies to try and extract the data we need to make an informed investment decision.

Boucher: At Sarasin we are relatively lucky, in that we choose to have a smaller, focused list of around 120 global stocks in total to analyse. The practical implementation challenges that other fund managers face are enormous. Many are trying to gather data and

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analyse hundreds or even thousands of companies and if this is a relatively new process for them, culturally, ESG is hard to integrate into the business.

All in all, it's really good that the industry is moving towards greater ESG awareness, but I do think we need to cut through some of this talk that 'we are all doing it now', and instead have some more output from the ESG analysis.

For example, things like voting are dreadful. Most big investment management companies are simply not voting on key issues; they don't look at what the directors are actually doing, they just merrily reappoint them.

Also, we talked about data. The data out there on environmental footprints in particular is appalling.

Over years and years of being part of the Carbon Disclosure Project, we have been sending questionnaires to companies and many don't respond. Or some only respond partially, because they have conflicts of interest. They don't want to expose the problem that they have got on the negative externalities.

So, it really is a difficult battle, and unless we use votes and collaborate more to engage on these issues and really hold directors to account, we're not really going to stem the greenwashing.

The big moves that are going to come in the next two or three years will be when shareholders stand up to companies and say, 'we're prepared to take a lower short-term return in order to have a sustainable long-term return'.

That's going to require a lot of hard analysis by fund managers; it is going to mean a new discussion with the management team, a new set of incentive measures for the management team. That requires focus and resource.

Chair: Do you think the asset management industry will get together on this?

Boucher: They will have to, particularly by using their votes, because it's the only way forward.

Escott: Also, asset owners have got to get better at working with their asset managers and asking them questions around what they're doing with their voting records, including those asset owners that are invested in pooled funds. The AMNT has developed the Red Line Voting initiative, and the Law Commission is currently looking at what the barriers are to the ultimate investor being able to exercise their voting rights.

Talking about collaboration, we see collective engagement as being a powerful tool going forward. If asset owners could get together and understand, for example, who is invested in the same pooled fund, they could work on the overlapping issues they care about and become more powerful. If I have separate conversations with asset owners expressing the same concerns about a fund, quite often I need to put them in touch with each other so they can, with their combined shareholding, have much more of an impact. There are many ways for them to do that – there's the Investor Forum, there's the PLSA, there are other initiatives. So hopefully we will see more and more of that happening, with asset owners taking an interest and realising that they have the power as shareholders to try and make companies improve the way they do things.

Takatsuki: In some markets the asset owner is already driving ESG, like Sweden and the Netherlands – quite often where there has been a large aggregation of public and private pension money.

In the UK, I am hopeful that pooling of local authority pension funds will be a major step we see in having a more visible presence of asset owners along these issues. It's true, part of it is just about the resource intensiveness of this topic.

If you don't have full-time members working at these pension funds, it's very difficult to build up sufficient traction. You're always outsourcing it to a third-party service provider, then you're always one step removed.

McAllister: Picking up on the earlier point around culture, I have never seen culture change so quickly as when a client starts to ask for something different, and that's been just incredibly helpful internally – as soon as things start impacting revenues, the culture changes just like that. So it would be very helpful if asset owners could start asking for these things more and more. That will change asset management firms' cultures very quickly.

The second point I would like to make is on the proxy voting process – I heard it described the other day as potentially the most important area of asset management in terms of changing things. If you were to democratise the voting process and ask beneficiaries how they would like asset managers to vote on some of these issues, you might end up with some very different answers as to how the established asset management industry does vote at the moment on issues.

That, I think, could be something that changes considerably over the next few years, with a more direct democracy type process.

A contingency plan

The Financial Conduct Authority (FCA) has recently been told that it needs to provide more evidence to justify its plans to ban contingent charging on defined benefit to defined contribution pension transfers. *Pensions Age* asks: Would a ban on contingent charging for DB-DC transfers be justified, and what impact will it have?

We believe a ban on contingent charging would be a positive step in helping to build confidence in the DB to DC advice market. The FCA has said that there is no data to support the perception that contingent charging leads to poor advice but this does not change the fact that there is a larger conflict of interest where contingent charging is utilised. Delivering advice on a fee basis has to help to reduce this risk and should also help to rebuild confidence.

The big challenge around this is educating customers so they understand the value delivered through the advice process regardless of the outcome of the advice. A wider focus on retirement planning rather than transactional DB to DC transfer advice needs to become the norm.

Aon senior partner and head of member options team, Benjamin Roe

In 2012, the Code on Incentive Exercises was first published, which banned cash incentives for transfers and scheme modifications. This was done because we saw that cash up front encouraged people to say yes to changes that were not necessarily in their long-term interest. Contingent charging is a form of incentive for change but applied to the adviser and in an indirect way to the consumer, who does not pay up front for the advice received. A ban would restrict choice to those willing to pay for good advice. The real issue is that people don't want to pay for financial advice at all, but contingent charging means they pay for it through the back door.

PSIG chair, Margaret Snowdon

Since the introduction of pension freedoms, there has been a huge demand from members of defined benefit schemes to take advantage of the decumulation options that the new regime permits. Statistics obtained by Royal London show that transfers in 2018/19 alone amounted to some £34 billion, with over £60 billion transferred in total since 2015.

Whilst it is right to recognise that many individuals will benefit greatly as a result of transfers, the Financial Conduct Authority is concerned about the quality of advice given to transferring members. Many members have been advised to transfer when retaining the security of a guaranteed lifetime income might have represented a superior alternative to transfer.

Of particular concern has been the phenomenon of contingent charging. If an adviser is only remunerated if a transfer is completed, this represents an obvious conflict of interest and presents a real risk that an unsuitable transfer will occur. For some years, the industry has accepted the principle that advisers should not be remunerated in a manner that accommodates conflicts of interest and it is absolutely appropriate that this principle should apply here too. If members' best interests are to be properly respected, it is vital that contingent charging be banned.

Pensions Management Institute technical consultant, Tim Middleton

Pensions history

Direction of investment

A hot potato in the pension fund investment world was how George Ross Goobey described direction of investment when speaking at the Pensions Conference of Analytical and Business Services Limited in November 1975. He reminded his audience that at the same conference five years earlier he had warned that the 1970s might see infringement of our investment freedom.

Freedom was something that the pension fund world in this country had always enjoyed. South Africa had for many years insisted on their insurance companies having 40 per cent of their funds in government securities and pension funds 30 per cent.

"Although government securities at the present rate of return stand fairly near to the top of my list of priorities for pension fund investors, I, nevertheless, do not wish to give up any freedom of choice unless it can be demonstrated that it is in the national interest. We are, in the main, trust funds and the trustees through their investment managers are responsible to get the best possible result. Once one departs from that principle the incentive and the impetus are lost," he said.

He gave the example of when Sir Harold Lever was raising money for lame ducks, the Finance for Industry loan was floated at below the return available on comparable British government securities and considerable pressure was brought to bear upon pension funds to support it for patriotic reasons. Fortunately, the fixed interest market improved sharply between fixing the price and the issue date and the loan was just about fully subscribed.

"Today we hear about Sir Henry Benson's equity fund to support industry. The basic concept of short-term support for companies in difficulties does not strike me as one in which trustees of pension funds would like their investment managers to invest their members' funds," he continued.

The Pensions Archive Trust chairman, Alan Herbert

Fun and games

Wordsearch

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Answer at bottom of page

I know that face... Answer: Aon senior partner & head of the member options team, Benjamin Roe

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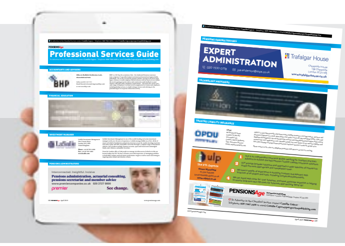

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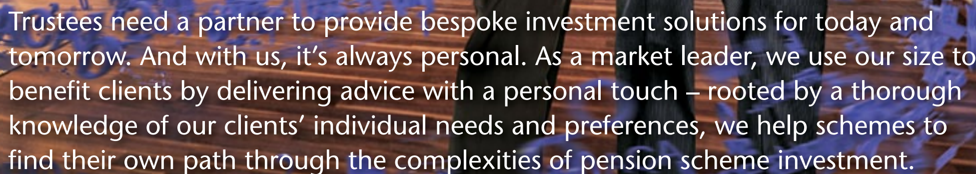

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