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October 2017

PENSIONS Age

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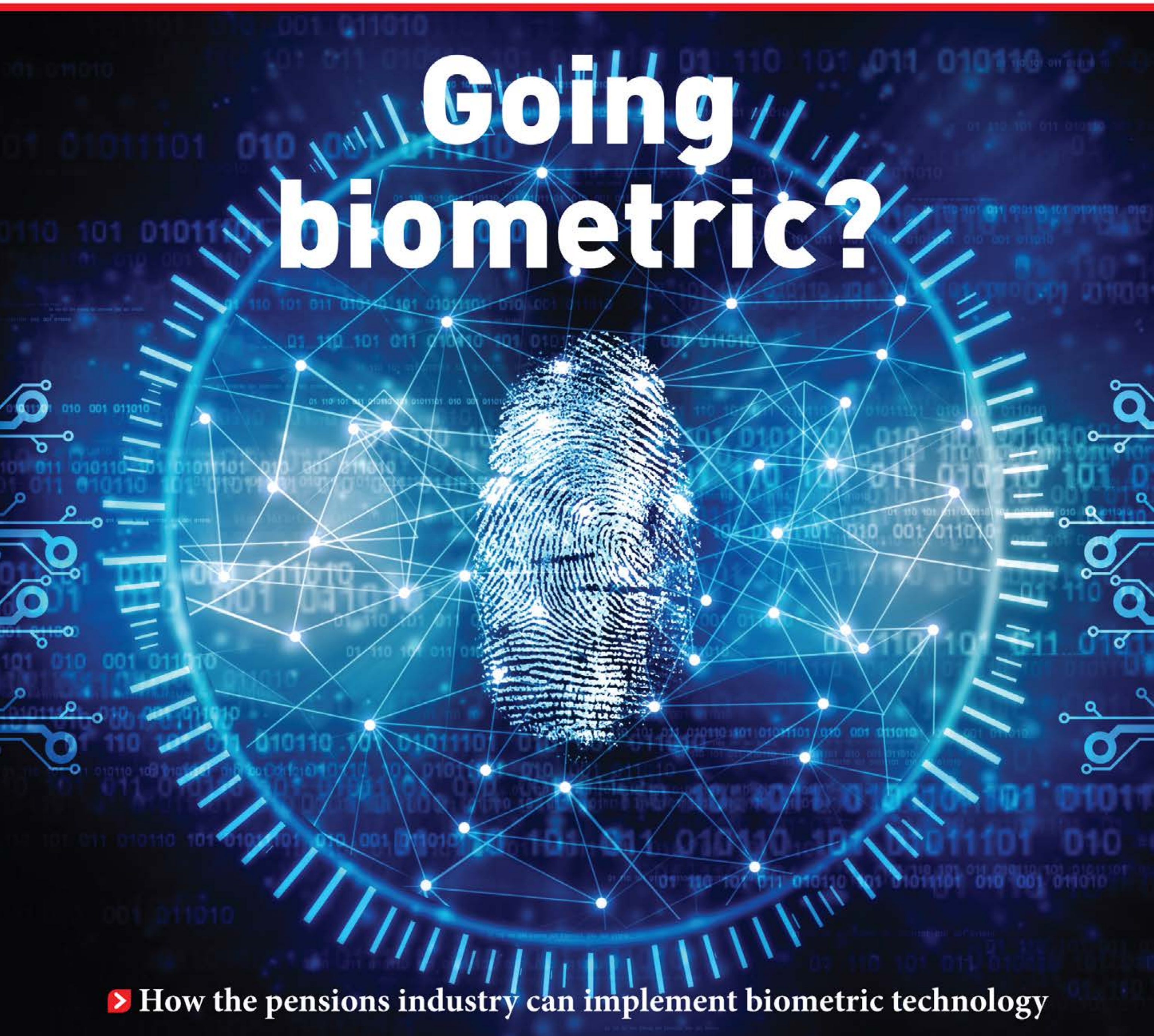
Robotics: *Changing industry job roles through automation*

Gig economy: *Providing pension solutions to a new type of workforce*



Going biometric?

How the pensions industry can implement biometric technology

PLSA interview - new CEO, Julian Mund, talks through his plans for the association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Editorial Comment

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I inherently mistrust people who claim to embrace change. It's not a case of disliking the sunny and optimistic disposition a 'go-getter' who enjoys change typically has – I'm not that much of an old misery yet. Rather, I simply don't believe what they say. More accurately, I do not think they really do embrace *all* change.

Sure, it's easy to embrace the changes that you want to make or have control over, such as the change a new job or new home (which you got out of want, not necessity) brings. Or, while not chosen, those changes that may mildly inconvenience but do not cause any real ripples are also easy enough to handle – such as having to rebook your holiday's flights from Monarch or Ryanair for instance.

No, what about those changes that are not beneficial or even cost-neutral to your life? What about those changes that seem to appear from nowhere, destroying your calm state of affairs and leaving you punch-drunk at what has happened – such as a serious illness, a bereavement or relationship ending? Those changes that you rage against, that you wish had never occurred, is hard for anybody to embrace.

That is why I have every sympathy for the pensions industry when it comes up against criticism for not modernising fast enough, for not running full tilt toward the latest innovation whether the sector wants it or not.

After all, the pensions industry is a traditionally-minded one – as it should be when its very nature requires a long-term outlook, with its savers' ability to afford, or even live through, retirement, the stakes at play for making mistakes. And the sector itself consists of many people with decades-enough career experience to heed Alexander Pope's warning that fools rush in.

The pensions industry can also provide evidence to justify its cautious approach to change. Just one example is the freedom and choice reforms, heralded in with a fanfare of cheers. Any note of dissent within the sector, any query as to the feasibility of its rapid adoption, was met by criticism from government and accusations of it being a self-serving industry dragging its heels. Now two years on, we have the announcement of a Work and Pensions Committee inquiry *[see p10]* looking into the problems brought about by rushing these reforms.

It is not surprising that the industry has a reputation that it is slow to evolve. Why would you want to, if what you are currently doing works, if not fully, at least well enough to handle and anticipate problems. New approaches bring new risks, new issues. They may even put you out of a job – who in their right mind would push to implement that?

So yes, change can be scary. Change can be difficult. But it is a fact of life that change will always occur. There are only two responses to this – to adapt to changing times to survive, or don't.

The pensions industry has walked the edge of the latter category, risking becoming a relic of a past time. If this was to occur, it would be savers facing pensioner poverty that would pay the price, arguably more than the people in the sector themselves having to move onto new careers.

But the pensions industry must fight for its own survival. It cannot sit back and hope for savers to realise its importance and willingly return to a sector that shuns the technological conveniences other sectors have adopted over the past 20 years.

Thankfully, the pensions industry is understanding this and becoming increasingly open to the benefits change can bring. As this issue's 'innovation' theme shows, throughout all aspects of the sector technological change, such as biometrics, blockchain and automation, will reshape the way in which the industry works for the better.

Also, utilising new technologies is not just for the greater good of savers and the sector; it can also be of individual benefit. As our feature on p86 shows, fears of automation taking jobs may be unjustified; instead it can actually help rebalance workloads.

However, the industry is keen to be an innovation follower rather than a leader. This is a sensible approach, to allow other sectors to handle the teething problems of new technology, and then the pensions industry can harness its rewards once established.

So I hope this issue helps you to, if not 'embrace' change, at least weigh up the risks and rewards change brings.

Laura Blows, Editor

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

NEW circulation figures

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

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ISSN 1366-8366
www.pensionsage.com

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Dateline - September

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

1 September The UK defined benefit pension deficit rose by £40bn in August, following a £40bn decrease the previous month, according to **PwC**'s **Skyval Index**. The deficit at 31 August 2017 stood at £460bn from £420bn at the end of July.

4 September The **Universities Superannuation Scheme** launches a consultation on raising member contributions to the higher education scheme by 6-7 per cent. The fund's trustee board says that it believes it is currently sitting on a deficit of just over £5bn, similar to the figure that it was assessed to have in March 2014 at its last triennial pension valuation. However, the cost of funding future pensions promises has increased by 35 per cent, according to USS.

5 September There is no evidence that UK expats in European Union countries, who are receiving the state pension, are returning to the UK since the Brexit vote, data from the **Office for National Statistics** notes.

6 September The **PLSA** says that The Pensions Regulator should concentrate on making sure the right people are appointed to trustee boards and committees, rather than focusing on simply ensuring that the right processes are in place. PLSA argues that regulation attempts to manage schemes from the centre, by mandating the individual processes that schemes undertake, have not delivered the necessary improvements.

7 September The **Plumbing & Mechanical Services Industry Pension Scheme** secures a £560m buy-in with Legal & General. The de-risking deal was completed in June this year and represents just over 10 per cent of the £5.1bn of bulk annuity business recorded in the first half of 2017. In addition to protecting the scheme's members, the buy-in will achieve a considerable reduction in the level of risk in the scheme's investment strategy and ongoing volatility in scheme funding levels.

11 September The **British Steel Pension Scheme** officially separates from Tata Steel UK and a number of affiliated firms. In a statement, Tata Steel UK notes that it has received confirmation from The Pensions Regulator on the approval of its regulated apportionment arrangement in respect of the BSPS. Tata Steel has made a payment of £550m and shares equivalent to a 33 per cent equity stake in the company to the BSPS as part of the RAA. These have been issued to the BSPS trustee under the terms of a shareholders' agreement.

13 September The state pension age would have already increased to 74 if it had kept up the same pace as life expectancy improvements, research from **Hymans Robertson** says. It also finds that if the state pension age were set at 74, it would allow for a weekly amount of £320, instead of the current amount of £160. Conversely, the government could instead keep the amount the same and save £50bn in state pension costs.

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

14 September The **Communication Workers Union** commits to the closure of three final salary pension schemes ahead of its triennial valuation in December 2017. The CWU intends to close three defined benefit schemes to future accrual and increase the retirement age from 60 to 65. With this, the employer proposes the introduction of a new DB career average earnings scheme for all of its employees.

15 September There is a 'huge gap' between the income retirees say they need to live on and the amount the average individual will receive. New research from **Retirement Advantage** finds that while people over 50 in the UK say they need an average of £1,435 a month to live on in retirement, based on an average saved pension pot of around £70,000 and a state pension of just below £160 a week, there is a £444 monthly income shortfall.


Twocoms / Shutterstock.com

18 September The chair of the **Treasury Committee**, Nicky Morgan, writes to the Chancellor to clarify how cross-border pensions and insurance contracts will be managed after Brexit. In her letter to Philip Hammond, Morgan says that little thought appears to have been given to how insurers will service contracts that were sold under EU passporting arrangements and that have a duration beyond 29 March 2019.

19 September The Pensions Regulator bans three individuals from acting as scheme trustees over suspicions that they scammed investors out of millions of pounds by using inappropriate pension funds from boards in which they were trustees.

20 September The Work and Pensions Committee launches an inquiry into the pension freedoms policy to gauge whether change is required to protect savers from "unscrupulous scam artists". The committee is calling for evidence regarding the effectiveness of the freedom and choice reforms and whether they are achieving their objectives.

21 September The Labour Party pledges its commitment to keep DB pensions for the public sector. Speaking at the Pensions Age Autumn Conference, shadow Pensions Minister Alex Cunningham was asked whether DB schemes are still a viable option for the public sector given the cost and that many employees in the private sector no longer have access to a DB scheme. In what he described as a "difficult question", Cunningham says he "firmly believes" in DB schemes for local authorities, the NHS, and the whole public service.

22 September Considering the lack of understanding of pensions among those approaching retirement, "pensions as we understand them are finished", **Centre for Policy Studies** research fellow Michael Johnson claims. Instead, Johnson outlines a proposal for a single savings product and an overhaul of the current pensions system.

25 September Auto-enrolment hit a record high in 2016, with the number of policies reaching 7.5 million, an increase of 11 per cent on 2015, and equivalent to 725,000 policies, the **Association of British Insurers** reveals.

27 September The **Pension Protection Fund** (PPF) sets its levy estimate at £550m for 2018/19 – 10 per cent lower than the £615m levy for 2017/18. The pensions lifeboat has also confirmed that it will implement the majority of proposals that it consulted on in March for the third levy triennium. It says that the proposals build on the success of the PPF-Experian model for assessing insolvency risk.

28 September Almost seven out of 10, 69 per cent, of employees consider employer pension contributions as an important benefit when looking for a new job, **The People's Pension** finds. According to its research surveying 500 human resources decision makers and over 1,000 UK employees, while a large proportion of employees value employer contributions, under half, 46 per cent, of employers are not promoting their pension scheme as an employee benefit to prospective employees.

News focus

Pension freedoms inquiry launched

The Work and Pensions Committee will explore whether the freedom and choice reforms have made consumers more vulnerable to scam artists

The Work and Pensions Committee has launched an inquiry into the pension freedoms policy to gauge whether change is required to protect savers from "unscrupulous scam artists".

The committee is calling for evidence regarding the effectiveness of the freedom and choice reforms and whether they are achieving their objectives. The probe has been spurred by concerns regarding increased scam activity since the introduction of the freedoms. According to police data, £43m in pension savings have been stolen and lost to fraud since the reform was launched in 2015.

The inquiry will look at what savers and doing with their retirement income, how they decide upon their chosen option, the information and guidance available and the operation of the pension product market. The committee has called for written evidence by Monday 23 October.

Work and Pensions Committee chair Rt Hon Frank Field MP said: "Pension freedom and choice liberated savers to choose what they wanted to do with their own money. This was welcome, but as with any radical reform it important to monitor its practical effects closely to ensure it is working as envisaged.

"In this case it is vital that adequate support ensures people are equipped to ensure they don't make decisions they subsequently regret. I am particularly concerned that savers are more vulnerable than ever to unscrupulous scam artists. This policy must not become the freedom to liberate people of their savings."

As part of its call for evidence it has asked what people are doing with their pension pots, as well as those with defined benefit pots who have transferred out. Other questions it has asked include whether people are taking proportionate advice and guidance, whether Pension Wise is working, whether there is evidence of product market competition resulting in cheaper and clearer products, and whether the government and the Financial Conduct Authority are taking adequate steps to prevent scamming and mis-selling.

The decision has been welcomed by those in the industry who say it is "well-timed and appropriate".

Legal & General Retail Retirement managing director Chris Knight said: "The select committee's inquiry presents an excellent opportunity for the government to address the imperfections of pensions freedoms, clarification of the implementation of regulation and laws around 'freedom and choice' and ultimately provide clearer pathways to consumers when it comes to making decisions about their retirement income."

Just group communications director Stephen Lowe shared a similar opinion: "This is a welcome and timely inquiry given the findings of the FCA's recent interim report on the retirement income market. The creation of flexibility and choice in how people can use their pensions has swiftly become the new norm, but it is far from clear that the new environment is working in all savers' interests."

The committee's announcement follows news from the Financial Conduct Authority that it has referred the investment consultancy market to the Competition and Markets Authority using a Market Investigation Reference (MIR).

It is the first time the FCA has made such a reference to CMA, and its executive director of strategy and competition Christopher Woolard described the move as a "significant step".

"We have serious concerns about this market and believe that the CMA is best placed to undertake this work," he added. The FCA has the power to make a MIR when it has reasonable grounds to suspect that any features of a financial services market prevent, restrict or distort competition.

Based on its own investigations into

the investment consultancy and fiduciary management market, it believes the features that support its decision include a weak demand side, with pension trustees relying heavily on investment consultants but having limited ability to assess the quality of their advice or compare services, with resulting low switching rates.

It also noted the relatively high levels of concentration in the market and its relatively stable market shares, with the largest three firms together holding between 50-80 per cent market share. In addition, the FCA believes that barriers to expansion restrict smaller, newer consultants from developing their business and vertically integrated business models create a conflict of interest.

The CMA has since published an issues statement detailing its intentions for its inquiry into the investment consultant market. The issues statement sets out a structure for the investigation, outlining potential issues and possible remedies to put in place if competition problems are found.

These include whether difficulties in customers' ability to assess, compare and switch investment consultants mean investment consultants have little incentive to compete for customers; whether conflicts of interest on the part of investment consultants reduce the quality and/or value for money of services provided to customers and, whether barriers to entry and expansion mean there are fewer challengers to put pressure on the established investment consultants to be competitive – which leads to worse outcomes for customers.

As part of its investigation, the CMA proposes to survey trustees of UK occupational pension schemes and has now appointed market research agency IFF Research to conduct the survey on its behalf. If it does find competition concerns, the CMA will decide whether, and if so what, action is needed to resolve them.

The Transparency Task Force has described the FCA's decision as "momentous". Commenting, TTF founding chair Andy Agathangelou said: "This is a momentous decision by the FCA, evidencing their determination to protect the interests of the UK's savers and investors. Every right-minded financial services professional must surely want a competitive, vibrant and conflict-free financial services market and that is what this decision is all about."

There has also been a positive reaction to the decision in the industry. In a statement, one of the three largest investment consultants, Willis Towers Watson, said: "As previously stated, we look forward to working constructively with the CMA following the announcement from the FCA. We hope that the process will help bring clarity and consistency to an industry that has to manage potential conflicts of interest. It is in all our interests to work together in continually improving industry practice to achieve the best outcomes for our clients, and the end-saver."

Touching briefly on the FCA's decision, another of the big three, Mercer, said it would "engage proactively and constructively with the CMA" during its investigation.

The last of the big three, Aon Hewitt senior partner Tim Giles added: "We welcome the clarification that the investigation covers the breadth of our industry and look forward to a constructive engagement with the CMA."

Written by Natalie Tuck and Talya Misiri

VIEW FROM TPR

Automatic enrolment (AE) is five years old this month. Since 2012, more than 8.5 million more people have begun saving into a workplace pension while nearly 800,000 employers have met their AE duties.

Providing a workplace pension is now the business norm and staff expect to be saving into a pension as part and parcel of their employment.

New businesses now have a legal duty to put staff straight into a workplace pension as soon as they employ them. We have launched a online suite of information and tools for new businesses where they will find all the information they need about what to do, and when.

While the vast majority of employers have successfully met their duties, there are a small minority who become non-compliant. We are here to help employers meet their duties, however we will use our powers where an employer is wilfully non compliant.

For example, we recently announced we are prosecuting a Greater Manchester bus firm and its managing director for deliberately not putting staff into a workplace pension. This is the first time that TPR has launched prosecutions for this offence.

Stotts Tours (Oldham) Limited is accused of failing to comply with the law on AE in respect of 36 members of staff. MD Alan Stott is accused of either consenting or conniving in the bus company's offence, or allowing the offence to be committed by neglect. Stotts Tours (Oldham) and Mr Stott were summonsed to appear at Brighton Magistrates' Court and the hearing has been adjourned to next month.

TPR director of automatic enrolment Darren Ryder

The Pensions Regulator

NEWS IN BRIEF

The **Pensions Administration Standards Association** (PASA) has announced it is launching a voluntary mediation service to resolve the issues experienced by schemes during the transfer of administration services from one provider to another. PASA chair Margaret Snowdon noted that changing administrators might be a relatively rare occurrence, but when it does happen the process must be smooth, safe and hassle free for all concerned, which, she said, is only possible when the ceding and receiving administrators work in co-operation.

Royal London AM has signed up to a new voluntary transparency code to help local government pension schemes to have better visibility on investment costs. The code was launched in May this year by the LGPS Scheme Advisory Board to enable funds' access to the necessary data in a standardised format.

The PPF has set its levy estimate at £550m for 2018/19 – 10 per cent lower than the £615m levy for 2017/18. The pensions lifeboat has also confirmed that it will implement the majority of proposals that it consulted on in March for the third levy triennium. It has said that the proposals build on the success of the PPF-Experian model for assessing insolvency risk. Chief among them are the use of credit ratings and the Standard and Poor's credit model for regulated financial institutions to assess the insolvency risk of certain employers.

Now: Pensions has confirmed its plan to make up the income tax relief shortfall for members of its scheme that aren't taxpayers. For the second year in a row, the pension provider has decided to top up the pension savings of its members, who aren't currently receiving income tax relief due to not being a taxpayer, typically those earning less than £11,000.

DB overhaul needed to protect schemes at risk, PLSA says

Its DB taskforce has proposed a number of suggestions, such as introducing a new chair's statement, standardising and simplyfying benefits and exchanging covenants for funding

The Pensions and Lifetime Savings Association has proposed an overhaul of defined benefit pension scheme processes to improve schemes facing the challenges of underfunding, weak employer covenants and lack of scale.

In its final DB taskforce report, *Opportunities for Change*, the PLSA made three key recommendations that DB schemes could implement to protect themselves. The first proposal is a new chair's statement for DB scheme trustees. The PLSA has suggested that schemes should be required to produce an annual statement to demonstrate that they are operating in line with best practice in areas including governance, investment performance and cost transparency.

The second recommendation is to make it easier to standardise and simplify benefits. The association has noted that the government could take action to simplify the tens of thousands of different benefit structures, while preserving each members' full benefits. The final proposal involved exchanging covenants for funding. The taskforce report has proposed that new measures are introduced to assist schemes with weaker covenants. "Such schemes could benefit from turning the uncertain promise of future support into tangible funding," the report said. As a result this could free employers of their funding duties and schemes could move into newly created superfunds, the PLSA said.

On the third proposal, the report noted: "Trustees would have a new choice beyond PPF and buyout. Our research indicates this would be affordable and attractive to many employers and attractive to many trustees."

According to the report, a superfund would be an occupational pension scheme regulated and supervised by The Pensions Regulator. It would aim to pay members their full benefits in more than 90 per cent of scenarios and payments would be simplified to a common structure. Further to this, these funds would be PPF-eligible, ensuring the same protection as in any other traditional DB scheme. PLSA DB Taskforce chair Ashok Gupta commented: "There is a real possibility that without change we will see more high profile company failures such as BHS or Tata Steel. It is vital that action is taken to address covenant risk, underfunding and the current lack of scale in the majority of schemes."

However, the taskforce's proposal to consolidate weaker schemes into a superfund could create a "moral hazard", one industry expert warned. Aegon head of pensions Kate Smith said: "Consolidation of weakened DB schemes into a superfund may look like an attractive option to some stressed companies, but giving employers an option to walk away from their DB schemes creates a moral hazard that needs to be treated very carefully by government and regulators alike."

Written by Talya Misiri

VIEW FROM THE AMNT

We all know that contribution levels are critical to the outcomes from DC pensions and the length of time we invest is another of the big factors. But what else matters?

Ah costs I hear and hence the frenzied focus on costs and transparency and previously our focus was the charge cap. But why do we shy away from the biggy – the elephant in the room – performance, or better: net performance?

But, say the ostriches – every scheme has a different member profile with different risk tolerances. And in any case, it's unwise to compare performance over short periods of time.

However, if I ask a group of DC scheme members what's most important to them I wonder how many will say quality of governance or transparency of transaction costs? To most net performance is their prime goal within suitable controls.

So let's start talking net performance before the national newspapers start publishing comparative data. How can they? Well it can clearly start with a focus on master trust default funds and the experience of a typical 30, 40 and 50 year old having invested at *x* per cent of average earnings for the last three years in the default fund.

But won't such data cause repercussions? Won't comparisons encourage best practice? Won't it encourage innovation in investment options? Won't some members be asking why their scheme has not done as well as others? Won't some members want to switch to other providers? That might even be pension freedoms?

Written by AMNT former co-chair Barry Parr

Association of Member Nominated Trustees

Govt should let older people use pensions to fund start-ups – IoD

The Institute of Directors has proposed that those over 55 should be allowed to use up to 10 per cent of their pension pot, tax free, to fund new businesses

The government should allow older people to withdraw up to 10 per cent of their pension tax-free to fund new businesses, the Institute of Directors has suggested.

The proposed tax-free allowance would be in addition to the already-existing 25 per cent that people aged over 55 are able to take as a tax-free lump sum that was introduced in 2015.

As part of its *The Age of the Older Entrepreneur* report, the IoD said a theoretical cap on the withdrawal amount could be at £100,000 for example, or 10 per cent of the fund value if smaller, provided that they are invested in the same tax year in the ordinary share capital of a qualifying trading entrepreneurial company.

An IoD survey earlier this year found that 53 per cent of its members define themselves as either an entrepreneur or company founder, with 67 per cent of member above the age of 50.

As a result, the Institute has suggested that its proposed reforms would assist with a more flexible, aging population.

IoD chairman Lady Barbara Judge said: "One option, being pursued by more and more people in later life, is starting their own businesses… As someone who is a strong advocate for working until late in life, I am delighted to see that many firms are now focusing on employing older workers."

A HM Treasury spokesperson told *Pensions Age*: "We have already made major reforms to pensions that give hardworking people real freedom and choice over how they access their retirement. Many people can now access their pensions from age 55 and can also withdraw up to 25 per cent of their money without paying tax."

The IoD report comes amid calls for those who are considering accessing their pension money to be automatically enrolled into a free Pension Wise guidance session, Just has said.

The call for compulsory guidance has been made by Just following the release of a report by the financial services company, which has found that pensions are less well-understood than mortgages and that people are less confident making decisions about pensions compared to mortgages.

Just has said that it is a glaring policy contradiction that professional guidance is required for most mortgage purchases, when most pension savers make some of the most complex financial decisions of their lives with little or no guidance.

The company's research has also found support for its idea, with 75 per cent of savers saying that financial advice should be a requirement for those deciding how to use their pension benefits.

Written by Talya Misiri and Marek Handzel

BT 'seeks clarity' from High Court on indexation amendment

In other pension fund news, a petition has been launched calling for gender equality in the Teachers Pension Scheme and John Lewis' deficit has increased by £28.6m

BT has appealed to the High Court for permission to change the indexation for a section of its pension scheme, it has been revealed.

In an attempt to plug its ballooning deficit, the firm is taking legal action to switch from its current method of indexation, RPI, to CPI. BT has sought permission for this change to be made for calculating increases to Section C of its scheme.

It has been noted that if BT are successful with their proposal, the firm is likely to enjoy considerable savings, however, at the detriment of members' pension pots. This change would affect around 80,000 current, deferred and pensioner members.

As part of an announcement earlier this year regarding its decision to make a court application on its indexation, BT said: "We will write to all potentially impacted members in due course, once further information becomes available."

BT will discuss its options with the High Court at the beginning of December 2017.

Also this past month, a petition has been launched that asks for the equalisation of survivor benefits for widows and widowers of members in the Teachers Pension Scheme. The petition, created by Shena Lewington, explained that despite both men and women paying exactly the same contributions into the pension scheme, and will receive equal pension benefits, survivor benefits are not equal.

The scheme provides for their surviving partners to receive 50 per cent of their pension. However, for the purposes of calculating these survivors' benefits, male teachers leaving a widow have all their years of service from 1972 included. Female teachers (and same-sex couples) have all service prior to 1988 disregarded.

The petition is open until 15 March 2018 and requires 10,000 signatures for a government response and 100,000 to be considered for debate. It currently has 116 signatures.

"I've been taken aback by the number of people who didn't realise this disparity existed or that sex discrimination could still be allowed nowadays. Not a single teacher that I have spoken to knew about the inequality," Shena Lewington said.

Regardless of the petition, a ruling made by the Supreme Court in July this year may mean the scheme will be forced to change its rules surrounding survivor benefits. In the case of Walker v Innospec Limited and others the Court ruled that same-sex couples that are married or in a civil partnership should have the same pension benefits as heterosexual couples.

However, the ruling is based on EU law and it is not known whether it will be transposed into UK law when it leaves the union.

And finally, the total accounting deficit of the John Lewis pension scheme has increased by £28.6m in the six months to 29 July 2017, its interim results have revealed.

As at 29 July 2017, the accounting deficit was £1,042.3m, compared to £1013.7m, a 2.8 per cent increase. Net of deferred tax, the deficit was £881.3m, an increase of £23.8m. Pension fund assets increased by £237.4m (4.7 per cent) to £5,282.7m, while the accounting valuation of pension fund liabilities increased by £266.0m (4.4 per cent) to £6,325m.

Written by Natalie Tuck and Talya Misiri

VIEW FROM THE PLSA

If proof were needed of what I wrote in this column two months ago – that Brexit is not 'the only game in town' in Brussels – then Jean-Claude Juncker's barnstorming 'State of the Union' address certainly supplied it.

The combination of more favourable economic conditions, the election of pro-EU President Macron in France and German Chancellor Merkel's fourth election win have emboldened many of those keen to see further EU integration.

Juncker was picking up that agenda when he set out a confident set of proposals for the EU's future, including a single EU President, a common Labour Authority to enforce EU rules on labour mobility, a 'European Standards Union' on social policy and shifting more decision making from unanimity to Qualified Majority Voting. It's not just the EU's Brussels institutions that have reform on the agenda. The EU's three financial regulators are also set for major upheaval, according to a draft EC policy paper.

The draft review, which I expect will be published in autumn, proposes more power and profile for the European supervisory authorities, most notably by merging them into one and enabling them to levy contributions from businesses and providers. That means pension schemes would pay a new levy to EIOPA or its merged successor.

As ever, all this information must come with a Brexit proviso, as we do not know what the future relationship between the UK and the EU regulators will look like.

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

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

Diary: October 2017 and beyond

PLSA Annual Conference & Exhibition

18-20 October 2017

Manchester

This year's PLSA Annual Conference & Exhibition will help pension schemes understand the forces shaping the future and how to respond to them. Whether it's technology, demographics, global politics or government policy, the PLSA conference is the prime opportunity to learn how your scheme can get ready for what might come next. The event attracts trustees, pensions managers, finance directors and HR specialists.

For more information, visit:

Plsa.co.uk/Conferences_and_Seminars/

Pensions and the Law 2017

31 October 2017

Staple Inn, High Holborn, London

This seminar will present speakers on a range of topical issues including the RPI/CPI pension increase switching, The Pensions Regulator's powers, the new General Data Protection Regulation, case law updates and more. Brought by the Institute and Faculty of Actuaries with the Association of Pension Lawyers, the seminar is suitable for actuaries of all levels of experience and both those advising trustees and employers.

For more information, visit:

actuaries.org.uk/learn-develop/attend-event/pensions-and-law-2017

PMI Protecting Members seminar

10 November 2017

90 Fenchurch Street, London

Cyber-security has become an increasingly hot topic over the past couple of years, with multiple major hacking attacks hitting headlines. Although none of these have involved a high-profile pension scheme, it doesn't mean they are immune. The PMI's Protecting Members seminar will help delegates understand what exactly cyber-crime is and what key issues need to be considered, as well as providing practical steps to take to ensure members remain protected.

For more information, visit:

Pensions-pmi.org.uk/events/

Irish Pensions Awards

23 November 2017

The Shelbourne Hotel, Dublin

The Irish Pensions Awards give recognition to those pension funds and providers who have proved their excellence, professionalism and dedication to maintaining high standards of Irish pension provision over the past year. The event was attended by over 300 guests in 2016 and therefore this year is set to be bigger and better than ever. Winners will be announced at the gala dinner and awards ceremony.

For more information, visit:

Europeanpensions.net/irishawards/

Visit www.pensionsage.com for more diary listings

Month in numbers

Ten times salary

Around 10 times your salary should be saved into your pension pot for a comfortable retirement, it has been claimed.

Speaking on BBC Radio 4's *Money Box Death of Retirement* series, Aviva head of savings and retirement Alistair McQueen explained that in order to achieve a desirable retirement, individuals should start saving 40 years before their target retirement age, try and save at least 12.5 per cent of their salary and have about 10 times of one's salary in a pension by retirement.

Nine million

Nine million people, almost a fifth, of the UK adult population are not saving for retirement, Pension Geeks has found. Eighty-three per cent are unhappy with the amount they are saving monthly into their pension.

90%

Around 90 per cent of pension professionals cite transparency of performance and risk when selecting a fiduciary provider, Aon Hewitt has found.

People on the move


Gregg McClymont

The Pensions Quality Mark has announced the appointment of Gregg McClymont as its new chair.

McClymont replaced the current chair Adrian Boulding on 18 September 2017.

McClymont joins from Aberdeen Asset Management, where he has served as head of retirement since 2015. Previously, he was the former Shadow Minister of State for Pensions between 2011 and 2015. McClymont is also deputy chair of the Financial Conduct Authority's working group on institutional transactions costs, and a visiting fellow at Nuffield College, Oxford.

McClymont also joined the Pensions Quality Mark as non-executive director in February this year.

Boulding had served as PQM chair since 2014 and had also worked as director of retirement at TISA. He is a director of policy at NOW: Pensions and an advisory council member at the Occupational Pensions Defence Union.


Damon Hopkins

P-Solve has hired Damon Hopkins as associate director. Hopkins joins from Willis Towers Watson (WTW) and will work in P-Solve's DC investment consulting practice.He will report into P-Solve co-head Ajeet Manjrekar. Hopkins previously advised trustee and corporate clients on DC issues at WTW and has had an extensive career in a number of business development initiatives at Mercer and JLT Benefit Solutions.


Nathan Searle

Dentons Pension Management has appointed Nathan Searle as business development manager for South Wales and South West England. He has over 13 years' experience in the pensions sector, with a specialist knowledge of SIPPs. Searle has previously held key roles at Legal & General as a business development manager and most recently at LV= as a retirement consultant for the past five years.


Deborah Gudgeon

Penfida has hired Deborah Gudgeon as a senior adviser. Gudgeon has over 30 years' experience in corporate finance and pensions advisory and joins from Gazelle Corporate Finance where she was a managing director and provided independent advice to UK DB schemes. At Penfida she will work with partners advising pension fund trustees on all aspects of employer covenant, corporate transactions and other areas.


Steve Bale

Aon has appointed Steve Bale as a principal consultant in its risk settlement team. Bale joins with 19 years' experience in life and pensions, having spent the past seven years at Legal & General, most recently as a risk actuary covering large UK and US pension risk transfer deals. He is a fellow of the Institute of Actuaries and has chaired the Continuous Mortality Investigation's (CMI) High Age Mortality Working Party since 2014.


David Whitehair

Franklin Templeton has appointed David Whitehair as head of defined contribution. Working closely with the UK DC pension trustees and investment consulting community, Whitehair will report into UK country head Martyn Gilbey and will be based in London. He joins from Fidelity International where he served as senior DC business development manager with some of the UK's largest DC pension schemes.


Mario Mazzocchi

The Association of British Insurers has announced the appointment of Mario Mazzocchi as the new chair of its Long-Term Savings Committee.

Mazzocchi is the current chief operating officer, insurance and wealth at Lloyds Banking Group, and succeeds Standard Life CEO Barry O'Dwyer as the new ABI chair.

Mazzocchi joined Lloyds in 2003 and formerly served as managing director of financial planning and retirement for over two years.

In addition to serving as the ABI's Long-Term Savings Committee's chair, he will also hold a seat on the ABI Board.

ABI director of long-term savings and protection policy Yvonne Braun said: "I'm delighted to welcome Mario as the next chair of our Long-Term Savings Committee. This is a key time for the long-term savings industry as it looks ahead to how it can best serve our ageing population and what needs to happen to ensure consumers can make the most of the new pension flexibilities."


Nordea
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VIEW FROM THE ACA

The initial findings of our 2017 ACA pensions trend survey paint a picture of defined benefit schemes where complexities introduced over the years – largely by dint of public policy – have taken their toll.

Whilst a majority of employers fear more legal restrictions will accelerate scheme closures still further, they seem sanguine about further legal restrictions being placed on sponsors and trustees in the upcoming government White Paper. That said, the vast majority also expect support in the White Paper for some greater flexibility in law to adjust future pension increases if they are in financial difficulty.

Some key findings that the survey found are that 53 per cent of respondents say the costs associated with their defined benefit (DB) schemes are having a negative impact on pay increases, with 80 per cent saying their cost was also having a negative impact on intergenerational equity.

This is also having a knock-on effect, as 42 per cent of respondents say that their DB costs are also having a negative impact on contributions into newer schemes.

Also, 84 per cent of employers say the law should be changed so that defined benefit schemes can reduce pension increases if continuing to provide increases at the level of scheme rules will severely and adversely affect the employer, with the largest number favouring this being subject to an agreement with trustees.

As the last chancellor found, there seems to be little support for radical tax reform, although employers seem accepting of those on lower incomes getting a larger share of the relief available.

Bob Scott is chairman of the ACA

ACA

ASSOCIATION OF CONSULTING ACTUARIES

Market commentary: Diversifying portfolios

UK pension funds have continued to face a variety of insistent challenges over the past few years as maturing scheme liabilities have been impacted by increased transfers following the introduction of the pension freedoms.

Russell Investments head of client strategy and research David Rae explains that "cash outflows are happening sooner and in greater value than was anticipated. At the same time, the investment return on offer from most traditional asset classes is best described as paltry".

But, as the calendar year nears its end, what can be expected for pension scheme investments in the coming year?

JLT Investment Management chief investment officer Darryn Lake notes: "The hunt for yield has the potential to become ever more frantic as pension schemes look further toward valuable income generation to help manage cashflow requirements."

A number of investment managers have voiced the view that the upcoming year will see a surge in diversified investments, as schemes look to de-risk as well as generate returns.

Invesco UK institutional sales director Stephen Messenger comments: "We see pension asset owners looking at strategies that have both a degree of capital preservation and certainty return, whether that be capital or income. The recent success of multi asset as a theme is possibly the clearest manifestation of this and we expect that demand to continue."

Lake adds: "Diversification has not been rewarded over recent years, but we believe now is the time to look outside of the traditional asset classes."

Similarly, Charles Stanley Asset Management head of fiduciary management Bob Campion says: "The trend towards greater diversification of investments continues apace and trustees who have not already done so should consider exploring a wide range of asset classes, particularly at a time when correlations between asset classes have been falling."

In terms of alternative income assets, real assets such as property "will continue to play an important role", observes Messenger. He adds that there is a continued "strong appetite for residential investment in the UK providing a pickup in yield and solid demand supply fundamentals".

Both Lake and The London Institute of Banking & Finance senior lecturer Stuart Lanigan share the view that alternatives will increase in popularity.

Lake says: "Alternatives, as an asset class, are looking more and more appealing and we are looking toward the introduction of funds containing a mixture of private debt, private equity, real estate and infrastructure to give portfolios further diversification, especially given the ominously strong current correlation between equities and bonds. The use of alternatives in pension scheme portfolios can also help to reduce overall portfolio risk with improved returns if implemented effectively."

Lanigan agrees that against the current backdrop of increased economic and geopolitical risk, pension funds are likely to reduce risk away from equity volatility and look at higher income, cash generating strategies. "I would expect to see increasing interest in alternative assets, including infrastructure and private debt."

Written by Talya Misiri

In my opinion

On the reduced Money Purchase Annual Allowance in the Finance Bill
"The reduction of the money purchase annual allowance from £10,000 to £4,000 will be very unwelcome news for anyone who has taken advantage of the pensions flexibilities introduced by the government."
Ashurst pensions counsel John Gordon

On the separation of the BSPS from Tata Steel UK
"Although much work is still needed to ensure the business is competitive in future, the next step in this pensions process involves necessary formalities to set up the new scheme with a lower risk profile following the necessary member consent process led by the trustee. This will take some time to implement given the wide membership base of the scheme. The net financial impact of the RAA, including the payment of the agreed £550m settlement amount, will be reflected in the Q2 FY18 financials."
Tata Steel Group executive director Koushik Chatterjee

On NEST's increased ESG focus
"We're concerned about elements of corporate pay. Executive pay can't be set in a vacuum. If pay is disproportionate, incentives are opaque or in some cases pay policies are being structured to get around the rules, these pose clear risks to long-term investors like our members. We've also taken a strong stance on gender diversity."
NEST chief investment officer Mark Fawcett

On the proposed closure of the British Airways DB scheme
"Instead of certainty, many will now face uncertainty as their retirement approaches. We would expect better treatment of its own staff from such a 'premium brand'. Both unions jointly demand urgent talks to discuss both the impact of this announcement, if a solution can be found and, if not, the consequences the airline may face."
Workers unions Unite and GMB

On slumping annuity sales
"Demand for drawdown is now outstripping annuities by almost three to one; it is clear investors have limited appetite for guaranteed incomes at today's relatively low interest rates. The worry is that for many people, at least some guaranteed income is extremely important, particularly at older ages. If this trend continues much further we may not have an annuity market at all and that won't be good for investors."
Aon Hewitt partner and head of integrated pensions clients Gary Cowler

On the closure of the CWU's final salary schemes
"The CWU has not been immune to the spiralling costs of pensions and the combined cost of these three schemes in terms of deficits, accrual rates, admin and the benefits due, are no longer sustainable...the union remains committed to providing all employees with an affordable alternative that will still provide decent pensions."
CWU general secretary Dave Ward and senior deputy general secretary Tony Kearns

VIEW FROM THE SPP

The discount rate for personal injury claims has been generating a lot of excitement in the insurance world recently.

For many years the discount rate had been set at 2.5 per cent but in a highly controversial move earlier this year the then Lord Chancellor, Elizabeth Truss, announced that this would be changed to -0.75 per cent. Yes, you read that right, minus 0.75 per cent. The rationale for this was that it more accurately reflected current yields on very low risk investments.

There was uproar about this as the impact on compensation calculations was severe. In response, the new Lord Chancellor, David Lidington, on 7 September, announced a new approach to set the discount rate by reference to expected rates of return on a low risk diversified portfolio of investments, rather than very low risk investments as at present.

If this proposal is adopted, likely from next year, then it is expected that the discount rate would fall within the range of (plus!) 0-1 per cent.

Why would a reader of *Pensions Age* be interested in this? Well, because the compensation calculations for loss of DB pension rights in Employment Tribunal disputes are based on the same 'Ogden Tables' as in personal injury lawsuits. These currently reflect the minus 0.75 per cent discount rate and so they will presumably be changed to reflect the new approach.

This means that for some high value employment law disputes where large DB pension rights are involved the cost of compensation will potentially be subject to wild swings.

Anyone involved in this type of dispute should be aware of this development.

SPP's European Sub-Committee chairman Tony Bacon

THE SOCIETY OF PENSION PROFESSIONALS
leading pension thinking

VIEW FROM THE PMI

In July, David Gauke announced that increasing the state pension age to 68 was to be brought forward to commence in 2037.

Although a disappointment for those directly affected – those currently aged 47 and under – the news could hardly be described as a surprise: this was essentially what John Cridland had recommended in his report earlier in the year.

However, the timing was interesting. Theresa May's government had just formed a Confidence and Supply pact with the DUP, and one of the conditions for the Ulster party's support was the retention of the controversial triple lock. Perhaps this was the political straw that broke the pensions camel's back.

"With the benefit of hindsight, it seems remarkable that the increases to state pension age did not commence earlier than they did"

Affordability has always been a problem for the state pension. Setting state pension age at a realistic level to allow costs to be controlled whilst avoiding the wrath of the electorate has always been a precarious political balancing act.

When state pension ages were set at 65 and 60 in 1940, a man at retirement age could expect to survive a further 11 years and a woman for16. By 2010, the comparable figures were 18 and 25 years respectively. At the same time, the ratio of people in work whose National Insurance pays for benefits to pensioners in receipt of them – the Dependency Ratio – has shifted dramatically. With the benefit of hindsight, it seems remarkable that the increases to state pension age did not commence earlier than they did.

Tim Middleton, technical consultant, the Pensions Management Institute

Soapbox: Unintended consequences

There was shock and disbelief on Twitter recently when something the pensions industry never thought possible, happened.

Centre for Policy Studies research fellow Michael Johnson admitted he did not foresee a "number of unintended consequences" to introducing the pension freedoms.

One industry commentator declared it the "closest we're likely to come in our lifetimes to Michael Johnson admitting he was wrong".

Johnson is known for being a radical when it comes to pension policy, and not looked on favourably by many in the industry. But nonetheless, this time, we cannot disagree that there have been many "unintended consequences" as a result of the pension freedoms.

Of course, as another industry stalwart claimed, they were "foreseen by everyone with an understanding of pensions".

The introduction of the pension freedoms has created a gold mine for the Treasury, netting it £2.6bn in its first two years, £1.7bn above original estimations. During the same period, statistics from HMRC revealed that over £10.8bn have been withdrawn from pension pots. For the Treasury the reforms have been a success, but recently, the Work and Pensions Committee announced these reforms were the subject of a new inquiry.

The probe has been spurred by concerns regarding increased scam activity since the introduction of the freedoms.

Work and Pensions Committee chair Frank Field MP said: "Pension freedom and choice liberated savers to choose what they wanted to do with their own money. This was welcome, but as with any radical reform it important to monitor its practical effects closely to ensure it is working as envisaged.

"In this case it is vital that adequate support ensures people are equipped to ensure they don't make decisions they subsequently regret. I am particularly concerned that savers are more vulnerable than ever to unscrupulous scam artists. This policy must not become the freedom to liberate people of their savings."

The scope of the inquiry will also look at those in defined benefit schemes who, tempted by the large sums of money, have transferred out of their DB schemes and moved into DC in order to utilise the pension freedoms. Given the amount of time the industry had to prepare for the freedoms, it really comes as no surprise that two years down the line, they are in need of an inquiry.

Along with all the issues surrounding shopping around, taking financial advice and withdrawing pensions to have in cash, the freedoms have also exacerbated the problem of scams.

I have no doubt that Field and his team will do a superb job in examining the pitfalls of the policy, and come up with solutions to fix the issues. But the hard work will start after, when the government and industry will need to implement the advice.

George Osborne, the policy's creator, would say, "we're all in this together". Unfortunately, however, he's left others to fix it.

Written by Natalie Tuck

Pensions history

The sweet taste of pensions

A few years ago, the Pensions Archive Trust (PAT) ran a pilot project to map the holdings of archive material relating to occupational pensions held at archives and record offices around the UK.

It identified various sectors of industry and individual companies that had taken action to preserve their historic pension records so that they were accessible for researchers subject to complying with the data protection regulations in the case of personal material. The sectors reviewed covered railway companies, the motor industry, the retail sector, the postal service and the chocolate and confectionery industry.

The chocolate and confectionery industry with its well-known brand names was early into providing pensions for its employees. It is gratifying that today, even though our leading confectionery companies, are now part of global groups, their historical pension scheme records have been preserved.

Pension scheme information for Cadbury consisting of Trust deeds and rules, annual reports and accounts, correspondence, explanatory booklets and publicity material covering the period 1906-1980 is accessible to researchers at the offices in Birmingham of its US parent, Mondelez International. Similarly, pension scheme information for its associated company J S Fry & Sons covering the period 1920-1968 can also be viewed there.

Rowntree, which is now part of the Swiss company Nestle, also has extensive collections of its pension material archived with the Borthwick Institute for Archives at the University of York covering the period 1862-1969. The Rowntree Pension Fund was established in 1906 following consultation with Cadbury and North Eastern Railway Co. The papers concerning this consultation and the advice taken when establishing the scheme are all available.

With the changes taking place in pensions today, sponsoring companies and trustees are encouraged to develop an archiving strategy for their pension schemes so that information is available for future researchers. PAT has developed an Archival Policy Guide for Pension Trustees and Managers to assist them, which can also be found on the PAT website.

Written by The Pensions Archive Trust chairman Alan Herbert

YOLO vs retirement

Perhaps it's because I'm of the YOLO (You only live once) generation that surveys on young people not prioritising saving for a retirement irk me.

Recently, one landed in my inbox, which found that the top financial priorities for women under 34 are rent/mortgage, day-to-day essentials, holidays, saving for emergencies and then retirement. Once women reach 35, retirement is bumped up the list to third. It may not please the pensions industry, but to me this seems logical.

You only live once. This is a phrase I batted around a lot when, at the age of 23, I spent my life savings on travelling. If I hadn't spent them all, by now I could be on the property ladder, and be in a position to save more for my retirement. But alas, I was young, and a pension was not on my radar. However, even if it had been, I would have still done the same.

I realise that I've pitched up my tent in the stereotypical millennial camp, but I do save. Each month, the majority of my savings goes into my Help to Buy Isa, followed by my holiday fund, then emergencies fund, with the least going into my pension.

In contrast to many of my peers, I am strikingly aware of how much is in my pension fund. I'm actively engaged. I have an app on my phone, and log on several times a week to check the value.

But based on my provider's portal, which is only an estimator, I would need to invest around 80 per cent of my net income to hit a target retirement income that is 10 per cent lower than my current gross salary.

This, however, does not take into account employer contributions and tax relief. But, even so, it seems so unobtainable that I've reserved myself to a retirement spent in poverty, so I might as well live a little in my youth.

There are many in the industry who worry that people do not understand that the pension they have been auto-enrolled into will most likely not give them enough to live on. I agree, which is why developments like the pensions dashboard are so important. So too are tools that can show how much you need to save to be able to live comfortably.

However, I don't think any of this will change the behavioural habits of young people, because regardless of which generation you are born in, when you are young, you have other priorities than saving for retirement.

Now, show me a survey that proves me wrong.

Written by Natalie Tuck

Musings of an MNT

What did you think of my poetry?

In that wonderful satire, *The Hitchhikers Guide to the Galaxy*, based on the famous radio series by Douglas Adams, the two 'heroes' Arthur Dent, from Earth and Ford Prefect, from a small planet near Betelgeuse, are captured by an alien race called Vogans. The Vogan captain is threatening to hurtle them into outer space, but first he has read them some of his poetry, which according to the 'Guide' is the third worst in the galaxy. At the end he says, "I present you with a simple choice – either die in the vacuum of space or tell me how good you thought my poem was". In an attempt to save their lives our two heroes try to provide positive feedback and a meaningful critique.

According to P.M.Munchinsky in *Psychology applied to work:* "How performance is managed in an organisation determines to a large extent the success or failure of the organisation. Therefore, improving performance appraisal for everyone should be among the highest priorities of contemporary organisation."

Performance appraisals have become the norm in workplaces, predominately in commercial businesses, but increasingly in any organisation that has specified outcomes. The performance appraised could be for the business as a whole, divisions within that business or individuals within the business, in essence any and all who contribute to the success of the organisation.

The majority of pension funds evaluate the performance of their fund managers as they are the primary movers in providing income from investments. However, how they are assessed is a point of contention. Traditionally this was based on the simple premise of return against capital invested, with comparison made against managers with similar portfolios. However, there is now greater scrutiny of fees and charges made by managers, and once they are deducted, whether overall value should be a truer measure. Whatever determinant is used, the important factor is that there is a performance assessment.

Recognising the strength of performance assessments, my board has undertaken a process of appraisals on all those who contribute to the pension fund, including advisers and board members.

Assessing advisers is based on the contractual and service obligations, but early in the process we recognised this was insufficient in itself, as the manner in which these obligations are delivered and the trust they engender are particularly important in enabling the trustees to have confidence in the advice received. So soft performance targets are as important as hard facts.

The most challenging appraisals have been on the trustees themselves. There are factors that can easily be assessed, such as the level of individual training undertaken and the attendance record. However, reviewing the contribution of individuals is particularly testing.

We are in the early stages of producing a meaningful assessment. Initial appraisals have been through 'self assessment', based on a series of questions, but I found that I was either prone to being over critical or over confident of my own abilities. I am sure a position shared by others who have to assess themselves.

Potential other forms of assessment are; peer assessments in which trustees evaluate and appraise the performance of their fellow group members based on an agreed marking system or 360-degree feedback based on evaluations from colleagues, peers, and one's self.

Whatever system is employed, the outcome should be positive with agreed actions for development.

So what of our heroes, Arthur and Ford; following a vain attempt to ingratiate themselves with the Vogan captain by saying that his poetry was actually good; they were thrown into space. As the captain says: "After that feedback, death was too good for them!"

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

Alternatives: Picking the diamonds from the rhinestones

Percival Stanion argues that true 'alternative' investments are hard to find, but diversification is still possible

Alternative assets are as prized as blue diamonds. Unfortunately, they're just as rare – most of what glitters in the investment universe is actually rhinestone.

That's because for all their perceived distinctiveness, most alternative investments ultimately act like either equities or bonds – or, more rarely, a combination of the two. More often than not, their only distinctive features are higher management fees and low 'illiquidity premia'.

A close look at property, widely considered a classic alternative, highlights the challenge. If you buy a building site, you are effectively investing in the stock of a high-growth company where performance hinges on capital gain. If you buy a finished building, meanwhile, your investment will act like a debt instrument, with rents playing the role of coupons.

Yet while true alternatives are hard to find, that doesn't mean they're not worth the effort.

And even if pure alternatives aren't available, finding ones that have the right mix of bond- and equity-like characteristics can also help – as long as they come at an attractive price.

Property, for example, can offer protection against inflation and has contractual cashflows that aren't necessarily fully synchronised with traditional asset classes.

Where we can, we also invest in private equity (through listed structures). It's an investment best suited to long-term institutional investors, who can take advantage of the illiquidity premium. The caveat is that there is a big disparity of performance across the asset class and careful due diligence is essential. Similar fund selection issues also hold for hedge funds.

We also like absolute return fixed income with scope for negative duration. Such a strategy aims to generate positive returns at all points of the financial cycle – whether interest rates are rising or falling.

Other alternatives come into their own at specific points in the cycle. For example, in the aftermath of the great financial crisis 2008, when large parts of the market were blocked from traditional sources of financing, we saw an attractive opportunity in aircraft leasing. This was both bond-like in the contractual income it generated but also had characteristics of equities as the value of the aircraft could appreciate. So we invested and the position did well.

Beware of infrastructure – and catastrophes

Infrastructure assets – such as toll roads, airports or hydro-electric projects – are less appealing. Because they're typically contracts with the public sector, they end up mimicking the public bond market, albeit with less liquidity and higher fees. Nor do they offer the prospect of equity-like capital gains.

Catastrophe bonds, meanwhile, tick the diversification box, but valuing the risks of hurricanes, earthquakes or plane crashes demands the sort of expertise that's the preserve of the very same insurance companies who sell such bonds.

After investigation, we have also rejected artworks, wine, stamps, diamonds and rare cars. On the face of it, the returns can be reasonably attractive. But these are speculative and highly illiquid assets with little intrinsic economic value.

As for commodities, not only do we not see them as alternatives, we don't even think of them as assets. They're liabilities. Take timber. It generates no income, you have to pay to store and insure it and, over time, it rots. Forests, on the other hand, are assets. Investors can vary input prices relative to revenue by choosing the pace at which trees are harvested and planted as well as the species mix.

One commodity that we do like is gold – not because of its commodity characteristics, but because it acts as a proto-currency. Like timber, gold doesn't generate an income and does incur ownership costs. But it isn't a wasting asset and has historically worked as a store of value. Today's concerns about North Korea and the erratic Trump presidency also play to its advantage. And, in an era of low or negative yields across assets, gold's lack of income is less of a concern.

Overall, we're sceptical about most of what is labelled 'alternative'. The majority behave just like conventional assets. But there are some viable options available. The big question investors need to ask is whether the returns are sufficient to compensate for that lack of liquidity.

However these investments are labelled, our aim is to adapt to the changing relationships between the assets in our portfolio. And we never forget that, conventional or 'alternative', the price you pay for an asset will have a meaningful impact on your ultimate return.

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

In association with PICTET 1805

Pension Awareness Campaign: The personal touch

We live in an age of ever-evolving communications, where technology can transport us to a state where we are so far removed from the person we are speaking to, they may as well be a robot.

As social beings, communication is key in our everyday existence, but it seems that easy access to information through the development of advanced technologies is taking away from personalised, face-to-face interactions.

When asked to cover the Pensions Awareness Campaign for *Pensions Age*, I wasn't quite sure what to expect. What impact could a bus touring the country discussing pensions actually have? After following closely on social media and having spoken to the campaign pioneers from Pension Geeks on the bus, my answer is 'massive'.

The Pension Awareness Campaign was launched in 2014 with the aim to alert the nation of the country's severe retirement savings shortfall. For its third consecutive year, Pension Geeks and Scottish Widows embarked on a five-day tour of central locations in Edinburgh, Leeds, Birmingham, Cardiff and London. Parked at each site, representatives from the two pension firms provided free pensions guidance to members of the public.

Visiting the bus in London on the final day of its campaign tour, the Pension Geeks directors informed me of common questions and queries individuals had put forward. Unsurprisingly, a lot of confusion revolved around communications issues. People explained how they were baffled by the jargon used in official documentation and, of how they were unsuccessful with fully comprehending their options or attaining answers to their queries over the phone to regulatory bodies.

"People came to the bus with their pension documents asking for assistance," Pension Geeks co-founder Rachel Parkinson said. In addition, Parkinson noted how individuals who had reached the state pension age queried why they had not yet received their retirement benefits. Pension Geeks explained that for something as simple as the state pension, people are still unaware of the requirement to make a claim in order to receive this.

Moreover, the bus also provided engaging digital tools such as an aging app that informed users of their predicted retirement age based on current age, salary and pension contributions, as well as producing a (horrifying, in my case) image of what they'd look like at this age. The results for most participants meant that users were made more aware of the necessity to increase their pension contributions and become more engaged with their savings in order to enable a more palatable retirement age.

While the bus, unfortunately, cannot become a permanent feature for the public, Pension Geeks is working to provide simplified communications through videos on its Pension Awareness website and social media channels.

This brings me back to my original emphasis on the significance of simple, direct communication. While a simple concept, in my opinion, this kind of engagement is what the under-saving, less financially educated population need. If financial education is not something that is going to be implemented into schools in the near future and information from regulatory bodies, schemes and employers continue to prove complex – clear, uncomplicated communication is what the public needs.

Explaining the purpose behind the Pension Awareness initiative, Pension Geeks director and co-founder J Bland told *Pensions Age*: "I have visited a lot of seminars and presentations where the industry discuss what we should be doing to simplify pension communications but I felt, in reality, we weren't really taking enough action. Instead of talking about it, I wanted to get out amongst the public and amongst the people we are trying to communicate to and find out, first hand, what the issues/stumbling blocks really are to saving for the future.

"This is really where the idea for the Pension Awareness Campaign is born – to me it's the perfect platform to engage with people directly and just offer some support on what can be a complicated topic. In return we can better educate people on the importance of putting away as much as they can towards retirement. More still needs to be done but this is a great step towards making a difference."

Written by Talya Misiri

Following the herd

David Millar explains how to use people's natural instincts to conform with the majority when planning retirement saving

Modern society teaches us that, as individuals, our rights and opinions should be respected and encouraged. We are a society that is as independent as any in human history.

But, deep down, we are a pack animal. We evolved not as solo hunters but as teams of like-minded people who roamed together – perhaps more like a pride of lions than a flock of sheep, but nevertheless as a group. And this group mentality has giving us some deep-rooted beliefs, some of which we might not feel entirely comfortable with in a society that associates individuality with positive connotations and herd mentality more pejoratively.

Our pack instinct is connected to survival – those primitive human ancestors who went their own way didn't survive as well as those who conformed to life in a pack.

And so, after hundreds of thousands of years of natural selection, we are all descended from people for whom individuality was akin to being alone, which was a threat to survival, and this fear lives on in primitive parts of our brain. The upshot is, we feel comfort when our choices conform to the crowd.

In communications, herd mentality can be used to good effect. In the world of TV advertising, 30 second commercials giving us statistics proving that a lot of people approve of a particular hand cream has been a consistent feature for over 30 years. Similarly, we like to read hotel reviews and speak to people who have done things we are about to do. We trust the pack, and if you can show people what the pack are doing, that can have a dramatic effect.

How can you use this in pensions communications? Here are some thoughts to consider:

Segmentation

You might have a broad idea of your membership, but you can't know each of them individually. Fortunately, there is a half-way house – personas, which represent segments of your membership. While these can seem like caricatures or stereotypes, when pulled together based on member data rather than guesswork they can provide valuable insight, showing the proportions of members in each segment and, crucially, giving you some idea of what media, messaging and methods will work well in order to get your message across.

"If we want pensions to be part of the daily narrative, we need to consider how to help people share information"

Peer comparison

One thing that pension schemes have is data – and lots of it. But we rarely see it used to provide members with an evaluation of what they are doing compared to their peers. As part of a wider discussion on pensions, a chart showing member's contributions as a percentage of salary against their age will demonstrate where members are paying less or more into their schemes than their peers of the same age. This, along with average fund size, could also be compared against what's required to get reasonable retirement pot.

Testimonials

Trying to encourage people to attend presentations? Or activate online access? Or respond to a particular campaign? There is very little as powerful as showing the number of people who have already done this, and if you can accompany this with a genuine testimonial from someone then that effect is magnified.

Peer to peer

Considerably more difficult to achieve, but with great potential, is unlocking the ability for members to share appropriate information with each other. Pensions systems have evolved to keep information separate and secure – and rightly so – but in the world outside pensions people are sharing an increasing amount of data and news about themselves. If we want pensions to be part of the daily narrative, we need to consider how to help people share information, decisions and questions, with their peers – or perhaps just 'like' content that they have read which helped them and which others might find useful.

Clearly, using powerful member communications techniques in the context of pensions – where the subject matter is complex and the impact of decisions potentially significant – could raise concerns. However, by remaining focused on positive member outcomes and good governance, they can result in a win/win for members and the pension scheme. The message you want to deliver has to be appropriate to the membership – it is the role of communications experts to determine the best media and method of delivering that message with the greatest impact. And that means making the most of our natural instincts.

Written by David Millar, head of client communications team, JLT Employee Benefits

In association with JLT

A liquid core alternative

David Morley at Eaton Vance discusses how non-traditional global defensive equity can be the 'core' of an alternative allocation

Successive years of stock market gains post the Global Financial Crisis (GFC), rising duration risk across fixed income assets and the paring back of return expectations have triggered keener interest in investment strategies that diversify well, reduce downside risk and have the potential to provide meaningful, positive returns.

Indicative of this trend is the marked rise in the availability and popularity of so-called liquid alternative investments (LAIs) – systematic investment strategies that target similar return sources to those of hedge funds, but in more user-friendly formats and offering potential advantages such as improved transparency, better liquidity and lower fees.

LAIs seek to harness alternative risk premiums (alternative beta) alongside portfolio returns sourced from simple asset-based exposures such as equity and bond risk premiums; the idea being that by incorporating alternative betas and different investment styles, investors can add return sources to traditional asset classes and enhance risk-adjusted returns.

LAIs can serve as the "core" of an alternative allocation, with the remainder ("satellite") of the alternative allocation invested in high conviction hedge funds or private equity funds that may supply true, after-cost alpha, according to Wei Ge, Phd., a senior researcher at Eaton Vance affiliate Parametric Portfolio Associates LLC.[1] Ge argues that if LAI funds can inexpensively provide extra return sources via alternative styles, risk exposure or structural hedge fund beta with transparency and liquidity undiminished, traditional hedge funds (although they make sense for some investors, particularly when the opportunities are unique and allocation is small), are unlikely to further enhance portfolio returns in a significant way.

Further, an even more central place for LAIs in an investor's portfolio is possible in instances where the LAI incorporates both traditional and alternative beta components, and is globally diversified. An example of such an offering is the Eaton Vance Parametric Global Defensive Equity Strategy, managed by portfolio solutions specialist Parametric.[2] It combines equity risk premium and volatility risk premium (VRP) elements with the aim of achieving equity-like returns over the long term but with a considerably less volatile path (less equity risk).[3] Its dedicated "defensive equity" construct:

- Replaces 50 per cent of the equity exposure in the base portfolio with a cash equivalent and;
- Systematically sells out-of-the-money index options (puts and calls) against the assets of the de-risked base portfolio to capture the more stable VRP and offset the "lost" return potential of the foregone equity element. All short index option positions are fully collateralised by the base portfolio and no leverage is employed.

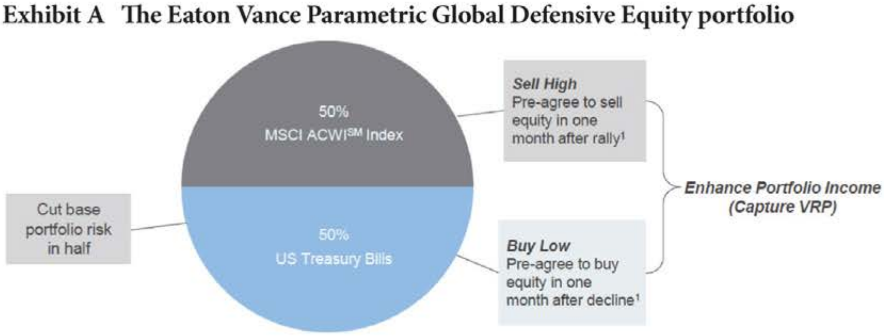
Parametric research indicates that this dedicated construct has the potential to reduce downside capture and to outperform the MSCI ACWI over a full market cycle while exhibiting around 40% less volatility, or risk.

In our assessment, the strategy is likely to deliver its best relative performance in down markets – experiencing significantly lower drawdowns during major market declines, while also recovering more rapidly due to elevated implied market volatility coupled with declining realised volatility (higher premiums/wider strikes) following crisis events – as well as sideways markets, but is likely to trail in strongly rising markets.

Designed to appeal to a global investor base, the Eaton Vance Parametric Global Defensive Equity strategy is different from a typical "defensive equity" or factor-based low volatility strategy.

Motivations for investor interest across the globe in this strategy include reducing equity portfolio volatility, working shrinking return-seeking asset allocations harder, accessing uncorrelated risk premia and finding lower cost, more transparent alternatives to hedge funds.

Exhibit A The Eaton Vance Parametric Global Defensive Equity portfolio



Source: Eaton Vance. Note that investors in this customisable strategy are not necessarily assuming a large USD concentration as FX exposures can be hedged back to the end-user's base currency.

Written by David Morley, business development director, UK institutional, Eaton Vance

1 Liquid Alternatives as a Viable Investment Choice, Wei Ge, Phd., The Journal of Index Investing, Fall 2015, Vol. 6, No. 2.
2 The strategy is also available as a UCITS fund - the Eaton Vance International (Ireland) Parametric Global Defensive Equity Fund.
3 The VRP refers to the observation that the implied volatility embedded in derivatives, such as equity options or variance swaps, is usually higher over time than subsequent realised volatility.

Smart beta: Index investing evolved

Patrick O'Connor explains how smart beta has adapted to meet the changing needs of investors

So what's wrong with straight beta investment?
Did you know that the largest 2 per cent of stocks in the MSCI All-Companies World Index account for 26 per cent of the index by market capitalisation weighting? Traditional indices weight stocks based on each company's market capitalisation. This means that the largest, highest-priced companies make up the largest portion of an index. These indices increase allocations to stocks that rise in price and reduce allocations to stocks falling in price – regardless of their value. As index investing has evolved, new approaches arguably offer better ways for investors to gain broad market exposure. Smart beta is one such approach.

Understanding smart beta
One of the simplest approaches to smart beta holds securities in equal weights rather than weighting them by market capitalisation. More sophisticated approaches select, weight and rebalance holdings based on certain characteristics – called factors. Some will focus on a single factor with others combining factors in a single portfolio.

As far back as the 1930s, professional investors began to recognise that stocks with certain attributes tended to perform better than the market. Starting in the 1970s, academic research has shown how certain factors were associated with persistent higher returns. This body of work forms the foundation for smart beta indices.

What is a factor?
A factor is a primary attribute of an investment that goes towards explaining its behaviour over long periods. We can group stocks based on the primary factors they share. Some factors have provided investors a 'return premium' over market indices over the long term. Other factors have been more closely associated with stock risk.

The list below describes some of the factors that have become the foundation for factor indices.

A look at individual factors

Factor	Description
Quality	Companies with stable earnings growth, strong balance sheets and efficient use of assets
Value	Stocks that are attractively priced relative to historical and forecasted valuations and historically have paid good dividends
Momentum	Companies that have demonstrated strong performance over the past six to 12 months
Minimum Volatility	Stocks that have shown lower-than-average variability of returns

A case in point: The quality premium
It is probably no surprise that, over time, the stock prices of 'high-quality' companies have increased more than the market. While we can define quality in several ways, in essence it refers to well-managed companies with relatively stable earnings growth, resulting from management making wise decisions about how to deploy capital.

The chart shows how an investment in high-quality global stocks would have performed better than an investment in the broader index over the period shown.

Every factor has its day
Whilst it may be tempting to choose one or two factors for investments, individual factors typically move in and out of favour and any attempt to follow them could be challenging. So we think a multi-factor approach can be an attractive option for addressing long–term strategic investment goals.

Applying multiple factors: innovation in index design
Combining several factors in a single index can result in lower volatility and a more consistent return. Like single-factor smart beta, multi-factor draws on decades of academic research. It also draws on research into how factors interact. This allows a manager to diversify among factors in a way that seeks to reduce risk and increase return potential. Research also helps guide the relative weights of factors in a smart-beta portfolio – which can help pursue specific investment outcomes.

As well as offering diversification, a fixed-weighting, multi-factor approach offers strategic exposure without the potential investment governance requirement that could result from managing individual factor exposures.

Source: Franklin Templeton/Morningstar. **Past performance is not an indicator or a guarantee of future performance.** Factor index performance is derived from back-tested pre-inception performance and is not representative of any ETF's performance. MSCI ACWI Quality Index was incepted on 18 December 2012; MSCI factor index performance includes pre-inception index returns, based on criteria applied retroactively prior to the index inception date and, as such is hypothetical and for illustrative purposes only. They provide a general indication of the risk/return profile of the respective MSCI single factor indices. Indices are unmanaged, and one cannot invest directly in an index. They do not reflect any fees, expenses or sales charges.

Such an approach also benefits from no costs for switching from one factor to another.

Putting smart beta to work

Pension schemes can use smart beta in a number of ways. Two examples:

Replace cap-weighted index-based funds. Multi-factor smart beta offers exposure to the same investment universe as cap-weighted index funds while potentially easing some of the risks. For schemes that use passive investments at the core of their portfolios, smart beta offers an efficient way to seek better long-term risk-adjusted returns.

Complement actively-managed investments. Smart beta can complement actively-managed investments. This approach may help improve overall risk-adjusted returns over time while still benefitting from the expertise of active managers.

Conclusion

Think of smart beta as an advance from the binary world of passive and active management. Both can offer transparency, diversification, lower costs and a rules-based approach. With smart beta, we combine these with active management insights.

Market cap-based indices are useful indicators of broad market performance. However, when it comes to constructing a portfolio, decades of research have shown the effectiveness of factor investing. Franklin Templeton has applied its expertise to this field with the creation of the LibertyQ multi-factor indices, offering pension schemes a strong new option for core portfolios.

For more information, please visit: www.libertyshares.co.uk

Written by Patrick O'Connor, head of global ETFs, Franklin Templeton Investments

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Conditional data – the bedrock of good scheme governance

Duncan Watson, managing director of products and services, EQ Paymaster at Equiniti, talks to Francesca Fabrizi about the importance of conditional data to good scheme governance and how to get there

What constitutes conditional data and why should trustees be thinking about it now?

Watson: There is some confusion around what conditional data actually is, so let's start with a very simple definition of the difference between common and conditional data. For me, common data includes the things that identify an individual – so their date of birth, their sex, things that would make sense outside of the pension scheme, that make sense in normal life.

Conditional data is the data that links that person to that particular pension scheme. For example, their pensionable salary, the date they contracted out and so on.

So it makes sense within the pension scheme environment – it's the data that the pension scheme then uses to calculate the benefits that are due to that particular individual, in very simple terms.

It is important because it really underpins the running of the pension scheme. Without good quality conditional data, the pension scheme can't calculate and pay benefits; they can't undertake annual exercises such as pension increase exercises; they can't communicate with their members about their entitlements in the scheme; and they can't really conduct the annual valuation.

Why should looking at conditional data be more important for trustees than their other financial priorities?

First of all, you can't really run the basic pension scheme without good quality conditional data – that's my first reason.

I'll break my second reason into three different sections. Trustees and scheme sponsors undertake proactive activities with regard to their pension scheme over the course of the life of the scheme. So there's the day-to-day running of the scheme. Then there are other things they might choose to do alongside this. For example, they may choose to engage their membership, they may choose to introduce self-service modelling tools so that their membership can log onto the pension scheme website and plan their future. They can do all that, but without good quality conditional data underpinning that, those modelling tools are frankly next to useless. So it hampers their drive to engage with their membership.

Secondly, in trying to drive down the efficiency or the cost of running the pension scheme, they may ask their administrator to introduce more automation. Again, you can automate the life out of a pension scheme, but if the data underpinning the scheme, the data relating to the members is not credible and not whole, then there's no point in having automation, because the automation will just spit out the wrong results.

My third reason is that many schemes are looking at the lifespan of a scheme, their funding plan, their flight plan and also possibly at de-risking the pension scheme over a period of time – through buy-in, buyout, through pension increase exercises or ETV exercises. Again, without that fundamentally strong conditional data, those exercises are really difficult to execute. In fact, without good quality data, an insurer will not transact with the pension scheme. Without good quality conditional data it's just a nonstarter really.

So the trustees have got a choice.

They can either look at their conditional data in a piecemeal fashion – so they decide to do an exercise, to look at the conditional data that relates to that exercise, fix it there and then, then move onto the next exercise. So doing it reactively or piecemeal is an option.

The option I would recommend is that trustees adopt a data strategy. So, running alongside all of the other things they need to do, the day-to-day running, all of the 'nice to have' exercises, they have running along in parallel a data strategy, a conditional data strategy so it almost becomes a habit to be looking at that data. Is it right, is it whole, is it appropriate, is it consistent? Then fixing it as part of their business.

Can we delve deeper into the risks that trustees face if they have poor quality conditional data?

I'd categorise risk into three areas. There's a reputational risk for having poor quality conditional data. There's a financial risk and there's a lost opportunity risk.

From a reputational risk, we know the regulator isn't happy with the way schemes are looking at their data and managing their data. They said so at the end of 2016; and from 2018, from the start of next year, they're asking trustees in their scheme returns to comment on the quality of their conditional data. This is something that they've never done before, so it's a sign that the regulator is starting to get tough on data. For me, if schemes don't adhere to that, then the regulator, with its powers, will intervene and that could damage the reputation of the scheme if that gets into the pensions press.

The other area of reputational risk is at an individual member level. If you have poor conditional data, there is a risk that you will pay benefits incorrectly. That could be on specific high profile cases, or on a number of cases at the same time. That could impact the reputation of the pension scheme and the sponsoring employer.

Then there's financial risk. Poor data could lead to inappropriate funding, expensive funding – you could be paying benefits too highly, paying people who have already died. There's also the cost of fixing that data – if a problem is discovered, then data rectification exercises, in my experience, are extremely expensive and take a long time to play through.

Going back to the liability exercise point that we raised earlier, if a scheme does a buy-in or a buyout transaction, for example, and the insurer deems their conditional data to be of poor quality, they will either ask the scheme to go away and fix it, which takes time, and removes the opportunity to transact; or they'll add a data risk premium onto the price, so the scheme ends up paying more than they need to in order to make that transaction. So there could be a real financial penalty for not having great conditional data there.

The third reason I highlighted was missed opportunity. So again, using the liability exercise example, if the trustees and the sponsoring employers see an opportunity to transact and see a price they like, if the data's not right there's no way they're going to be able to transact straightaway. Insurers will make them, as I said earlier, clean their data. That may take so long that they may miss the opportunity to transact.

There's another potentially missed opportunity as well. If, for example, the administrator of that scheme has got some really clever technology, some really engaging technology for members to take advantage of, of self-service, of modelling, of automation of quotes, et cetera, that may be great but if the data's not there then the trustees can't take that opportunity to give the members the experience they deserve.

So what should schemes do?

There are three first steps that a trustee or a sponsor can take. The first one is admit there's a problem, so take it seriously. Whilst they may not be able to allocate a lot of budget and time to it straightaway, at least allocate an element of budget just to do a feasibility or a scoping exercise. So make it a priority and put a plan around it.

The second thing they can do straightaway is to pause and look at what they've already got. Most administration systems will have some sort of inbuilt checks around the quality of data, or some reporting mechanism that the trustees can have a look at and see immediately if there are any obvious areas for concern.

The other area is the annual or the triennial actuarial valuation. In my experience, the actuaries will look at the conditional data. They will check whether dates look inconsistent. They will almost certainly play that back to the trustees or the administrator and say 'these are the things we found in your data'. So the question to ask is: did the scheme actuary play it back to the administrator and then did the administrator fix it? So there are some things that the trustees and sponsors can do there for which they already have the information.

Having done that, the next step is to then decide how they're going to make the assessment of the remaining gaps. So are they going to ask one of their existing providers, the administrator or the actuary to do some forensic reporting? Are they going to go and buy a solution elsewhere from a third party? There are third party tools out there in the marketplace that will do an assessment of the conditional data.

But I think the main thing is to recognise that they want to do something to develop a strategy and to devote, albeit a little bit of time and money just to do a proper scoping exercise before they launch into it.

To view this video, please visit pensionsage.com

Written by Francesca Fabrizi

In association with EQUINITI

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Pensions Age Autumn Conference: Staying on track

Francesca Fabrizi reviews a conference dedicated to helping trustees and pension managers meet the needs of their managers

This year's Pensions Age Autumn conference was busier than ever and, as the name 'Staying on track' suggested, included presentations from a whole host of industry professionals who were keen to highlight ways in which trustees and pension managers alike can do just that – stay on track of what they need to do to meet the needs of their members.

After an introductory welcome from the chairman of the event, pension trustee Roger Cobley, *Pensions Age* was delighted to welcome Shadow Pensions Minister Alex Cunningham to kick off the day's sessions. The Minister offered his thoughts on some of the key challenges facing UK pensions in the current environment, arguing that there was "no longer a system properly geared to the interests of people who invest their hard-earned cash with the expectation of fair return and a decent pension upon retirement".

He also claimed that pension funds were not operating efficiently enough, placing economic strain on employer sponsors and scheme members. He added it was unacceptable that pension fund costs were unclear, adding that "no commercial company would be allowed to operate without knowing its costs and accounting mistakes would be picked up".

Following on from the Minister and tackling the first hot topic of the day, Aon senior partner Sion Cole reflected on the current state of play in the world of fiduciary management and then looked at what the future had in store for the solution. He first outlined the key drivers of the strong growth that have been seen in the space; how the provider landscape has evolved; the different selection processes that are being used – highlighting how advice from TPEs has increased; how fee structures have changed; and also how satisfaction with fiduciary management overall has increased. Looking ahead, Cole outlined how he sees things changing further in the future and the impact this may have on the wider pensions and investment industry.

Aquila Heywood group product director Christopher Paul was next to the podium to tackle the topic of long-term savings, displaying how, given the changing nature of the industry; the different profiles of the member base; and the death of the 'one-size-fits-all' approach, a more personalised approach to long-term savings was needed in order to achieve optimum results.

Paul also highlighted how, given how member expectations have risen over the years, so much

more is expected of the industry. He showcased how the use of intelligent data, combined with more personalised engagement, can lead to improved service, lower cost products, increased transparency, maximum value for the consumer and, all in all, more positive member outcomes.

Integrated risk management (IRM) was the next session of the day, whereby Barnett Waddingham associate and scheme actuary Chris Ramsey explored the most effective way of using risk management techniques to produce better outcomes for DB pensions schemes as well as giving practical risk management solutions for trustees.

Ramsey began with a look at what constitutes integrated risk management per se, then went on to look in depth at how understanding the relationships between the key risks pension schemes are facing and thus applying IRM effectively can lead to better decision making and better solutions all round.

A second look into the future, this time the future of pension scheme investing, was presented by Xafinity head of investment consulting, North, Ben Gold, who explained why the typical 'gilts plus' approach is no longer optimal and the role that cashflow matching can play. He began by looking at what cashflow matching actually is; when it works and what assets it uses; why it is relevant given today's investment climate; and what it can do for scheme funding.

He offered a thorough explanation of why schemes and their advisers should spend more time and thought on the right approach to scheme funding in order to ensure schemes have a clear plan to manage risk, and that it is integrated and appropriate.

M&G Investments investment director Ritu Vohora continued the investment theme by taking delegates on a journey to find value in the uncertain world we live in.

In her detailed presentation, Vohora explored the key challenges and risks of the current market environment, and highlighted some attractive pockets of opportunity that are available for investors today, showcasing how as uncertainty remains, an active and dynamic approach is needed, with a focus on the facts.

How to deliver income was the next topic up for discussion, as UBS senior investment strategist, investment solutions Michael Walsh shone the spotlight on various investment options that schemes can adopt to meet their cashflow needs. Given that more than half of UK DB schemes are currently cashflow negative, Walsh looked at how important it was that schemes address the issue in the most effective way, outlining investment options that will help trustees to address their short-term challenges whilst still achieving their necessary long-term returns.

Coming back to the engagement theme, Capita Employee Benefits head of client communications Lou Harris presented delegates with a pension communications masterclass, highlighting the key findings from Capita's latest *Educate & Engage Research and Report 2017*. By using industry case studies she explained how schemes need to explore new ways of communication to address the education and engagement challenges they are facing, and the success that can be achieved by doing so.

The last investment session of the morning was presented by Amundi Asset Management client portfolio

Sponsored by

manager David Greene, who looked at ways to deliver alpha in the low return world.

With equity markets fully valued and bonds yields still close to historic lows, Greene explained how institutional investors are unlikely to enjoy the level of returns achieved over the past decade. He discussed what investors should realistically expect from future asset returns and considered how alpha can best be obtained in this environment. He highlighted that rather than relying on beta, investors should be seeking new sources of return.

The afternoon sessions began with an intriguing session entitled 'Black Box Thinking for Pension Funds', whereby Cardano UK head of business development Phil Redding explained how delegates can learn from other industries in order to improve success going forward. He gave a refreshingly candid perspective on what has gone wrong in the DB space over the years and what needs to change – in addition to regulation – in order for trustees to be able to improve their chances of successfully paying their members the benefits that they have been promised.

Wellington Management managing director and investment director Paul Skinner next addressed the pertinent question of how investors should manage their credit risk 10 years on from Northern Rock.

At the end of August 2007, he explained, investment-grade credit yielded over 5 per cent. Investment-grade credit now yields just over 2 per cent. As policymakers look to reverse course he asked what the risks facing fixed income investors were, how they should be managed and what was next for the asset class.

NEST was next up to the stage, with a presentation by NEST director of investment development and delivery Paul Todd, who looked at how is working hard to deliver value and quality to its more than 5.4 million members, despite the ever-changing landscape.

He went on to describe how NEST's investment approach seeks to deliver a smooth savings journey in an ever changing geopolitical environment, how it manages uncertainty in the short and longer term; and how NEST is stacking up against the benchmark.

Staying on the DC theme, AllianceBernsein portfolio manager, multi-asset solution, Karen Watkin, at addressed what trustees need to think about when assessing whether their default investment strategy offers value for money. She further looked at how a transparent and measurable framework can be implemented by trustees and governance committees to measure whether value for money has been delivered historically and equally importantly whether it will continue to do so in the future.

The second keynote and final speaker of the day was The Pensions Regulator (TPR) head of policy, Fiona Frobisher, who was keen to outline ways in which TPR was changing – becoming clearer by setting tailored expectations for trustees and key players, for example via its 21st Century Trusteeship campaign; quicker to take action on governance failures; and tougher, using a wider range of powers and where standards can't be met, encouraging consolidation.

For full details of the event and selected presentations, visit www.pensionsage.com/autumnconference

Written by Francesca Fabrizi

The GDPR/pensions relationship

Lisa Lyon explores how the upcoming GDPR requirements will affect pension scheme management

From May 2018 GDPR will replace current data protection laws. The scope and detail of these new regulations will not only change what information tracing companies can use when offering a compliant service to their clients, they will substantially affect how pension companies maintain and manage member data.

Consider the following GDPR requirements:

• You will have to demonstrate that you maintain accurate member data, and that every reasonable step has been taken to rectify inaccuracies and correct data omissions without delay.

• You will need to demonstrate compliance with the new 'accountability principle' and the GDPR states explicitly that this is your responsibility. You will be requested to demonstrate how you keep your data accurate and up to date.

• Your organisation will be required to document all personal data held, where that data originated and who you share it with. If you have retained inaccurate personal data and shared this with another organisation, GDPR compliance will demand that you inform the other organisation about the inaccuracies, enabling them to make the appropriate corrections. These requirements will be unattainable without appropriate record-keeping and a programme to check data accuracy.

• You will be obligated to report all data breaches that your organisation incurs. This includes any breach of security that leads to the destruction, loss, alteration, unauthorised disclosure of, or access to, personal data. In some cases, you will be required to report directly to the individuals affected.

GDPR compliance demands far more than adhering to the four aspects mentioned, but the necessity to achieve and maintain accurate member data is reinforced by them. While this is a familiar message, it is now being voiced with much more gravity by both The Pensions Regulator and the Financial Conduct Authority. In 2018 trustees of both DB and DC schemes will need to report on the presence and accuracy of their data in scheme returns. Additionally, we will see a new IORP II regulation in January 2019, which will require all deferred members to be sent annual benefit statements.

In simple terms, if your data is not accurate and up to date, you risk sending sensitive data to an out of date address. This could open the doors to potential data breaches or even fraud.

All of this intensifies the urgency to ensure that the personal member data you hold is accurate and up to date, but there are additional considerations. GDPR also places constraints on how this can be done. Tracing companies and data specialists use specific data sources to locate your members; some of these sources are categorised as 'consented data' or, in other words, the person that the data is relevant to has given consent for that data to be used.

However, the GDPR will change the way data is consented and held. From May 2018 data categorised as 'consented' for processing will require a specific and positive 'opt in' from the individual to enable the data to be used. Any data without this 'opt in' will not be permitted for use and will require deletion. Many data sets currently used in people tracing and address verification will be negatively impacted by this legislation and will need to be discontinued.

Therefore, if you are conducting accuracy checks regarding the personal and address details of your members for the first time, or renewing such an exercise; ask the following questions of the tracing company you employ:

• What specific data sets will you utilise in locating my scheme members?

• Is the data you use sourced from a Credit Reference Agency?

• Is that CRA security certified and externally tested for vulnerability?

• Is your tracing company security certified and externally tested for vulnerability?

• Will the data you use be 'consented data'?

• Has it been consented in line with forthcoming GDPR legislation?

This intensified legislation does not need to be prohibitive to the administration of your schemes.

Some pension organisations have already made pre-emptive changes to meet GDPR compliance and this has not restricted them from achieving the accuracy that regulations require.

It does not need to prevent you from doing so either.

Written by Lisa Lyon, managing director, Target Professional

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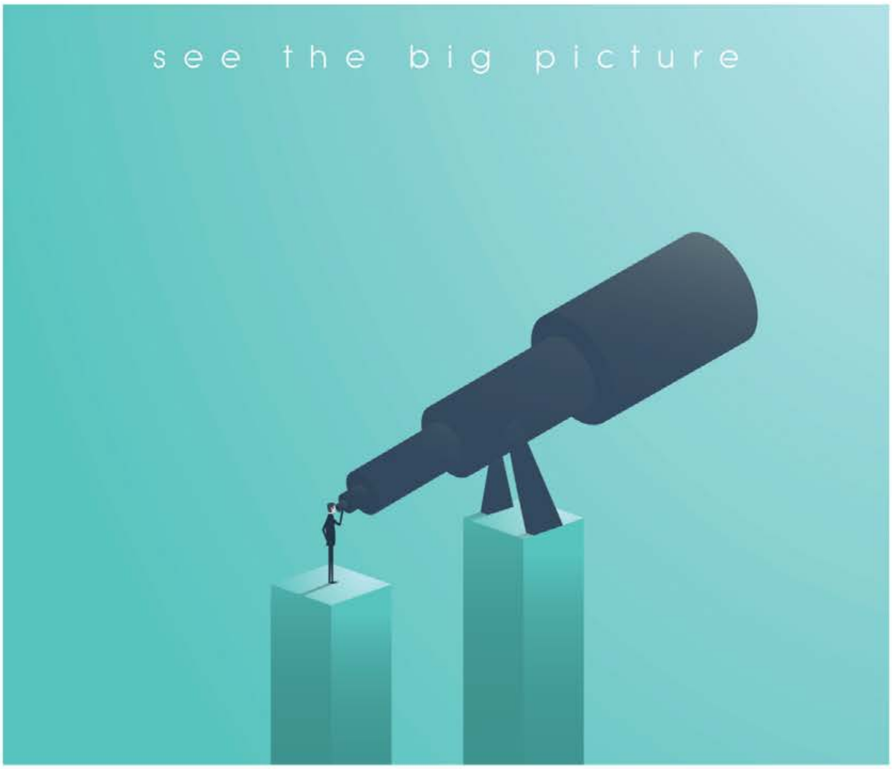
Pensions governance: Step back and see the big picture

Suzi Lowther reveals why pension fund trustees need to take a holistic view to pension fund governance



Once upon a time many people thought of pension scheme governance as analogous to compliance. We all now know the world has changed and governance means so much more.

The Pensions Regulator has certainly been busy on the topic, introducing 21st century trusteeship to us last year and, more recently, issuing new compliance and enforcement bulletins. But what are trustee boards actually doing in practice?

We're seeing three key themes – strategy, effectiveness and efficiency.

Go back 10 years and trustee boards weren't really talking about a strategy for their scheme. They may well have had one, just not recognised or labelled it that way. Now, it is central to how many schemes are managed – and rightly so. This need to be strategic has brought pension trustee boards closer to the world of corporate governance. I have sat on the board of my local housing association for the past eight years and have found the convergence between governance and boards in the two sectors fascinating.

Trustee effectiveness is pivotal to the regulator's idea of 21st century trusteeship and a pension trustee board (like any other corporate board) needs to be made up of people with the right mix of skills, competencies, experience and knowledge. A board needs to work well together too. Assessment against a competency framework is one thing, real life behaviour is quite another.

A board that doesn't gel and give each other space to make sure the views of all are shared and heard isn't effective, no matter how experienced and knowledgeable the individual members are. I've seen it fail in practice. A small number of dominant individuals effectively crowd out those that are less vociferous – usually the tenant member on a social housing board or the member nominated trustees on a pension scheme board.

In social housing, I have been involved in board effectiveness reviews as a board member for several years now, but this type of formal review is relatively uncommon in the pensions world. I don't think it will be for much longer. Over the last year, more and more schemes are asking us to either carry out a full external board review for them or check how well their internal review processes are working.

To help assess and improve board effectiveness, we work alongside the Non-Executive Directors Association. Their expertise helps immeasurably by bringing ideas and experience from the 'outside world' into areas such as developing strategy, board dynamics and board member selection, as well as corporate governance tools and techniques that can work well in the pensions environment.

Understanding the effectiveness of a board hinges on three elements: purpose, people and process – the 3Ps. We have found that purpose – the main driver of having a clear understanding of the role, culture and objectives of the board itself – is often missing. Sometimes the mix of people isn't quite right – with some boards choosing to take on a professional independent trustee to help create the right environment for an effective board (as well as adding valuable pensions knowledge and experience).

Process takes us nicely onto our third theme – efficiency. Any governance structure naturally involves a significant amount of process and procedure. These tend to build up over time and are rarely reviewed and, if they are, it tends to be a piecemeal approach when an adviser or supplier is changed. Good governance requires looking them as a whole. As well as helping you understand where risks to the scheme sit – be that the potential for non-compliance with a statutory requirement (like signing a Chair's statement for defined contribution scheme) or the effect of a mis-timed investment decision – you may find areas where you make efficiency gains or improve member experience.

We have recently helped several scheme sponsors streamline governance to achieve efficiencies and focus trustee time. These clients had multiple pension arrangements and we could see having numerous trustee boards for what were often legacy arrangements made no sense from a time and cost perspective.

The Pensions Regulator's recent compliance and enforcement bulletins make it clear pension trustees who fail in their duties will face penalties. They highlight a worrying lack of governance and understanding of trustee responsibilities for some smaller pension schemes (under 100 members).

Employers with small schemes and tight budgets can be nervous of undertaking a trustee board review – which could help combat the increased likelihood of a failure to comply in these schemes – or appointing a professional trustee, who can help ensure penalty-free compliance and manage their scheme more effectively. Many see it as an additional layer of cost, which they believe they cannot afford. That's not looking at the whole picture.

We act as pension trustee for a number of small schemes and our remit includes managing scheme budgets and getting the best value out of advisers by focusing them on the key issues. This means scheme governance improves without increasing (and often reducing) the overall spend on advisory fees. Happy employer, happy regulator, happy scheme members!

The regulator's demands for more professional trusteeship and more effective governance are fair and only right for pensions scheme members. Our responsibility is to them, after all. Trustees and scheme sponsors need to be in the driving seat here, not advisers. Take a step back and look at things as a whole. It will enable you to spot the easy wins (there will be some), where you really need to improve and where you (and your members) have most to gain.

Written by Suzi Lowther, director of marketing and communications, PS Independent Trustees

Case study

Our client had four defined benefit schemes with different trustee boards and only a few common advisers. As trustee to one scheme, we worked with the company to find a way to govern them all more efficiently.

The solution

With the challenges posed by merging schemes too difficult to overcome, we created a common trustee board for all four schemes with one trustee from each original board and an independent chair.

From the outset we recognised conflicts of interests may arise between competing interests of one scheme to those of another, so we implemented a robust conflicts of interest policy.

To maximise efficiencies and ensure a common meeting for four schemes would be practical, we reviewed scheme advisers, aiming to have the same set of advisers for each scheme.

We suggested a training day to help each trustee become conversant with the intricacies of each scheme and discuss how investment strategies could be aligned and funding negotiations agreed.

Benefits gained

- 16 trustee meetings a year reduced to 4 – saving significant management time and costs.
- The employer and trustees work more closely together – a company representative attends each trustee meeting.
- Adviser costs have reduced – duplication of work and presentations to trustees have been removed.
- Greater compliance control and certainty for all schemes.
- Trustee expertise retained with broader knowledge and experience now benefitting all schemes.

Happy birthday auto-enrolment

According to TPR's Darren Ryder, auto-enrolment marks its fifth birthday with success, but more still to do

This month brings a significant landmark for workers and savers alike – the fifth anniversary of the start of automatic enrolment (AE).

The Pensions Regulator (TPR) assumed responsibility for shepherding employers through AE, to take what was estimated to be between eight and ten million people into a new world of saving for retirement.

There were some who warned that workers did not want AE, that employers could not afford it and that TPR might struggle to implement it. Those doubts have been firmly answered since the launch on 1 October 2012.

It would be hard to deny that these first five years of AE have been a huge success. More than 760,000 employers have confirmed to us that they have met their duties, including more than 500,000 small or micro businesses.

What started as a trickle of organisations enrolling their workers into schemes now involves a huge volume of employers. In August this year alone, 68,000 employers told us they had become compliant – more than had declared their compliance in the whole of the first three years of AE.

Some predicted that employers, in particular smaller ones, would struggle to find the time to manage the introduction of workplace pensions. Yet our research suggests that the majority find it relatively straightforward to become and remain compliant.

The vast majority of employers – more than 95 per cent – are compliant. Most importantly, more than 8.5 million people have gained a workplace pension – the first savings many of these people will ever have made towards their retirement.

It is easy for us to look back with pride on these figures and reflect on a job well done. But we are not complacent. In truth, it is a job that has only just begun.

Millions of workers are saving for the first time for their retirement and that must be applauded. But this is just the first step. With employer contributions, many are currently putting aside the equivalent of 2 per cent of their salary but it is important to acknowledge that workers will need to save more to deliver a meaningful retirement income.

It is in that context that the rise in minimum contribution rates – to a total of 5 per cent in April 2018 and then 8 per cent in April 2019 – is so important.

We support employers funding workplace pensions at a higher rate than the minimum if they chose to, and indeed some already are. It may be that social pressure will be exerted on businesses to offer far more generous rates of contribution to keep their workforce happy. In fact, *Pensions Age* reported on research recently that four out of five employers think that minimum contributions should rise even higher.

The future direction of AE is the focus of the government's consultation and review. Whether AE should be broadened to include the self-employed, those under 22 or those being paid less than £10,000 a year will continue to prompt debate in the coming months. Again, it will be for the government to decide, but our role remains to ensure employers help as many people as possible to gain the benefits of saving for their future through this enormously successful policy.

Educating employers, including new businesses, about their pension duties, and making sure workers are aware of their right to a workplace pension, will continue to be our focus. And where we need to we will use our powers, and fine non-compliant employers through our enforcement activity. But what is certain is that the future of AE will play a major role in the financial futures of millions of people across the UK. We all need to play our part in making sure AE continues to succeed.

Written by Darren Ryder, director of automatic enrolment, The Pensions Regulator

Summary
- Today's young savers expect their pension schemes to be flexible, accessible and understandable.
- Many of them could end up as DC millionaires if auto-enrolment is extended and reformed to capture the far peripheries of the labour market.
- Technology and the pensions dashboards should allow for better member engagement.
- State pension reform and deferred annuities could help smooth phased retirement in the future.

Getting an update

The pensions sector is shaking off its image as a static and archaic monolith and could soon, with a little help from the government, match the expectations of a new workforce that values personalisation and flexibility above all

Ask your typical 20-something-year-old about what they expect from retirement saving products and you'll probably get an answer sprinkled with the following: Accessibility, simplicity, flexibility, immediacy, and a personal service.

The problem for the pensions sector however, is that it still has a reputation for harbouring opaque mechanisms, hidden costs, jargon and red tape. It's no wonder, therefore, that so many young people still have their suspicions about the pensions sector. A YouGov survey conducted earlier this year found that 44 per cent of 18-34 year olds have no pension provision whatsoever.

But this could soon change. Whether by accident or design, today's pensions industry is well positioned to match Millennials' savings expectations.

Royal London's director of policy Steve Webb puts it like this: "In many ways, the move from old-style final salary to new defined contribution fits much better with the labour market of the future."

"Instead of workplace pensions being linked to a specific employment and salary level, and perhaps being the preserve of the better-paid, DC pensions in a world of automatic enrolment enable people to build up one or more pot of money which can be combined at retirement to generate an income," says the former pensions minister.

To redress young people's disengagement from pensions, the first thing to do is to get them saving in the first place. And given today's fluid work environment, that means extending auto-enrolment to the far peripheries of the labour market.

To make this happen, The People's Pension head of policy, Darren Philp, says that auto-enrolment must be simplified and include the self-employed.

He suggests that the government could achieve the former by getting rid of band earnings and allowing for contributions from the first pound. This would make auto-enrolment easier to understand and administer, and ensure that more young people on low wages start saving.

The latter could be made a reality by using the National Insurance system and a carousel of providers willing to take on the self-employed. These would pick up members who would then see part of their NI contributions diverted into their pension as a way of mimicking the employer contribution.

As well as catering for the gig economy, the pensions industry needs to take a further step and start using a bit more empathy, as Philp explains: "We talk about engagement and choice, but we put barriers in the way of those things."

The way to pull down those barriers, he says, is to increase the personalisation of pensions. This means allowing people to stay with a scheme that they were happy with during their time with a previous company and not losing their employer contributions, for example.

"Imagine a world where I say to my new employer, 'here are my bank account details, and here are my pension account details'. I can see that coming."

The unsuspecting millionaires

With these further auto-enrolment foundations in place, Millennials will be able to build up substantial pots, says Standard Life's head of pensions strategy, Jamie Jenkins. Challenging conventional DC doomsday scenarios, he believes that many people starting out in work today are set to become millionaires in retirement.

"If a person has a minimum of 8 per cent that goes into their pension over their working life wherever they go, then they can walk away with an amount which doubles their state pension lump sum which is worth somewhere between £250,000 to £300,000 in today's terms," he says.

However, a conflation of a generous employer, gradually increased personal contributions and decent investment returns could see workers build up anything from £500,000 to a million pounds in private savings.

"It's like the option of winning the lottery really slowly.

"It means you can be comfortable saying that you've done the right things early in life and that you have choices after 55, such as taking a year out, or moving to a less strenuous job."

To make the best of the options Jenkins speaks of, however, the pensions sector must help workers with multiple pots to be able to see their overall position.

As Xafinity head of pension investment Ben Gold says: "This is critical so they have a chance of making informed investment and financial planning decisions through their lives. Technology will have a key role to play."

The power of tech

A big part of that technology will be the pensions dashboards.

With near on 20 providers, covering most of the market, expressing a willingness to build them for 2019, Jenkins believes that is can do much more than just act as an online pension scheme aggregator.

"It's a leap in technology that opens up a whole host of possibilities," he says.

If people can retrieve all their retirement savings data and view it online or in an app, then, asks Jenkins, what's to stop them from looking at the charges, consolidating, transferring and even conducting DB transfers – with the help of some advice, be that artificial or human?

"The move from old-style final salary to new defined contribution fits much better with the labour market of the future"

The Netherlands has had a dashboard since 2011. To date, it has only truly caught the interest of those aged 50 and over. Jenkins sees this as a valuable lesson that the financial services and insurance sectors can use to draw younger savers in.

"Millennials are also more inclined to live their lives through their smart devices so perhaps more likely to keep an eye on what they've got."

With some clever use of gamification techniques, they may become quite happy to begin managing their wealth accounts on a regular basis.

"The dashboard is not a narrow piece of technology, it's a step change in how customers interact with their pensions," says Jenkins.

And if such interaction does take off, then technology could be used to nudge people into saving more, says Webb. So an app could easily prompt someone to review their savings at key points such as turning 40, or receiving a pay rise.

Decumulation

It's clear that morphing the delivery of pension schemes will not stop at the accumulation phase in the future.

Part of that is down to pension freedoms and the flexibility the reforms have handed over to savers, but part of it is also down to the end of the clear demarcation line between work and retirement.

"There is now a clear generational gap", says Gold.

"Older workers are more likely to have a significant DB pension. For these lucky ones, the concept of retiring, i.e. completely stopping work on a given date may still apply. *[But]* for most workers, they are likely to have some combination of DB and DC benefits, or even no DB benefits. For many of these people, work may wind down over an extended period.

"Businesses will need to consider how they accommodate and get the best out of this ageing workforce who will certainly have plenty to offer. The quid pro quo requires businesses, with support from the pensions sector, to help their workers achieve their lifestyle aspirations."

How this can be achieved is something that SSGA's head of European DC investment strategy, Alistair Byrne, says still needs to be worked out. However, the blueprint will be based on supplementing part-time incomes with a combination of state and private ingenuity.

"One idea we've been toying with is letting people to partially access their state pension," he says. "To fund the gap between what they were used to earning and what they're earning with reduced working hours.

"That's something that has happened in Sweden and we could consider it here."

Later on in retirement, however, Byrne says that annuitisation still has a strong appeal.

"In the early stages of retirement flexibility is valuable. But later on, having the security of a regular payment coming into your bank account is highly prized. You don't need to worry about budgeting and how long you're going to live, or making your money last.

"So we believe that some form of annuitisation will come back to the fore."

The right product for this way of retiring will eventually grow out of the currently nascent deferred annuity market, says Byrne.

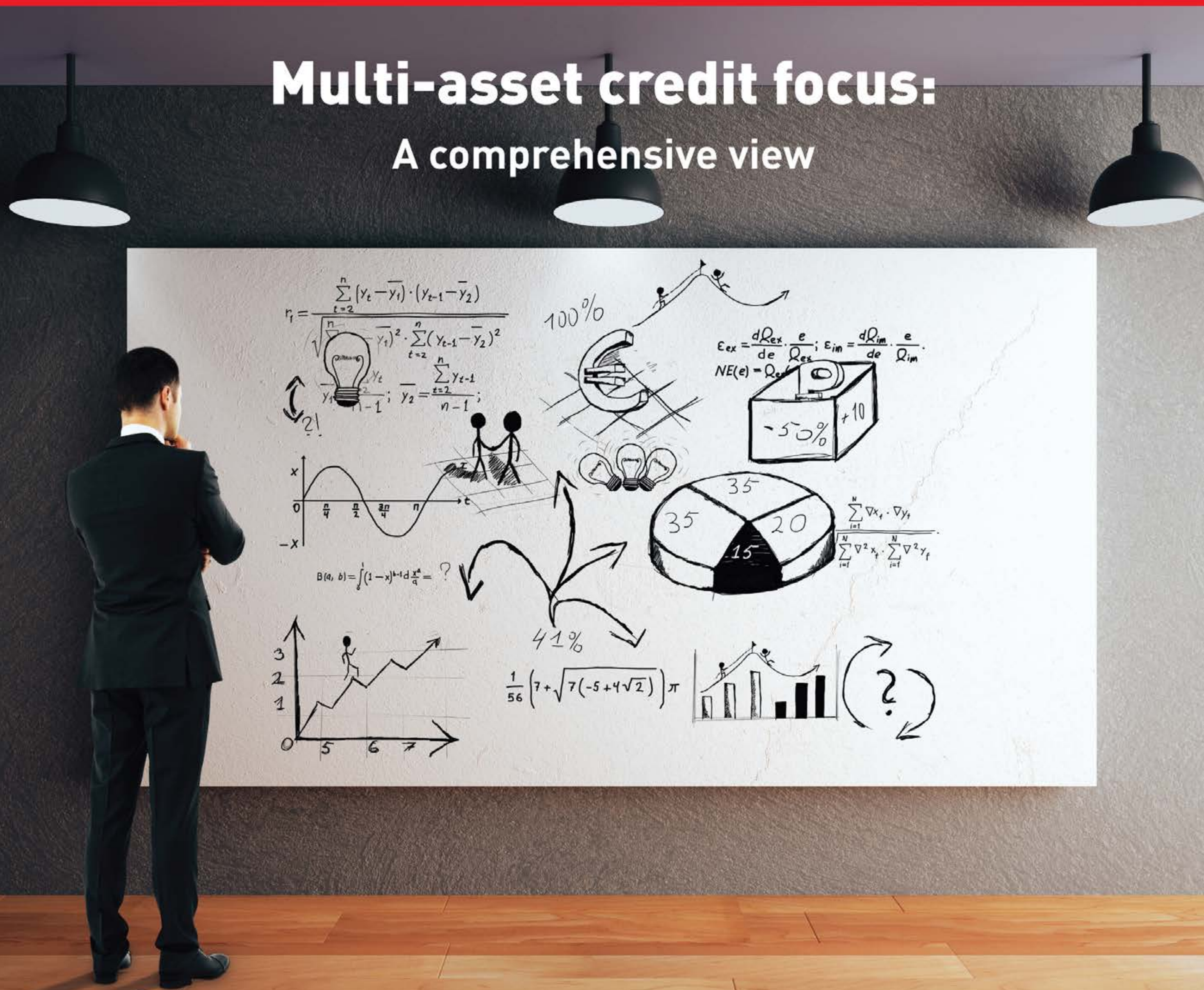
From tech to at retirement, the pensions sector is waking up to new possibilities.

Written by Marek Handzel, a freelance journalist

A delicate balance – *Craig Scordellis reveals how to capture opportunities, including income, and minimise volatility among diverging markets* *p48*

A closer look – *Lynn Strongin Dodds considers why pension fund investors should explore the differences between different MAC strategies* *p50*

Multi-asset credit focus:
A comprehensive view



Craig Scordellis, head of long-only multi-asset credit, CQS

A delicate balance

Craig Scordellis reveals how to capture opportunities, including income, and minimise volatility among diverging markets

In the prevailing macroeconomic environment, with low interest rates, potentially higher inflation, central bank activity and sporadically high asset price volatility, it is a challenge to maintain reasonable expected returns while moderating volatility. Alternative credit enables portfolios to reduce volatility, i.e. de-risk, relative to equities, while maintaining attractive risk-adjusted expected returns relative to government and investment grade bond markets. It also enables portfolios to generate income, reducing the requirement to fund liability cashflows from capital. Furthermore, a lower growth for longer environment should be generally attractive for credit, certainly relative to equities.

Over the past seven years, the size of credit markets and the number and breadth of credit securities traded has grown significantly, increasing the credit investment opportunity set. Meanwhile, challenges to liquidity driven by regulatory change are increasing relative value opportunities, while increased dispersion between individual credits is adding to opportunities for idiosyncratic returns from fundamental research.

MAC investing offers access to a broad investment opportunity set within credit. With exposure to the full spectrum of issuers and asset types, a manager can select investment opportunities across different credit asset classes and regions and be nimble in rotating between them. Flexible MAC investing can profit from cyclicality and help to manage credit, liquidity and interest rate duration risks.

MAC strategies can also be tailored to different risk and return profiles depending upon investor considerations. There is a need therefore to find asset solutions through partnerships that offer the portfolio management flexibility to position portfolios appropriately.

Broader opportunity set

MAC offers a broader opportunity set than traditional single strategy vanilla credit, with access to a wider range of issuers and asset sectors and can maximise bottom-up driven fundamental credit research to mitigate risks associated with single strategy credit portfolios, capturing opportunities that present themselves.

With the flexibility to invest in multiple sectors and not tracking a broad index but targeting an absolute return, a MAC portfolio has ability to avoid a substantial portion of an individual sector, such as Energy. It can therefore potentially avoid such a drawdown or the volatility associated with its price correction and ultimate rise in defaults.

In addition, the ability to opportunistically select and trade assets within a certain sector can provide the ability to outperform indices whilst taking less fundamental credit and drawdown risk. An example of this is in the Senior Secured Loan Market between December 2014 and August 2017, where investing in fundamentally safer (lower default rate, higher recovery) BB rated US Loans over higher risk B rated Loans returned more to investors, contrary to traditional returns implied from taking on a higher amount of risk.

Relative value between sectors

Credit market sectors are cyclical in nature, with this cyclicality driven by variations in fundamentals, supply and demand dynamics, liquidity and regulation. MAC investing can help to both mitigate risk from this cyclicality and profit from it. MAC portfolios can be highly selective and focus on being in the most opportune asset classes at the appropriate time. For example, as illustrated by Figures 1 and 2, relative European and US High Yield and Senior Secured Loan spreads have moved significantly in recent years, with Loans periodically yielding more than High Yield even though they sit higher in a firm's capital structure.

This shifting relative value has presented an opportunity for MAC portfolios to effectively earn more in spread and yet take less fundamental and technical risk. This is because High Yield bonds are traditionally riskier instruments than Senior Secured Loans; bonds have exhibited higher default rates, lower recoveries and more price volatility. Such market conditions can present themselves because of technicals (supply and demand factors) in alternative credit asset classes. In capturing higher spreads in Loans, for a select period of time, investors have been rewarded for avoiding the incremental risks associated with investing in bonds.

Relative value across geographic regions

Figure 1: Euro High Yield Spreads[1] vs. Euro Loans Spreads[2] US Loans Spreads[7]

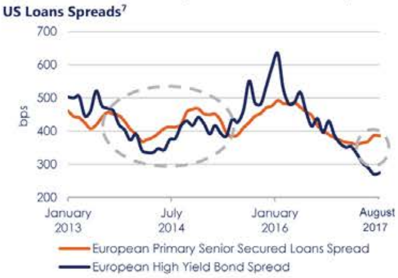
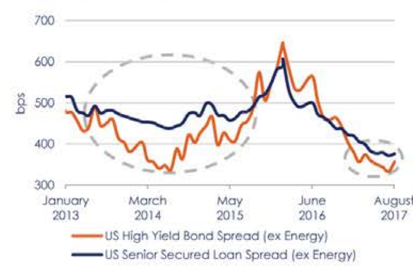


Figure 2: US High Yield Spreads[3] vs.



The relative value between geographic regions can also increase and decrease in relative attractiveness. Global MAC managers are able to take advantage of such opportunities. These can be driven by shifts in fundamentals or by different supply and demand conditions for an asset class between geographies.

For example, Figure 3 highlights that US and European loan spreads have diverged greatly in recent years, with the spread on US Loans shifting from below to above that available on European Loans. The incremental spread in US Loans presented MAC portfolios with an opportunity to earn more spread while fundamentally de-risking the portfolios; US Loans have traditionally exhibited lower default rates and higher recoveries than their European counterparts.

Liquidity

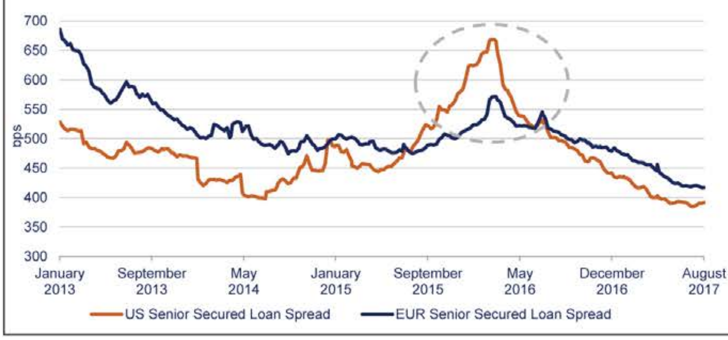
As the increase in global financial market regulation and pressures on bank capital have been reducing liquidity in markets, MAC managers are able to take advantage of opportunities created when individual credits or credit asset classes become mispriced due to market technicals. The multi-billion retail fund outflows, and associated selling of a broad range of assets across a sector, presented an opportunity for MAC portfolios to access quality product at wider spreads when US Loan spreads were materially affected by retail flows into the asset class in 2013 and subsequent outflows from Q2 2014 onwards.

In the event there is limited liquidity in certain sectors, MAC can also help to mitigate liquidity risk as a multi-asset portfolio can opportunistically access the best pockets of liquidity at any time.

Relative value within the capital structure

Within an individual issuer, greater value may be available in selected parts of the capital structure. In order to select the most appropriate part of a capital structure both fundamental research and technical analysis is required. For example, bottom-up research may uncover fundamental concerns about a business therefore a safer investment in the senior secured instruments might be selected. Similarly, if a business is performing well the MAC portfolio can maximise returns by investing in subordinated debt instruments.

Figure 3: US Loan Spreads vs. Euro Loan Spreads[4]



Duration management

Importantly in the current macro environment, MAC investing can help to manage interest rate duration risk by selecting appropriate duration instruments at differing points in the credit cycle. At certain points, asset allocation can favour shorter interest rate duration instruments, for example Convertible Bonds, Senior Secured Loans and ABS, the latter two of which are typically floating rate. Duration management is therefore a central tenet to MAC investing: Figure 4 highlights that a volatile rate environment can create potential problems for all forms of credit while as Figure 5 shows, higher 3 month Libor rates benefit floating rate credit as maximum floors are surpassed.

Conclusion

Global pension funds and other institutional investors face material challenges in the current macroeconomic environment, with lower interest rates, potentially high inflation, central bank activity and sporadically high asset price volatility. We believe that for many investors, alternative credit in multi-sector format is an attractive solution to de-risking from equities and maintaining reasonable expected returns with dampened volatility. MAC investing can also be fully flexible so that solutions can be tailored to sit alongside and complement existing investment allocations. It is however vital that a nimble and active multi-sector portfolio management approach, with skill in fundamental credit selection and robust risk management, is adopted to take advantage of opportunities, mitigate risks and secure solid through-the-cycle returns and provide downside protection.

Written by Craig Scordellis, head of long-only multi-asset credit, CQS

In association with CQS

Figure 4: US Ten Year Treasuries[11]

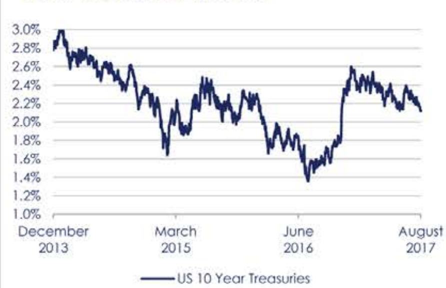


Figure 5: 3 Month Libor[11]

Source: 1Bloomberg, BofA Merrill Lynch Index HEC0 as at 31 August 2017. 2S&P LCD European Leveraged Lending Review, as at 31 August 2017. 3Barclays US High Yield ex-Energy Index. 4S&P LCD as at 31 August 2017. 5Bloomberg as at 31 August 2017.

Summary

- As MAC strategies become more popular, the marketplace becomes more crowded, squeezing returns.
- MAC strategies remain attractive in the current low-yield environment, as it allows investors to capture opportunities and mitigate risks across a diverse set of investments.
- It is important to conduct rigorous due diligence of MAC strategies.
- MAC can be used to capitalise on interest rate changes, along with accessing EMD opportunities.

A closer look

Lynn Strongin Dodds considers why pension fund investors should explore the differences between different MAC strategies

While multi-asset credit (MAC) remains a favourite in institutional portfolios, increasingly-stretched valuations means some strategies are losing their lustre. This has led to a narrowing of opportunity sets, which is why investors are advised to closely inspect the risk and return characteristics of the underlying constituents.

The MAC label is all-encompassing and can cover a multitude of investments ranging from asset-backed securities (ABS) to emerging-market debt (EMD). Although the blend of assets can vary, most promise to deliver superior risk adjusted returns with low volatility. They have steadily gained a following over the years as their trusted fixed investment universe, most notably investment-grade corporates and sovereigns, failed to deliver the returns pension funds needed to meet their liabilities.

Squeeze

However, as with many fashionable investments, the marketplace became more crowded, squeezing returns. This has certainly been the case with high-yield bonds where spreads relative to comparably-dated US Treasuries are as tight as they have been throughout the post-crisis period. They have slid to around half a percentage point this year to levels not seen since 2007, according to Bloomberg Barclays bond indexes.

Investors though do not have to look at the charts to realise there are cracks. The recent bankruptcy filing of Toy R Us serves as a reminder of the perils of piling on mountains of leverage. The company's $5.3 billion in debt included a large number of leveraged loans and high-yield bonds.

Despite the pitfalls, MAC's place in a pension funds investment armoury seems secure. "The credit market is less attractive and there are some fund managers who not being as aggressive as in the past," says Amundi's head of global corporate credit Grégoire Pesquès. "In our case we have slightly reduced our exposure to the market but continue to have a long bias towards credit because of the fundamentals and the fact that the unwinding of quantitative easing that has been announced in the US and Europe will be done at a slow pace."

CQS head of long-only multi-asset credit Craig Scordellis also expects MAC's appeal to be long lasting. "Globally pension funds are facing a challenging low-yield environment that may make it challenging to meet liabilities," he adds. "Multi-asset credit strategies allow them to capture the opportunities and mitigate the risks across a diversified set of investments such as investment-grade bonds, high-yield bonds, senior-secured loans and asset-backed securities. "

Russell Investments head of client strategy and research David Rae sees two, seemingly contradictory drivers of demand for these funds. On the one hand, pension funds are looking to compensate for the paltry returns on offer from government bonds by moving into extended segments of the fixed income universe. On the other hand, and conversely, "some schemes are keen to reduce risk and the over-reliance on equity exposure as the primary source of return", he adds.

Other factors, according to Rae,

include changes to the demographic profile of schemes, the impact of pension freedoms and the increasingly cashflow-negative position of schemes. "The access to the full spectrum of opportunities and the ability to dynamically switch between market segments is critical for investors to reap the full benefits of a multi-asset credit investment," he adds. "Return opportunities and entry points can be fleeting. For example, the selloff in high yield bonds in early 2016 was a great buying opportunity."

Insight Investment head of secured finance Shaheer Guirguis also believes more attention should be paid to returns and that league tables can be misleading indicators of success. "If you look at the performance of the entire range of MACs, it would be hard to know what to invest in," he says. "While the top quartile and deciles look reasonable, there is a huge dispersion around the median. The question that needs to be asked is what approach do you take to reduce the volatility of the outlook?"

Due diligence

This only underscores the need to conduct rigorous due diligence. "Although the number and breadth of credit securities traded has grown significantly, it is important to conduct credit analysis in order to be in the right geography and asset class," says Scordellis. "This means understanding the regulatory environment, the fundamentals and the technical aspects to properly assess the risks."

M&G Investments director, global institutional distribution, Annabel Gillard, also stresses the importance of doing rigorous and "proper" homework and research in order to identify and establish the creditworthiness of the individual securities. "The main objective is to find sensible companies to lend money to and get a clear source of return," she adds. "We build portfolios that will deliver consistent returns with low volatility and it should not matter if interest rates go up or down."

Opportunities

In the current environment, fund managers are changing the mix and adding more short duration securities and floating rate notes (FRNS), which as their names suggest do not have a fixed interest rate, but are pegged to a benchmark such as the US Treasury bill rate or Libor, allowing their coupon to be rebalanced at regular intervals. According to Scordellis, loans and parts of the asset-backed securities market are attractive because as they are typically floating rate, they can help immunise the portfolios from rising interest rates.

These investments are also a popular staple in the MAC funds of M&G Investments, which, like CQS builds portfolios using a bottom up, dynamic and active approach. "The main attraction of a floating rate MAC is that it avoids doubling up on duration for those clients who are matching their liabilities more directly via an LDI mandate," says Gillard. "Unlike in the past, pension funds are managing duration through a liability-driven investment strategy while using a flexible MAC fund to move into a broader range of assets."

The US is leading the charge, with the Federal Reserve on track to raise its benchmark fed funds rate three times in 2018. However, it only pegged two further rates in 2019 instead of three. Equally as important, the central bank flagged its intention to unwind its hefty quantitative easing programme, which stands at around $4.2 trillion (£3.1 trillion) in US Treasury bonds and mortgage-backed securities bought in to bolster the economy after the collapse of Lehman Brothers.

Meanwhile, the Bank of England is considering pulling the QE plug but has made more definitive noises about increasing rates by 0.25 per cent before the year end. This would reverse last August's post-Brexit cut and lift base rates to 0.50 per cent. As for the Europe, the European Central Bank is expected to sit tight on the rate front but it has signalled its plans to end its €2 trillion economic stimulus programme.

Aside from the interest rate play, MAC are looking to capitalise on the rebound in emerging markets, especially as the debt, although by no means cheap relative to historical norms, is paying higher returns than other parts of the bond market. For example, the yield on J.P. Morgan's Emerging Market Bond Index, which tracks hard currency debt, is around 5.5 per cent compared to roughly 6 per cent on the J.P. Morgan Government Bond Index-Emerging Markets Global Diversified Traded Index. This outshines the UK 10-year gilt yield of about 1 per cent as well as the approximately 2 per cent generated by the 10-year US Treasury bond.

Other benefits of emerging-market debt are exposure to economies such as Russia and Brazil, where growth is returning after two years of recession. Moreover, local debt markets are becoming more alluring amid slowing inflation, relatively high interest rates and strengthening currencies.

Guirguis also points to structured credit as a good investment due to their risk-adjusted return profiles. "Their spreads are wider in Europe than fair value because regulation such as Solvency II does not allow insurance companies to invest in them," he adds. "A related investment is secured finance loans where an illiquidity premium can be extracted because these are bi-lateral contractual agreements between a borrower and its lenders. Due to regulation such as Basel III, banks are playing less of a role."

Written by Lynn Strongin Dodds, a freelance journalist

In association with CQS

Summary
• The number of people who are self-employed has increased, but pensions participation within this group is in decline and they are not covered by auto-enrolment.
• The government has pledged to address the issue. The forthcoming review of auto-enrolment may recommend a new system to auto-enrol the self-employed, based on payment of pension contributions into a private pension by default, using HMRC infrastructure.
• The exact form of the system and whether government might top up or match an individual's contribution; and/or increase NICs for the self-employed, is as yet undecided.

Getting the gig

David Adams questions what more can be done to encourage self-employed 'gig workers' to save into a pension

If we had wanted proof that what academics Richard Thaler and Cass Sunstein have called the 'yeah, whatever' heuristic is visible within the UK workforce, auto-enrolment has delivered it. Almost eight million people have been brought into workplace pensions, arguably because they couldn't be bothered to stop it happening.

Brits shouldn't beat themselves up about this (if they could muster the effort to do so), because the same trick would almost certainly have worked in most other countries. And although there are still some questions hanging over the policy, such as whether opt-out rates will increase when employee contributions rise, the success of auto-enrolment is good news for everyone.

Excluded groups

The trouble is, it doesn't cover all the UK's workers. One significant group not yet in the fold are the self-employed. There were 4.85 million of them in the UK in September 2017 – just over 15 per cent of the total workforce, according to the Office for National Statistics (ONS). Not enough of them are saving into pensions.

While the DWP's 2015/2016 *Family Resources Survey* shows that the pension participation rate among the self-employed had increased slightly during the past year, to 17 per cent from 16 per cent in 2014/2015, it was well below the 2009/2010 level of 23 per cent. A 2016 government-commissioned report showed that one in five self-employed people thought they would just rely on the state pension for retirement income.

Of course, entrepreneurs running start-ups may just have too many other things on their minds to think about pensions. Some may also plan to sell their business to fund their retirement.

Other self-employed people may find it very difficult to save, because their incomes fluctuate and/or are very low.

This is particularly likely to be the case for low-paid workers in the gig economy, some of whom may be technically self-employed but relying on a single employer. The Taylor Review of modern working practices, published in July, recommended the creation of a new type of worker status, 'dependent contractor', to distinguish this group from other self-employed people. This would also make it easier to ensure these people could join auto-enrolment pension schemes run by the employers upon which they depend.

Inclusion methods

The Conservative manifesto for the 2017 General Election included a pledge to bring the self-employed into auto-enrolment, which should ensure that the issue is high on the agenda of the forthcoming DWP-commissioned review of auto-enrolment, due to report by the end of the year.

Any new system it proposes must exploit the power of inertia and a default-based approach, says Royal London director of policy and former pensions minister Steve Webb. He and Aviva head of financial research, John Lawson, worked on a document published jointly earlier this year by their companies that considered several different ways to address this issue.

Most were based on a default position of a pension contribution, of, for example, 3-4 per cent of an individual's taxable profit, being paid to a pension provider when the individual paid their tax and National Insurance contributions (NICs). If the individual already had a personal pension it could be paid into that pot instead. HMRC infrastructure could be used to manage the process. NEST could be the default option, or the pension might be allocated to one of a group of providers on a carousel basis.

Many in the industry believe it would be important to allow individuals to opt out. "The default will be that you're in, but you don't have to be," says Hargreaves Lansdown senior pension analyst Nathan Long. "It's not going to be for everyone."

But others suggest this could be an opportunity to increase NICs for the self-employed, to help pay for the system and to address the inequality between NICs for employees and the self-employed that the Chancellor tried and failed to remove in the March 2017 Budget. Class IV NICs for the self-employed could be increased from 9 per cent to 12 per cent, with individuals then given the option to divert the extra money paid into a pension (or a Lifetime ISA), rather than simply going to the Treasury. One suggestion is that the government could sweeten the pill by topping up the contribution with, for example a contribution to the pension pot equalling 1 per cent of the self-employed person's taxable profit.

An alternative proposal, suggested by the Tax-incentivised Savings Association (TISA) in 2015, is that the default would be a pension contribution of, say, 4 per cent of taxable profit that would then be matched by the government, effectively providing the equivalent of an employer's contribution.

One possible problem that might arise for a government trying to implement one of these proposals, or a hybrid version, would be the difference between the way employees and the self-employed interact with the tax system. Some employees may scrutinise their pay slips in great detail, but many do not give a great deal of thought to tax or National Insurance payments – or, indeed, to auto-enrolment contributions – because they never actually have that money in their bank account.

The self-employed, on the other hand, are very conscious of the amount of money they need to set aside to pay tax bills each January and July. An attempt to introduce any system that increases the amount of money with which they are asked to part, twice a year, might simply feel to them like a tax increase.

Long acknowledges that opt-out rates would probably be higher than for employee recruitment, but suggests that as more people were brought into the system it would eventually become the norm.

It might also be possible to break the contributions up, into monthly or quarterly instalments – but this would

have operational implications. "The problem is, you've got to manage the process of collecting the money," notes Pensions Management Institute (PMI) technical consultant Tim Middleton. "How practical that would be is something we must look into."

Webb emphasises the importance of communications – the advantages of following the default option would need to be very clear, including details of tax relief and perhaps also the government's matching or top-up contribution.

Industry help

Such a system would surely present the pensions industry with a significant opportunity – but could the industry have done more already to serve this growing market?

One reason this has not happened is that the economics of providing workplace pensions are so much more attractive than developing and marketing products to self-employed individuals.

Another is the impact of the Retail Distribution Review (RDR), which dismantled the commission-based sales model that helped to contact and sell pensions to the self-employed in the past.

But Lawson believes the industry is already making progress in this area. "We've developed direct products that are really good value for money," he says. ". You could probably get a SIPP very similar to what you would get with a workplace pension for about 0.6 per cent. We need to get that message out."

Many self-employed people would still find it difficult to lock money away for the long term, so it might be useful to encourage use of more flexible savings products like the Lifetime ISA instead. But this is currently only available for people aged under 40, and many of the newly self-employed are older than that.

For now, we will wait to see what recommendations will come out of the auto-enrolment review – or are announced in the Budget in November. Industry observers seem torn between optimism and pessimism when asked how quick we should expect meaningful progress.

"Brexit is going to dominate the parliamentary timetable," says The People's Pension head of policy Darren Philp. "But the government has said this is going to be a key feature of the auto-enrolment review.

"Whether they'll have the legislative space to do anything about it in the next couple of years, we'll have to wait and see."

But Middleton urges the government to take action. "The trend for self-employment to increase is unlikely to end any time soon," he says. "It's gone beyond the point of saying it would be nice to address this – this is something that needs to be fixed."

Written by David Adams, a freelance journalist

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The optimist

Just a few months into the job, Julian Mund is getting stuck into a new daily routine serving as the PLSA's chief executive. Natalie Tuck speaks to him about the future of the association and his thoughts on some big industry topics

Julian Mund is a self-declared optimist, which, given his new role as Pensions and Lifetime Savings Association chief executive, can only be a good thing. After serving as interim chief executive, he was officially announced as Joanne Segars' permanent replacement in July.

Coming from a commercial background, most recently serving as commercial services director at the PLSA, he is particularly excited about the opportunity to engage with the association's fund members as part of his new role.

"I was commercial services director for four years, so understanding that day and the pace of the day and how it unfolds and what you do, and rhythm around that, I knew it really well," he says. "I have had to adapt to a new set of demands and one has been trying to engage with the members that I wouldn't have engaged with as much in the previous role…I've been making a real effort to get out and speak to them and to understand what they think about the PLSA."

His experiences so far have been positive, noting that members are "very supportive" about the future of the association. The PLSA has a 95 per cent retention rate, of which Mund is very proud.

"I like to take that as a measure that there's a lot of support and a lot of good will, looking very favourably upon the work we are doing. When I've been out meeting them, that's been coming through. They are behind what the PLSA is doing, they really appreciate having us out there, a strong voice, speaking on their behalf," he says.

Having rebranded from the National Association of Pension Funds two years ago, Mund's new role involves deciding the future direction of the association. "I've been looking at it with our board, kicking it around with members, and we've done some member surveying over recent months. We've been out there talking to our members but also with people at the PLSA, we're a small team so it's really important to suck in all the views and opinions from people across the organisation."

Since its rebrand, Mund believes there's already been a shift in the organisation to include the lifetime savings part of its name. This has been through its conferences and events with members, as well as its research, such as its understanding retirement study.

One of the reasons for the rebrand was to keep up with the shift generally happening surrounding pensions and retirement. Mund believes it's a "perception thing", noting that the way we think has started to change. "It won't be a pension and other forms of savings, you'll just talk about savings for later life, and it takes times for that shift."

Decoding the future

This month, the PLSA hosts its annual conference, with this year's theme on decoding the future. So what is that all about? "Things are changing", he says. "The way people work, the way people live, the way people save, it's all moving on, it's all developing. It's about bringing

forward insights and examples and challenging schools of thought about the future.

"We come at lots of things from lots of different angles, some very detailed complex explorations, to some very thought-provoking, high-level discussions, and there's plenty of stuff in there for everybody who goes, whether they've got a career of working in pensions or whether they are new to the industry."

He highlighted some of this year's speakers, such as Nick Bostrom, who wrote a book called *Superintelligence: Paths, Dangers, Strategies*, and is one of the world's leading thinkers on artificial intelligence, who will be "challenging our thinking on how that might impact us in the future".

It has been claimed before that many jobs will be threatened because of the development of artificial intelligence, but, being an optimist, Mund looks upon the developments positively. Advances in technology that make things as "easy, simple and as streamlined as possible, that's something that I like the sound of".

"I'm not an expert…but there's plenty of jobs still out there even though technological advances are kind of kicking in. There is a different range of jobs and roles that people do," he says.

Another speaker is Matthew Taylor, author of the Taylor Report, which looked into the gig economy, and recommended the government auto-enrol the self-employed into a pension. "It is clearly exciting isn't it," he notes, "to get as many people as possible potentially saving and investing. We would all want to see that wouldn't we, as many people as possible being able to invest and save to provide for a retirement, that's got to be a good thing."

The conference is also Pensions Minister Guy Opperman's first big address to the pensions industry. What does Mund want to hear from him? "I want to hear what his plans are, what his ambitions are. I'm also looking forward to the opportunity to speak with him and for him to have an opportunity to meet some of our members."

Savings gap

With such a focus on the future, Mund is also mindful of today's savers, and their futures. He notes that the PLSA is behind increasing contribution rates up to 12 per cent in the 2020s. Not deterred by the thought of people potentially opting out, he says it will be "fascinating" to see the reaction rate once contributions increase to 8 per cent in 2019.

"We believe it's the right thing to do and it's a challenge for us across the industry to help people understand how important it is to be saving what they can, and helping people understand what that will look like for them when they retire. We've also got to help people understand that if they put something in, then there's also something else being added from their employer. That's going to be a big challenge."

This is when he describes himself as an "optimist", who "likes to be hopeful". He comes across as someone who is not deterred by a challenge, noting that if something doesn't work out, then there are "always other routes you can take".

Brexit

As head of the UK's biggest pensions association, Mund is simple and clear on his wishes for the UK once the Brexit negotiations are done. "I would like to see us land in a position post-March 2019 where we are going to have a strong and robust economy," he says.

Currently, however, he does not believe it is an issue at the forefront of PLSA members' minds, stating that he is "not aware of Brexit being something that's having an impact on their day-to-day job".

Mund sits on the board of PensionsEurope, of which the UK is a founding member. However, he is not willing to say whether the PLSA will remain a member of the European association post-Brexit.

"We've had a lot of benefits from being a member of PensionsEurope, we're a founding member, my predecessor set up PensionsEurope, we work incredibly closely with our colleagues in Europe, and I'm sure we will continue to work very closely with them, we can't afford not to.

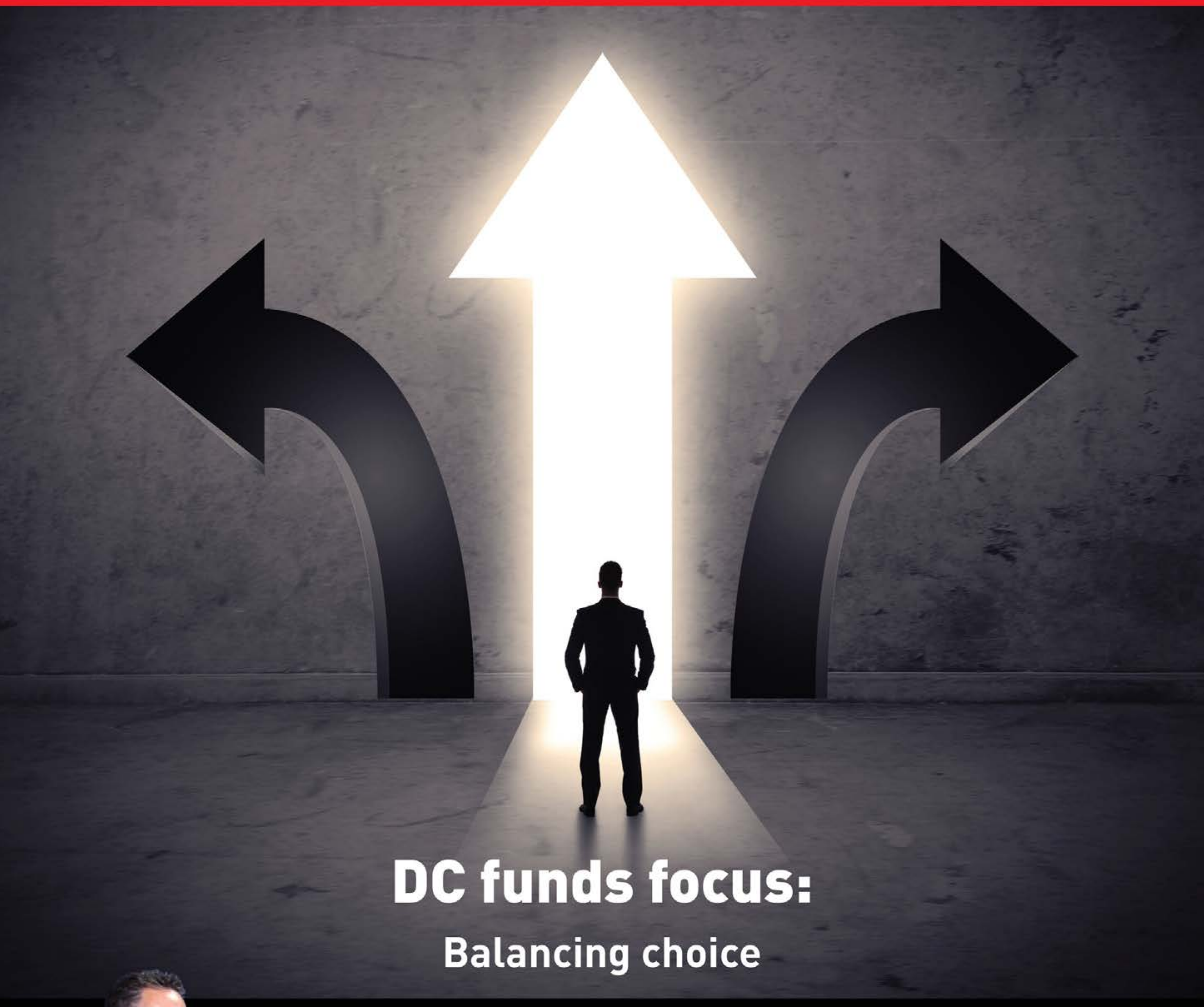
"It is about doing what is right. It is about doing the things that are right for our members," concludes Mund, something that appears to be at the heart of every decision he makes.

Written by Natalie Tuck

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

Investment matters – *Laura Blows talks to NEST CIO Mark Fawcett about managing market conditions and compiling the best fund choices for DC members* ***p60***

The needs of the many – *How much choice should DC members be given with fund selection? Peter Carvill examines these conundrums* ***p62***



DC funds focus:

Balancing choice

Mark Fawcett, CIO, NEST

Investment matters

Laura Blows talks to NEST CIO Mark Fawcett about managing market conditions and compiling the best fund choices for DC members

Could you provide me with an overview of current market conditions?
It is pretty challenging at the moment, although the global economy seems to be growing pretty well. A lot of asset classes are looking fairly fully valued, and there are a number of risks on the horizon.
In the short to medium term we are seeing political risks. In Europe they have tended to subside a bit, but clearly we have the issue of what's going on between the United States and North Korea that is creating a lot of tension.

Longer term, we are concerned about the amount of leverage in China. So the amount of private debt in China as a percentage of GDP probably exceeds that of Japan at the peak of the bubble, so that is a ongoing concern.

And then finally, in the very long term, we are very aware of climate change risks and we are looking to manage those in the portfolio.

That's quite a few risks, both short term and long term, for pension schemes to manage. How do you recommend they handle changes in market conditions?
For NEST, one of the key ways we manage risk is through diversification. We invest in a range of asset classes, trying to take the opportunities that are available. So recently for example we added emerging-market debt and high-yield debt in addition to the equities and property that we are investing in.

Then we need to be proactive and innovative when it comes to longer term risks. So I talked about climate change being a key risk for us and we have started investing in a climate aware equity fund, which looks to overweight the beneficiaries of climate change, such as renewables, and underweight companies that are heavily exposed, such as companies with large carbon reserves or high carbon emitters.

And we dynamically manage shorter-term risks, so for example we've looked to hedge some of the political risk in Europe during the 2017 election cycle, through an equities derivatives overlay strategy.

While managing changing market conditions, how do you ensure you still maintain your own scheme's investment priorities? What are they for NEST?
We have very clear objectives for our membership. For us, understanding our members and meeting their needs is absolutely top of our list. So we have a number of investment beliefs that support that. For example, we believe taking investment risk is rewarded in the long term and that diversification is a key tool for managing risk. Our beliefs also guide our approach to passive and active investing. There's this myth that NEST is just passive because we are low charge, but we have a number of active managers in both credit and property. And then managing the long-term risks is really important, so that we can deliver a smooth journey and grow the members' pots over the long term.

I believe NEST has its own in house investment team. Is that an advantage in terms of ensuring that you always stick to your aims and objectives of meeting members' needs?
Yes, we as a house do a lot of research on our members to understand their needs and wants. Meeting the members' objectives is important and having the in house team means I can align their incentives with meeting those objectives.

The other key thing is academic evidence shows asset allocation decisions drive investment returns and therefore we make sure that we do the asset allocation in house and then we allocate to best in class managers for each of the individual asset classes.

So you provide a wide range of fund choice I assume?
Most of our members, and most of the members in DC schemes generally, are in the default fund. Typically something like 90 per cent of the members in DC schemes are in default. Ours is actually higher than that, it's over 99 per cent, so we put a lot of effort into designing the default fund and we have a series of 47 target date funds that are tailored depending on the age of the members.

But, default funds are not right for everyone, therefore it is really important to make alternatives available and provide clear choices. So we have five other fund choices, and they are very clearly differentiated in terms of the objectives, to the default fund. And because there's a carefully selected range, it's easy for the members to choose. So an example would be the ethical fund. The ethical fund is similarly diversified as the default fund, it has the same investment objectives, but it screens out companies that some people don't want to invest in, for ethical reasons, like tobacco.

How important would you say fund choice is to employers looking to select a pension scheme for their staff?
I think it's very important and employers need to know that their employees have a suitable range of investments. At the same time the behavioural research shows that if you give people too much choice, or if you give them the individual building blocks of different asset classes, equities, bonds etc, it's very hard for them to make investment decisions.

Employers don't want their employees coming and saying 'well there are 200 funds to choose from, which do I go into'? So keeping the fund choice relevant, differentiated and focused I think is vital.

As you mentioned, the vast majority of people will never move away from the default fund. So, for employers looking to select a pension scheme, a good quality default fund must be key. What are the characteristics of a good quality default fund?
The first thing is to have clear objectives, and objectives that are aligned with what the members need. For NEST, the first thing we did was do that research to understand what our members' risk appetite was likely to be, and understand what their end objectives were going to be.

Then it's really important to build in flexibility. We have flexible target date funds that allow us to adjust asset allocation. So when market conditions change, the economy changes, we are able to adjust. A good example is when freedom and choice was announced, and compulsory annuitisation was abolished, we were able very quickly to change the glidepath so that we were no longer targeting annuitisation but targeting the sort of strategy and portfolio that would suit members as they took their money out of the scheme at retirement. So having clear objectives, meeting member needs and having flexibility is important.

I think also, longer term, we clearly have a lot of scale. We have five million members, over 400,000 employers, and currently £2 billion of assets growing very rapidly. That's going to allow us to access a range of asset classes that aren't usually associated with DC, such as private markets, infrastructure etc. So I think employers probably want to look at the ability to get the benefits of that scale at low cost and have a truly multi-asset,diversified default fund.

To watch this video interview, please visit pensionsage.com

In association with nest

Summary
- Despite customers expressing a willingness to engage, actual engagement is pretty low.
- Giving too many options for customers is a bad idea – most schemes should only offer eight to ten funds, and make any more than that harder to access.
- Since most customers stick within a default fund, that remains the most important part of any scheme.

The needs of the many

How much choice should DC members be given with fund selection? Too much choice can leave members overwhelmed and disengaged. But no choice could put people off engaging with their pension savings. But why should schemes even offer choice if most do not engage? Peter Carvill examines these conundrums

It is a truth self-evident within the industry that our end customers, the pension holders themselves, do not engage with the product. And yet they should; slight differences today will make a huge difference tomorrow.

Engagement

The statistics are fairly stark. In *Damage by Default: The Flaw in Pensions Auto Enrolment*, a recent survey by Decision Technology, it discovered the depth and breadth of the ignorance of pension holders towards their assets: just under a third did not know who their pension provider was, four-fifths had no idea how much was in their pension pot, and more than nine out of ten did not know which funds their pension was invested in.

Other research, *Workplace Pensions: The Members' Perspective* by Price Bailey, indicates that two-fifths did not know whether they were part of a DC or DB scheme; around half did not understand the fees charged, their purpose of those fees; and despite 40 per cent saying that they actively wanted to avoid investing unethically companies regardless of investment performance, the majority did not understand in what companies or sectors their funds were invested in.

But the benefits of being engaged are obvious, no? After all, as Decision Technology writes in *Damage by Default:* "If people were to engage with their pension and choose a better fund to invest their money in, each employee could increase the value of their pension pot by an average of around £180,000."

Despite this bleak picture, there is no real dearth of pension holders looking to engage in thinking about their futures. Price Bailey also noted: "Over half of pension scheme members in England profess an active, regular interest in their pension savings and retirement planning."

But still, the authors add, "[...] half do not feel confident that they have the knowledge they need to make informed decisions about their retirement and – particularly among women – a lack of understanding is seen as the main barrier to being more engaged in pensions."

Choice

As a consequence, most find themselves within a fund's default option at the beginning, and then stay there. According to NEST, 99 per cent of pension holders within a fund go down this route. Other organisations, such as Fidelity, place this figure lower – 80 per cent of its members remain in the scheme's default, with only 45 per cent taking up the open market option.

So little engagement begs the question of why should funds work to offer a range of investment choices. PTL managing director Richard Butcher says that regardless of actual engagement, it is still best practice to offer a choice. "I'm not sure the two things go together," he says. "But the fact that they choose not to engage doesn't mean we shouldn't offer a range of funds. But when we set up the fund, there's still a default strategy that's designed around the needs of the average member."

In fact, says Butcher, the lack of engagement from pension holders may be of benefit to a pension trustee. "It may not be such a huge problem when it comes to actually investing," he explains, "as most of them tend not to make good decisions in this area. A lack of engagement means that we can put

them in a well-designed and managed default fund. Overall, that's probably a better outcome than them trying to do it themselves. The only thing we don't get enough engagement of is in their contribution decision. That's the significant leverage that they have and if we can engage with them more on that, the better."

Butcher points to what he calls the split between freestylers in a typical scheme. He says that you will often get a 25 year old with investments in cash or a 63 year old with their money in emerging markets or equities. Those choices, he says, may have been made for their own reasons but are not likely to be sound investment decisions.

For those that do engage, there is a risk of too few funds or too many. Give them a too-limited choice and a pension holder may become resentful, feeling somewhat powerless or as if they are being treated like a child. But at the opposite end of the spectrum from the illusion of choice is having far too many options. In that case, those non-professionals may find themselves overwhelmed and consequently become frozen like deer in headlights.

"Choice confuses people," says Butcher. "On the funds we work on, we usually limit the choice to about eight. So you'd have things like cash, property, diversified funds, etc..."

At this point, NEST and PTL diverge in how they approach the issue of too much choice. The difference between the two is small in principle, but important.

NEST CIO Mark Fawcett says: "While offering a small range of choices is better than offering a vast range, the choices need to be clearly differentiated and sufficiently different from each other so members know what they're getting. One of the main problems of too much choice is that all the fund options are pretty much the same as each other, so how can members possibly choose between them?"

In contrast, Butcher posits that an approach that gradually gives access to a great range of pension funds, but with progressively-tougher access. "If you don't like the default, here are eight other funds. After those eight, there's a further 20 but only accessible through a website. After that, there's another 100 but through a website with a login. If they don't like those, there's more—but they have to phone up the company. So if someone wants to look at 1,000 funds, they can. But they've got to be committed in order to gain access."

The present also brings challenges because many pension holders will have reservations about the type of investments that are being made, as it were, in their name. Price Bailey's figures show that over half (53 per cent) of respondents said it was important to them for their pensions to be invested ethically, in companies with good human rights records and high standards of socially-responsible behaviour. At the forefront of this was an aversion to investing in 'payday' lenders, which were held up to being particularly 'not acceptable'.

Fawcett, however, is keen to point out that SRI and ethical investing are two separate and distinct things. NEST, he says, applies a 'responsible approach' to all its funds. This is because, he adds, "*[this]* delivers better risk-adjusted returns. Some people want to invest according to moral or ethical convictions. That's a completely different issue."

Default

Questioning the number of funds, though, may be sleight of hand for the real topic: the strength of the default fund. Since so many never stray from this, a trustees' priority in this regard must be its strength; it is, after all, is set up to best serve the interests of the average member. On a Bell Curve of priorities, very few will deviate from this and, even then, probably not by much.

"Most needs are very similar," says Butcher. "So our members, by and large, are happy with the default. In fact, they're almost nearly always better off that way."

The ideal default, says Fawcett, will look and be constructed a certain way. It needs to be designed for the membership, to be flexible in order to enable dynamic risk management but also respond to change. Cost, he says, is also important, especially when choosing appropriate strategies for different asset classes and the delivery model. And it needs to have clear objectives that are tied into members' needs.

The key to good governance, then, is not to give members a huge number of choices but to give them the right options that are best suited to them. For most, that will be to remain in the default. As it should be.

Written by Peter Carvill, a freelance journalist

In association with nest

Continued innovation

Talya Misiri speaks to West Yorkshire Pension Fund business development manager Yunus Gajra about how the scheme has innovated over the past few years

Can you outline the make up and structure of the scheme?
West Yorkshire Pension Fund (WYPF) is part of the Local Government Pension Scheme (LGPS). WYPF administers the LGPS for over 285,000 members representing 422 active employers.

City of Bradford Metropolitan District Council is the administering authority for WYPF. Bradford Council's administering authority responsibilities are met by WYPF's in-house pensions administration and investment teams.

The WYPF is one of few funds that have introduced monthly contribution returns (rather than annual year end returns), what are the advantages of this method and has how has it been received?
WYPF was the first LGPS fund to introduce a comprehensive monthly data return for pension administration and contribution management. Prior to this we received annual returns of member records and contributions but monthly payment contributions and remittance advice, which we had to reconcile at the end of each year. The advantages to moving to monthly returns were: a reduced the bottleneck of large volume of year-end work and less delays in dealing with simple transactional errors, members records are much more accurate, removing inefficient, open ended, complex annual processes, introducing a simple, complete, accurate system where the remittance advice validated the amount of contributions paid each month.

It has enabled us to issue Annual Benefit Statements almost immediately after the March return and meet The Pensions Regulator's deadline of 31 August.

The project was well received by the majority of employers although some did express concern that this would cause them extra work. Some of the smaller employers were concerned that they would not have the resources to configure their payroll systems to extract all the information we required. For those employers we provided technical support either directly to them or to their payroll providers.

Can you explain the WYPF's activity regarding partnership working? What does the fund offer and how is this beneficial?
One of the key areas WYPF have developed partnership working is for the internal disputes resolution procedures. WYPF has developed knowledge and expertise in the internal disputes procedure and has been chosen by over 150 employing organisations (who are not in the WYPF) to provide this expertise at stage 1 of the procedures. This enables WYPF to pass on their expert knowledge of the LGPS and give an independent review of complaints. This enables employing organisations to understand their role better and review their processes and decisions to ensure transparent, consistent and fair decision making takes place.

Pensions administration has, in recent years, been faced with the challenge of declining resources, loss of skills and unfilled vacancies. At the same time, the implementation of a new, more complex scheme, coupled with wider regulatory and governance changes in the form of initiatives such as freedom and choice, the end of contracting out and the Public Service Pensions Act have combined to present LGPS administering authorities with considerable challenges. As part of the national LGPS framework for third-part pensions administration services, WYPF can provide resources to support public service pensions administrators and administration work areas, including but not limited to: GMP reconciliation, trivial commutation programmes, TUPE transfer programmes restructuring programmes, data cleansing and employer support, pension administration project management and multi-channel scheme communications.

Also, short-term pension administration support including: pensions payroll services, member pensions taxation support and pensions accounting and financial administration.

The WYPF has a shared service partnership with Lincolnshire Pension Fund, providing pensions administration to the LGPS and firefighters' pension schemes. What are the benefits of sharing services in this way? Are there any losses?
WYPF has also entered into a shared service partnership with Lincolnshire Pension Fund to provide a full pensions administration service for both the LGPS and firefighters' pension schemes. This includes pensioner payroll, all member

and scheme level events, reporting to statutory bodies, provision of data to external bodies such as the actuaries and LCC Resources Directorate for the production of the scheme accounts. This has a number of advantages and benefits for both WYPF and LPF, including increased membership leading to economies of scale and lowering admin costs for both WYPF and LPF, providing the scheme an extensive knowledge of the LGPS, fire and police pension schemes, duplication of costs for a pensions administration system is avoided as would duplication across other areas (i.e. newsletters, booklets, procedures, training etc), experienced WYPF technical team, which leads to an accurate and consistent interpretation and application of legislation to ensure correct payment of benefits.

Further to this, WYPF has specialised teams i.e. technical, communications, service delivery, contact centre, finance, IT, quality assurance that specialise in their own areas, where knowledge is shared across both funds.

WYPF has also been chosen by a number of fire authorities to administer the Firefighters Pension Scheme on their behalf. This has largely been due to them struggling to meet the complexities of the Fire Pension Scheme rules introduced over recent years. WYPF have a skilled and knowledgeable fire team that provide the expertise and specialist skills needed to ensure that all the regulatory requirements are met.

The WYPF has also invested in a transactional website for employers. Of the key functions on the site, you have enabled members to view, update and amend data, how is this information protected? Have you experienced any potential threats?

WYPF's transactional websites are secure using SSL certificates, which establish an encrypted connection between a user's browser or computer and WYPF's servers. This connection protects information from being intercepted by non-authorised parties. We also conduct penetration testing using authorised third-party organisations to try and hack into our systems.We have not experienced any potential threats.

Can you give an overview of the scheme's member communications strategy? What makes the WYPF different?

WYPF's communications policy has been prepared to meet our objectives about how we communicate with our key stakeholders.

Our key objectives are: to communicate the scheme regulations and procedures in a clear and easy to understand style, to use plain English for all our communications with stakeholders and to use technologies to provide up to date and timely information.

The fund is a corporate member of the Plain English Campaign and a number of booklets have received the campaign's 'Crystal Mark' for clarity. Each year members get the following communication items: an Annual Benefit Statement (actives and deferred), 'For Your Benefit' newsletters – tailored editions for active deferred or pensioners, a short Annual Report, and an Annual Meeting Report.

In partnership with Affinity Connect, WYPF launched a retirement workshop to support and guide members who are considering what retirement might mean to them. It has proved very successful with positive feedback from members. The workshop raises awareness of the key issues to consider and the decisions that members need to make regarding their retirement plans.

To ensure we're meeting the expectation of our customers, WYPF carry out a survey of a sample of members both online and via a paper version. Feedback is monitored and any corrective and preventive action is taken where negative comments or complaints are received. Quarterly reports are submitted to senior managers to review and is also shared with staff.

WYPF has introduced the use of Facebook and Twitter as an additional channel to communicate with our scheme members.

WYPF's Contact Centre provides a communication channel between the fund and our members and other customers. All our front line staff have attended customer care and telephone courses and we received some excellent feedback from members.

WYPF receives over 100,000 telephone calls per year to its small, dedicated contact centre. Last year we upgraded our telephone handling technology so we could add additional members of staff to this group to increase our capacity to handle calls at busy periods.

What area of innovation is the scheme most proud of?

The introduction of monthly contribution returns has made a huge difference to efficiencies and improved service, reduced cost and both improved compliance and satsifaction for members, employers and payroll.

Detailed knowledge of our pensions administration systems and software has also enabled us to develop streamlined procedures and processes to carry out areas of work that other pension administrators have stockpiled such as automated aggregation of employments.

Any other comments regarding the scheme's future plans?

WYPF continue to find innovative solutions to deliver a high-quality service to both our employers and members. We are also looking for opportunities to work collaboratively with other local authority pension funds to deliver high quality services and to further reduce costs.

Written by Talya Misiri

West Yorkshire Pension Fund

Getting animated, getting personal

Stuart Anderson explains how utilising gamification and mobile technology to provide tailored messages can increase pension savers' engagement

Summary

- Online communications can lead directly to increased contributions.
- Schemes' data can be used to create highly personalised automated communications.
- Mobile works better for groups with simpler needs.
- Jargon destroys trust and drives disengagement.

Over the past five years pension communications have had to deal with the introduction of auto-enrolment and freedom and choice, as well as the continued winding down of private sector defined benefit schemes such that, for active members, defined contribution is now the dominant model.

The same period has, according to figures released in August by the Office for National Statistics, also seen the percentage of UK adults accessing the internet via a mobile device grow from 36 per cent to 73 per cent. Ninety per cent of UK households now have an internet connection.

Today people expect to be able to interact and transact online. More than that, there is evidence that interacting with scheme members digitally actually helps engage them and stimulate them to take action.

Communications consultancy AHC chief commercial officer Francis Goss says: "For one client the impact of moving statements online was an increase in responses to calls to action from 23 per cent to 78 per cent."

Rain or shine?

One of AHC's projects is www.lvpensionsvillage.com, a website for members of the pension fund operated by life insurance company LV= for its own employees.

As well as providing a range of generic information, much of it in the form of animated videos, and member-specific functionality such as online statements and the ability to switch investment funds, the LV= Pensions Village site also includes a number of 'modellers'. One of these enables the user to input basic details such as their age, existing pension pot value, current salary and preferred retirement age, then use 'sliders' to model the effects of altering contribution rates, tax-free cash amounts, investment risk and retirement ages.

The results are represented in the form of an animated house and garden, with the weather changing from a

deluge, indicating that the member is horribly off-track, to bright sunshine for members who are on course to meet their objectives. The hard facts are also shown numerically.

"It does work," says Goss. "People say they have increased their contributions because they want to make the sun come out in the animation."

Getting personal

The LV= site allows members to personalise their own experiences. Some other platforms automate this element, proactively presenting each member with their own unique communication.

Employee benefits consultant Mercer has developed an offering that enables clients to generate personalised animated videos for each scheme member. These videos explain graphically, and via a realistic synthesised narration, how much the member has saved over the past year, how much it has cost them, and what their total pension fund value is.

They also provide a projection of how much pension income the member could expect based on their current position and contribution rate.

This, one might argue, is simply an engaging way of providing the information from a statutory money purchase illustration. However, the video also compares the projected monthly pension income to the member's current pay and suggests an increased level of contribution to get the employee on track and – vitally – ends with a button that members can click to increase their contributions there and then.

Another employee benefits consultancy, Hymans Robertson, has developed a service called Guided Outcomes (GO) which, again, takes scheme data and personalises the messages it provides to members. Its head of workplace savings, Paul Waters, says: "GO takes all the data from the employer and the pension scheme, looks at the member position and what level of pension the member might need and asks whether they are on track. It places everyone into a green, amber or red category – green meaning they are on track."

About one in four people tend to be "on track", he continues. "If you aren't green we'll tell you how to get on track.

"It is important to present people with a solution, rather than just giving them the problem to solve. Even if they have access to the tools and help to do it, they won't act."

Waters says that at one client, Scottish Power, one in ten people increased their contributions immediately after using GO. A year on that had increased to one in five with, on average, those people saving over 5 per cent more than before GO.

Getting the message

The information held by pension schemes and employers can also be analysed to help develop tailored messages that will resonate with different groups.

The Good Communications Guide, a website and resource library launched this autumn by the Pension Quality Mark, takes a marketer's view of pension communications. It represents members as customers who need to be understood, and communicated with, at an individual level.

The first stage it identifies is broadly to segment people into categories according to factors such as age, salary, seniority and gender. This can all be done using technology.

Then things get more human. The guide encourages communicators to brainstorm a set of priorities and attitudes for each workforce segment, which can then inform the messages that are directed to them.

It also recommends seeking feedback from members and that schemes should measure and analyse responses in order better to target future campaigns.

It is also important not to overload people with unnecessary information, which can turn them off. Aviva policy manager Dale Critchley says: "We have realised that the majority of members don't want to know absolutely everything about pensions and, as a result, we try to produce bitesize communications that clearly provide what the member needs to understand but then signpost to further information if this is required."

Going mobile

Online engagement may be increasing but how well these tools work on mobile platforms is hit and miss. This is not necessarily a problem, according to PLSA policy lead – defined contribution, Tim Gosling.

He says: "Mobile is clearly a way that a lot of people prefer to use the internet but I would want people to be making high-quality, considered decisions about their pension schemes. I don't know that you want people to be doing these things on the bus."

One group that it may be a good idea to engage on public transport, however, are the auto-enrolment target market, who tend to be younger, poorer, more transient and less financially capable than other occupational scheme members – and for whom a mobile phone number and email address can be more permanent than their place of residence.

The website of auto-enrolment provider The People's Pension is, therefore, designed with a "mobile-first" approach, according to director of policy and market engagement, Darren Philp.

He says: "What we want people to do first is to get to know their pension. So we would encourage them log in online and do things like update their beneficiaries.

"For most people that's all they want. They have the ability to change their investments but 99.4 per cent of members are in the default fund."

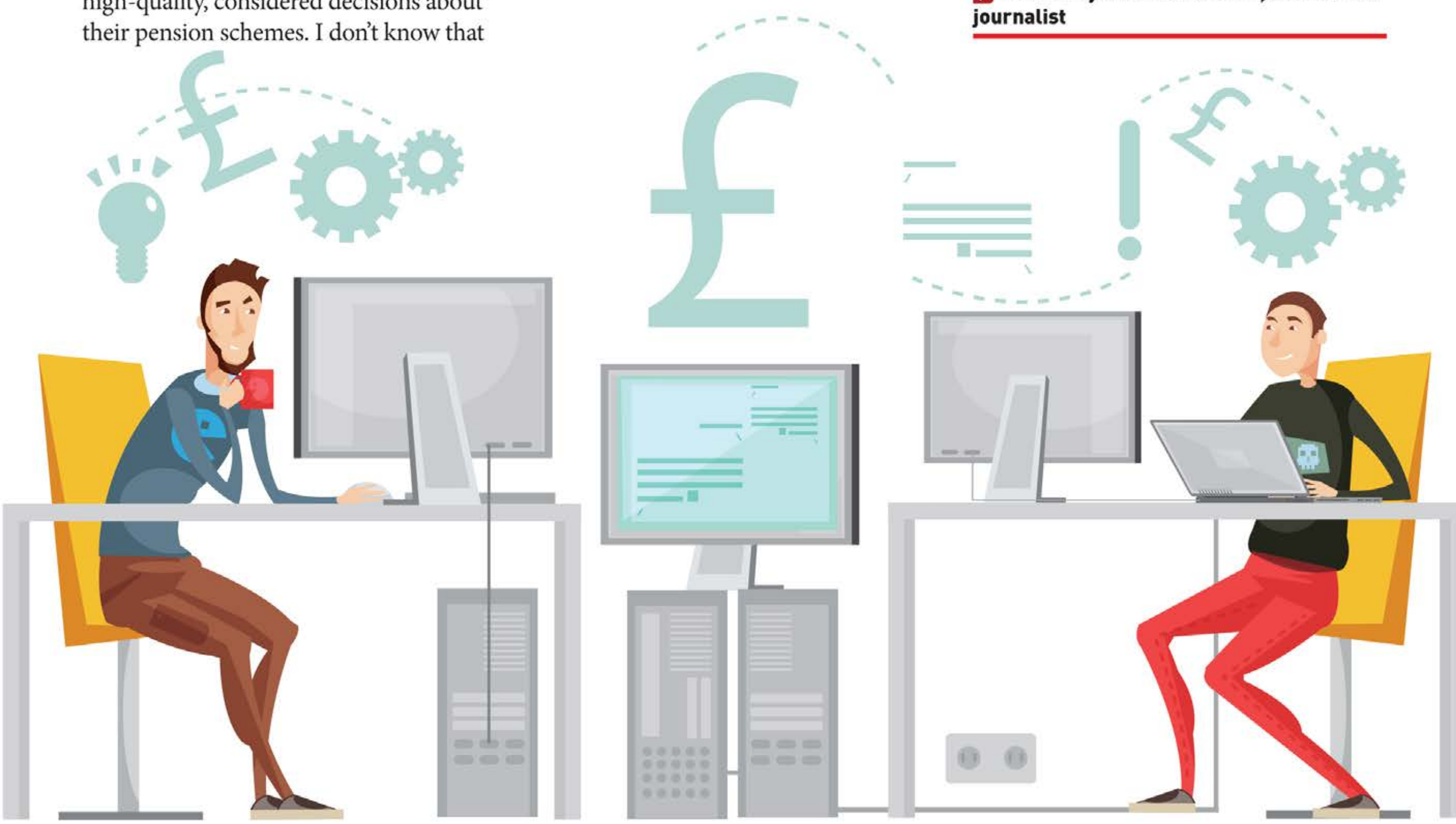
Watch your language

Whatever the medium, the most important thing is to communicate in language that members can actually understand, says NEST director of marketing Ranila Ravi-Burslem. NEST itself has developed a 'Phrasebook' and a 'Golden Rules of Communication' document, both of which are available in the Library section of its website – the Phrasebook under 'General information' and the Golden Rules under 'For employers and professionals'.

Ravi-Burslem says: "Use of jargon acts as a barrier. Trust underpins confidence in saving and if you talk to people in a way that makes them confused it makes them worry and affects their confidence in saving.

"We did some research in 2012 that showed one in three people were putting off saving for their retirement because they didn't understand the system. Make it too complicated and people just withdraw."

Written by Stuart Anderson, a freelance journalist



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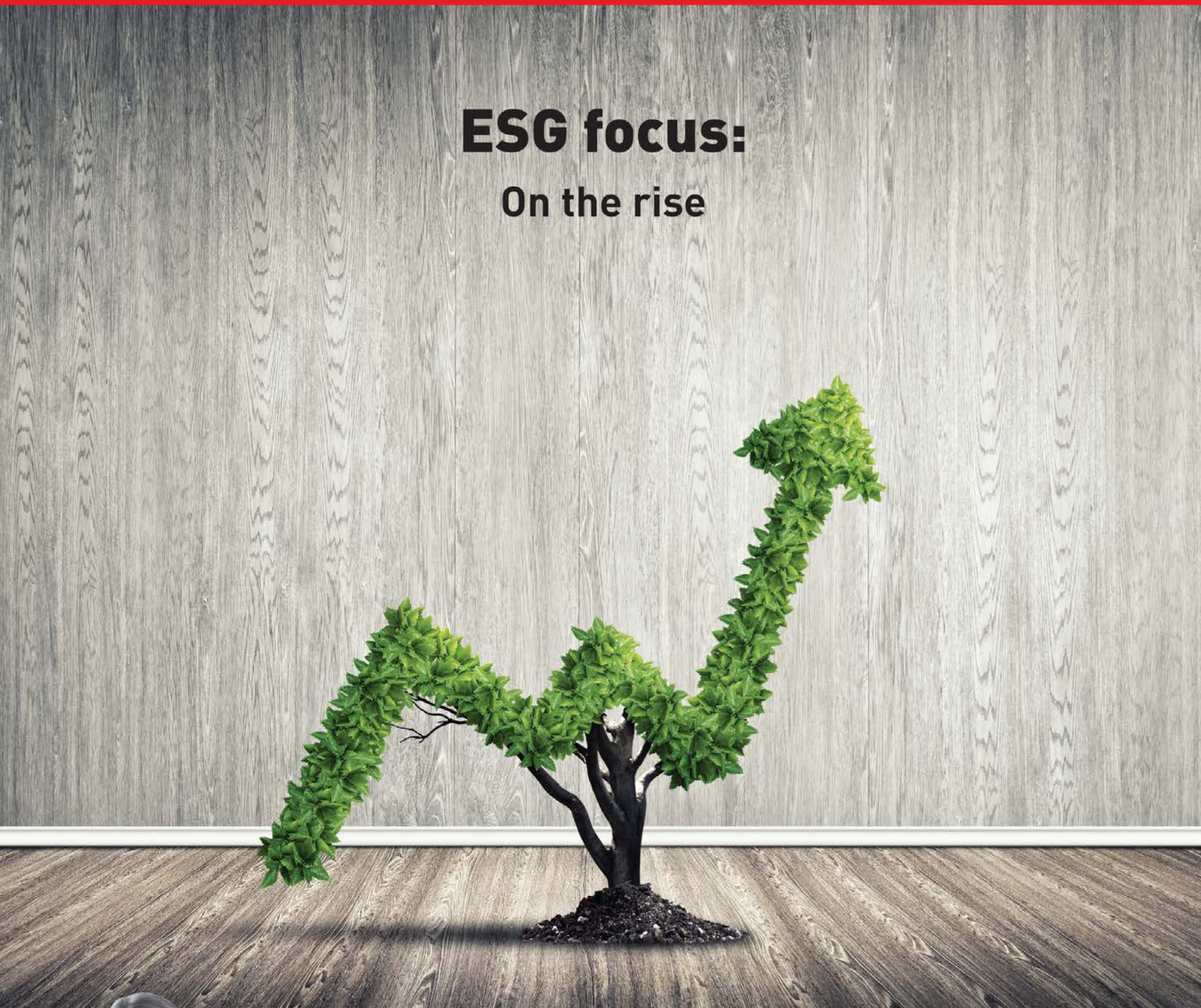
The accelerating growth of ESG – *Cindy Rose looks at the growing importance of environmental, social and governance matters within a pension fund's investment portfolio* ***p72***

Embracing ESG – *Andrew Williams examines why interest in ESG strategies continues to rise* ***p74***



ESG focus:
On the rise

Cindy Rose, head of responsible investing – stewardship, Aberdeen Asset Management

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The accelerating growth of ESG

Cindy Rose looks at the growing importance of environmental, social and governance matters within a pension fund's investment portfolio

Over the past few years, environmental, social and governance (ESG) and related types of investing have emerged as key considerations in investment analysis. Socially responsible investing (SRI), which involves screening out investments based on certain criteria, has been available for decades but investors are increasingly moving to a more nuanced strategy of integrating qualitative ESG considerations into investment analysis. The ESG approach aims to accurately identify the intrinsic risks and opportunities that an asset has to offer.

Why all the fuss?

ESG and SRI have been gaining international prominence in recent years. According to the Global Sustainable Investment Alliance (GSIA), assets invested in funds integrating ESG factors and applying SRI screens rose to $22.89 trillion globally at the beginning of 2016, up 25 per cent from the start of 2014. In the US, assets under management in SRI funds grew to $8.7 trillion, up 33 per cent since 2014.

The United Nations' 17 Sustainable Development Goals to be met by 2030 played a key role in increasing the awareness of social and environmental issues. The establishment of the Principles for Responsible Investment (PRI) was instrumental in underlining the importance of integrating ESG principles in investment management. And the 2015 Paris climate agreement (COP21) helped to unite the global response to the threat of climate change and will lead to significant reduction in carbon emissions. This sets a challenging regulatory backdrop for businesses around the world to adhere to.

National regulators and governments are increasingly focusing on how appropriate and transparent governance structures can support a higher degree of integrity and ethical behaviour. In some countries (particularly in Europe), a focus on corporate stewardship is a central part of the public policy agenda. Corporate governance failures (like the Volkswagen emissions scandal) and concerns about rising inequality in executive pay have driven ESG issues further up the agenda.

There is also growing acceptance that incorporating ESG factors is a key element of investment analysis and therefore an integral aspect of investment managers' fiduciary duty to clients. Funds increasingly need to actively integrate ESG considerations into the investment process to be considered for pensions mandates, particularly in Europe. Many investment managers are marketing their knowledge of ESG factors and launching funds for competitive advantage.

Aberdeen's long-standing record of analysis and integration of ESG factors as part of our overall stewardship approach places us among the leading investment managers capable of capitalising on the rising trend towards ESG, SRI and thematic investing.

A stewardship approach

ESG, SRI and thematic investing have always been integral parts of Aberdeen's stewardship approach, which (along with engagement and proxy voting) outlines the fiduciary role that we play as guardians of clients' money. ESG integration focuses holistically on the intrinsic risks and opportunities of our investments and thereby helps us to better understand the quality of an asset, along with its key concerns. The integration of ESG factors into our investment process has long been a core element of Aberdeen's investment philosophy, providing us with a comprehensive analysis of the risks and opportunities associated with an investment.

We may find that an asset has material risks with regards to governance, cybersecurity, labour standards, or bribery and corruption issues. By considering all the risks and opportunities that an asset offers, we can better understand its true quality, how much we should pay for it, how much of it we should allocate in our portfolios and where to focus our long-term engagement.

We also offer a variety of screened portfolios which help clients avoid investment in certain areas, such as tobacco, alcohol, weapons, child labour or animal testing. Finally, we have the capability to create thematic portfolios tailored to clients' needs. For example, if an investor wishes to focus their investments in a specific theme, such as renewable energy or invest in companies that have a lower carbon footprint, then we can create bespoke products to meet these needs.

Active equities

Our bottom-up stock selection process is long-established and, with lengthy average holding periods of generally eight years or more, we actively consider matters of long-term value for both potential and held investments. We maintain close contact with the companies in which we invest, and can respond pragmatically to their individual needs and seek to consider what is in the best interests of the company and its

shareholders at the relevant stage of its development.

By maintaining a positive working relationship we find we can often help companies find positive ways forward, and educate management about the expectations of their shareholder base.

Fixed income

Our approach from an ESG perspective is to examine factors which have a potential, material impact on the credit risk of the underlying investment. This includes factors such as remuneration, board structure, corruption, climate change, human rights and supply chain issues. We also look to engage actively where we believe this can add value.

Property

If both direct and indirect environmental and societal impacts are well managed, the portfolio risk of our property investments can be reduced, with higher rental growth and occupancy rates achieved. The consideration of ESG factors is integrated into each stage of our investment process – from allocation to selection and management.

Our approach is not just about saving carbon and energy. It's about managing our risks and increasingly operational efficiencies to the longer term benefit of building occupiers and ultimately our investors.

Alternatives

For indirect investments, our first step is to understand how managers integrate ESG considerations into their investment analysis and decision making. This can provide additional insight into the quality of a company's management, its culture and risk profile as well as identifying opportunities for growth and improvement. It is therefore important not only for value protection but also for value creation.

We have, and will, make decisions incorporating metrics other than just financial ones, including not progressing with an investment on ESG grounds even when on financial metrics alone we would have chosen to proceed.

Quantitative investments

We ensure that our stewardship across voting and engagement is as robust as appropriate for these equity holdings. We take up opportunities for dialogue with the boards of investee companies and regularly monitor business performance, governance and risk matters, seeking to maintain and enhance value over time for our clients.

Multi asset

Our multi-asset funds are built around a clear philosophy of diversification and utilising the team's expertise in managing the market risks of traditional and alternative assets. We are able to draw on the breadth of Aberdeen's investment capabilities, including ESG integration, to provide multi asset solutions to meet client needs.

Written by Cindy Rose, head of responsible investing – stewardship, Aberdeen Asset Management

Summary
- Typical environmental, social and governance (ESG) strategies can look at environmental issues, renewable energy use, fossil fuel divestment, management remuneration and labour rights throughout manufacturing supply chains.
- ESG is less about specific topics and more about an overall approach to investing.
- There has recently been a 'divestment spinoff', with pension funds diversifying from sectors such as tobacco and high-carbon companies.
- Research finds that ESG issues are moving up pension funds' agendas, which is in turn increasing awareness of ESG generally, beyond the sector.
- Pension funds are becoming increasingly aware that being an effective long-term investor means understanding how companies will adapt and change in the face of ESG pressures.

Embracing ESG

Andrew Williams examines why interest in ESG strategies continues to rise

The adoption of an environmental, social and governance (ESG) strategy is one of the key ways in which pension funds can reduce exposure to risk and manage ethical performance. So, what ESG elements are currently important to pension schemes and their members? What are the key recent trends? And is interest in ESG increasing amongst pension funds?

Robust approach

Typical ESG strategies can relate to a wide range of different elements, including environmental issues, renewable energy use, fossil fuel divestment and labour rights throughout manufacturing supply chains. However, according to Schroders' head of sustainable research, Andy Howard, high-profile topics like climate change, labour standards and management remuneration "'continue to receive a lot of attention". That said, he reveals that pension funds are also beginning to recognise that ESG is less about specific topics and more about an approach to investing.

"Their attention is shifting from 'how are you approaching a specific issue' to 'how are you approaching ESG investment and how is that reflected in the portfolios you manage." he says.

"Specific issues will always attract a lot of attention, but it's becoming more and more important to have a well thought through and robust approach to incorporating ESG trends into both investment decisions and engagement," he adds.

EUROSIF (European Sustainable Investment Forum) executive director, Flavia Micilotta, agrees that a successful investment approach should take into account all aspects of ESG, and argues that "no sensible prioritisation" can be applied in order to achieve a successful sustainable and responsible investment (SRI) strategy.

"Different pension funds decide to define their specific focus of investment, which is usually intertwined with core convictions and issues that are hotly debated at a national level," she says.

Micilotta also explains that, over the past year, the sector has experienced a 'divestment spree' – a trend that has been particularly boosted by the actions of pension funds like CalPERS, which has recently divested from tobacco and pushed to broaden the investment restrictions to also cover the debt externally managed portfolios of the Public Employees' Retirement Fund (PERF). In the UK, the National Employment Savings Trust (NEST) has also recently announced its support for higher environmental governance standards, as it divested £27.2 million ($35.9 million) from companies that failed to adapt to the low-carbon economy, including Exxon Mobil and Royal Dutch Shell.

Long-term view

Meanwhile, at Aberdeen Asset Management, head of corporate governance Paul Lee, contends that it is impossible to generalise about which factors are most important, largely because relevant ESG factors vary so much across individual companies and portfolios.

"However, the issue we are seeing gaining particular focus from clients is climate change and the associated challenges, particularly those seeking to assess and, over time, reduce the carbon-intensity of portfolios," he says.

The clearest example Lee has seen of this trend is a client that has set a baseline of CO2 emissions from its portfolio – calculated as its share of the emissions released by companies it invests in – and which is seeking ongoing reductions in emissions from this baseline.

"In effect, this is an asset owner equivalent of the government undertakings in the Paris climate accord. Increasing numbers of clients are seeking disclosure of the carbon intensity of their portfolios and we expect more and

more will seek reductions over time in some way," says Lee.

Elsewhere, Howard points out that Schroders recently commissioned a survey of over 700 institutional investors from around the world, which found that ESG issues have moved firmly up pension fund agendas – with over 40 per cent of respondents reporting that such issues were already important, almost as many again saying they were becoming important – and only one in five thinking ESG matters would not become important.

For Howard, this increasing willingness to take relatively long-term views is naturally going to raise the importance of ESG issues to pension funds, "particularly since pension fund investors expect to hold their investments close to five years on average – much longer than private investors".

"We are also seeing funds become more focused on new innovations in analysis and measurement. There seems a recognition that, while measures like carbon footprints have been around for a long time, the feedback we have had to some of the work we have done on climate risk measurement demonstrates a real openness to new ideas and approaches," he says.

Micilotta also highlights the fact that asset owners are now the true 'movers' in this space and points to the leadership shown by some of the biggest pension funds in the world. For example, this summer, Dutch funds PGGM and APG communicated about their focus on Sustainable Development Investment opportunities in favour of the United Nations Sustainable Development Goals (SDGs) and started working on devising ways to integrate them across their portfolios – a move she believes looks set to "transform the UN's targets into tangible returns for institutional investors".

In another example, Micilotta describes how the Japanese Government Pension Investment Fund (GPIF) has begun taking a strong position on long-term investing, following its decision to comply with Japan's Stewardship Code.

"This had serious implications on the new GPIF investment strategy, showing a clear link with the Stewardship Code, calling for stronger corporate governance, with renewed engagement expectations," she says.

"Today, the responsible investment strategy pursued by GPIF, characterised by a strong commitment to social and governance priorities, represents a strong force in helping to implement government policies while signalling a much-needed shift in priorities for the financial industry," she adds.

Key decision-making factor

In Howard's view, it is now very clear that interest in ESG-related investments is rising quickly across the major markets – a trend he believes is occurring for two key reasons. On the one hand, he explains that fund beneficiaries are becoming more aware of companies' impacts on societies and the impacts of societies on companies. On another, he argues it is becoming increasingly clear that being an effective long-term investor means "understanding how companies will adapt and change in the face of ESG pressures".

"We are well past the point of debating whether funds could or should consider ESG issues. Instead, the question is how we do so and how we measure its effects," he says.

Micilotta agrees that interest is increasing, and predicts that ongoing legislative pushes in "some countries and at a European level" is helping to heighten this interest. In Europe, she points out that some of the biggest pension funds, such as those in the Netherlands and the UK, have "always been very much in favour of sustainability and pushed greatly in this direction".

In her view, innovation has been more noticeable in those countries where the responsibility of larger pension funds to take into account sustainability issues is felt more strongly – whereas sustainability considerations "continue to be somewhat dismissed in countries where pension funds are small".

"The French Article 173 and the Dutch regulatory framework are both very good examples of ambitious agendas, yet it cannot be expected that all pension funds will be equally active on the ESG front," she says.

"The new European regulation includes several provisions for issues around climate change and ESG and further consideration on how to embed them in risk management as part of the investment policy and reporting. We hope to continue witnessing an increase in this trend, making sure that the legislative push can smartly enable pension funds to make better investment decisions in their role as long-term investors," she adds.

Although he admits there is certainly a continuing increase in ESG interest, Lee is also keen to stress that areas of particular interest vary between regions and indeed between individual clients.

"It is now rare to face an RFP *[request for proposals]* without questions on ESG and, whereas a few years ago this felt relatively superficial, it is now very clear from the intensity of interaction on these issues that ESG forms a key factor in many clients' decision making," he adds.

Written by Andrew Williams, a freelance journalist

In association with Aberdeen

Tomorrow's world

Those who correctly see which innovations will change the world can benefit from becoming early investors in these new solutions. Therefore *Pensions Age* asks the industry for its predictions as to which sectors will be the stars of the future

Electric vehicles and battery power

Electric cars present a disruptive force that threatens the very survival of traditional car manufacturers. Conversely, it presents a rich opportunity for disruptive entrepreneurs to seize a slice of the trillion-dollar global car industry. The biggest obstacle to mass adoption is price, with the large battery packs the main culprit. However, like other technologies, electric car technology is continually advancing and becoming cheaper. Following discussions with leading battery manufacturers including LG Chem and Samsung SDI, we believe costs will continue to decline far more rapidly than the market predicts, catalysed by scale increases, energy-density improvements, advances in materials composition and process enhancements.

Beyond 2020, we believe the cost structure of electric vehicles will surpass traditional vehicles. As well as substantial fuel savings, repair and maintenance costs will be cheaper because there are 90 per cent fewer mechanical moving parts, resulting in less wear and tear. This reduces the need for an extensive repair network. Additionally, the change towards internet-based consumer researching habits warrants a smaller sales footprint. This significantly lowers distribution costs for pure electric vehicle manufacturers, but will prove difficult for incumbent carmakers to adopt.

Standard Life Investments thematic strategist Frances Hudson

The move to electric vehicles (EVs) is beginning to be understood and recognised in the financial markets, but in our view the rapid development and deployment of energy storage technologies – while linked to the growth of electric vehicles – is even more significant.

Investors should take note – the battery era is upon us. This will have obvious positive implications for battery manufacturers and their suppliers, while electric utilities and automotive OEMs, worldwide, will need to adjust their business models to the new technology and cost regime.

Demand for battery storage looks set to increase rapidly, as adoption is being led both by the automotive market (via mobile batteries) and the electric utility market (via stationary battery storage). There are several reasons for this. Bigger and better batteries are needed to address the electrical grid problems caused by renewable energy. In addition, within the automotive sector, the fallout from the Dieselgate scandal and the advances made by Tesla Motors has forced other car manufacturers to launch their own EV models. This, combined with the rapid declines in battery costs (helped by huge improvements in cell chemistries and power density), have changed the economics of the industry.

KBI Global Investors senior portfolio manager Colm O'Connor

Healthcare
Med-tech, biotech, DNA-sequencing, gene editing, stem cells, phages and more contribute to a health care revolution where cost-effective treatments are tailored to individuals. Precise targeted approaches supersede broad-spectrum hit or miss solutions. Remote-controlled robots are utilised in delicate surgery and the barber-surgeons of history become the robot techs of the future. Autologous (self-sourced) treatments and transplants reduce risks of rejection. Examples include growing teeth or skin from stem cells, , tissue engineering, 3-D printing of replacement joints and bones, targeting specific cancer cells/types to effect cures and limit side-effects, editing mosquitoes to fight the diseases that they now carry and meeting the ultimate goal of reversing ageing in cells.

Standard Life Investments thematic strategist Frances Hudson

Cyber-security
Cyber-security may be an area long term pension funds could be interested in, with long-term trends underpinning the growth of the sector. High-profile data breaches have heightened corporate concerns and trends such as the internet of things increase vulnerabilities in the system. On top of this, there are growing regulatory burdens such as the EU's General Data Protection Regulation, which takes effect in May 2018.

The challenge with investing in long term themes is that the themes are often widely known in advance, raising questions as to how much value there really is in investing in them. Those who do invest for the long-term need to be able to ride out any short-term underperformance relative to wider equity markets, and maintain confidence in the ideas they have selected.

Fidelity International portfolio manager, multi asset, Ayesha Akbar

Food
Data abundance and new approaches to lighting allow for vertical production of food. LED lighting can be colour-tilted to promote photosynthesis and discourage pests. Hydroponics and Aeroponics reduce the need for land and remove pesticides and herbicides from the cultivation of crops as well as being much more water-efficient than conventional farming. Urban solutions take lessons in lighting from 'rhubarb triangle' warehouses in Yorkshire and current small-scale cultivation in brownfield sites, such as unused underground tunnels in London. Vegetable production is viable for widespread localised provision and can be GM free. More complex crops, such as grains, are in scope but laboratory-grown meat faces further challenges.

Standard Life Investments thematic strategist Frances Hudson

Suppliers
This summer it was 10 years ago that the first iPhone was launched. In just 10 years this device has changed from a mobile e-mail box and phone into a digital explosion of consumer services. Today 10 per cent of all our retail sales, 50 per cent of all our holidays and 33 per cent of all our relationships have started with a swipe on our smart phones. We believe that we are today at same point for the production side of the economy as we were 10 years for the consumption side.

The roll out of connectivity and digitalisation in our factories will lead to cheaper, more efficient and locally produced goods customised to the needs of every customer. In the next 10 years the roll-out of technologies like IoT, big data, artificial intelligence, robots and 3D printing will have given us cheap robot taxis and digital assistants. Just as with the consumer the digitisation of the producer will lead to lower barriers to entry. New companies will come with cheaper and better ways to democratise production.

On top of that, digitalisation will also kill the middle men in the production process. For instance, blockchains will simplify all financial administrations. A way to profit from these early but disruptive trends is to invest in suppliers rather than try to guess who is going to strike it lucky. It is for example hard to

determine who will launch the world's first self-driving car, but what investors do know is that these cars are full of sensors and powered by electricity so they can invest in manufacturers of sensors and batteries.

Robeco head of the trends investing equity team, Henk Grootveld

Written by Laura Blows

Summary
- The industry will be a follower rather a pioneer in adopting biometrics.
- Schemes will be 'jolted' into adopting biometrics – a case of 'when' not 'if'.
- Costs and reliance on traditional ways are holding back trustees and administrators.
- Biometrics should be higher on schemes' development agendas.

Going biometric?

Raji Menon considers how biometrics may play a crucial role within pensions

Biometrics is likely to play a key role in pensions in the future, but only after well established standards and procedures are put in place, according to industry players.

New technology through fingerprint, voice and iris scanning is gaining ground in the financial services industry, and there are calls for these new technologies to be implemented in the pensions industry to simplify areas of administration such as member identification.

Pension Administration Standards Association (PASA) chair Margaret Snowdon believes that pension schemes would benefit greatly from an increased use of biometrics.

"Biometrics is a great way to cut out hassle and cost for pension scheme members while at the same time reducing the risk and cost of fraud and mistaken identity," says Snowdon.

Snowdon says that as chair of the PASA, she is currently focused on improving the efficiency and reducing the "friction in pension processes", with technology and biometrics playing a key role.

Experts believe that while biometrics will play an important role in pensions, the industry will be a follower rather a pioneer in adopting biometrics.

Barnett Waddingham partner Paul Latimer says: "I expect the pensions industry will join in with the use of biometrics, but I do not expect them to lead or do so until protocols are proven and standardised."

This view was echoed by PAN Governance chief executive Steve Delo: "No doubt biometrics will have a part to play in the further future but I'd rather pensions was a later adopter of tested, robust, proven technology than in the vanguard."

PwC partner Peter Sparshott says biometrics would play an increasingly-important role in assuring the identity of a member and their entitlement to benefits.

He says: "It is not if this happens, but merely when. I envisage this is most likely to become mainstream following a major cyber-security breach occurring, which is also a 'when' not an 'if'.

"The industry rarely trailblazes, so until something jolts it to adopt it or until it is proven beyond reasonable doubt to be more reliable and robust than current methods, we will not see this uniformly adopted for some years - perhaps the mid 2020s."

Hurdles to implementation

Snowdon says that a key stumbling block to the wider use of biometrics is trustees who prefer traditional methods of member identification.

"Trustees may be a little reluctant to adopt it because it is new and often the old methods of identifying members by requesting certificates feel safe and foolproof, but unfortunately they are not. We all have examples of fraudulent use of certificates to claim benefits," she says.

Pension administrators too may be reluctant to invest in the technology needed to read biometric information, but the gains are worth it, she says.

Voice biometrics could be an easy way forward, but Snowdon noted that pension scheme members do not contact the administrator often enough for voice patterns to be established and updated.

"This issue is not insurmountable. The use of SIRI and similar help apps paves the way to comfort with adopting voice ID, but the technology is not full proof as some banking colleagues have discovered," she adds.

Voice biometrics came under scrutiny in May this year after HSBC's voice recognition security was breached by a twin mimicking his brother's voice to access his account, as part of a BBC report.

Delo says: "To my mind, the thought of trying to collect and maintain biometric data for pension scheme members fills me with dread. Data protection issues, security issues, volume of work issues, unintended consequences, timing. We've had trouble enough with guaranteed minimum pensions (GMPs), let alone DNA. Most pension schemes have missing address data – next stop missing face maps or fingerprints."

Sparshott says the accuracy of biometric software still needed to develop, mature and be proven.

He says: "After all, we need to recognise that even with facial recognition to unlock devices, there remains a one in a million chance someone else's face could unlock it. That's too much risk for pension schemes to accept at the moment, given the amount of money involved."

Latimer says that in order for third-party administrators to use biometrics to identify members, standards need to established, especially those relating to the type of biometrics being used, collection of data, amount of data points needed to uniquely identify the member, and how the member will present their biometric data.

He says: "We are all nervous about the data we entrust to companies. Is handing over biometric data going to increase that nervousness? We all know that passwords, and security Q&A can be a painful reality of interacting online and no one enjoys the security dance we have to do. However, a compromised password is easy to change."

A major study by HSBC earlier this year of more than 12,000 people in 11 countries found that four in every five people, or 80 per cent, believed that technology makes their lives easier but less than half, or 46 per cent, trust fingerprint recognition to replace their password, despite it being recognised to be at least five times more secure and significantly more convenient than traditional passwords.

HSBC says this lack of understanding and trust in technology was stalling mainstream adoption of innovative new services. The report says that education was the key to ensuring a greater understanding of new technologies. The survey found that trust in biometrics rose 6 percentage points after a short briefing.

Future role

Financial technology services firm Equiniti, which has been developing its biometrics proposition over the past 12-18 months, says its biggest challenge was adapting the technology to suit the current pensioner demographic.

Equiniti Data Services managing director Duncan Stevens says: "We have tried to ensure that our biometrics proposition is such that the current generation of pensioners feel a sense of familiarity with the technology they are using."

Equiniti's offering, which is expected to be launched in early 2018, is initially aimed at identification of overseas pensioners, but the firm is hoping to be able to incorporate biometrics across pension administration processes.

Citing the example of a pensioner in Australia, who would need to make a separate trip to authorised agencies to validate his identity, through biometrics, this pensioner would be able to do that in his own home.

"For a 90-year old, this could represent a real inconvenience if you have to make that trip to a local pharmacy or wherever. But with a smart phone and some instructions, the same pensioner would be able to do this in the comfort of his home," says Stevens.

Equiniti's director of pension administration and strategy Paul Sturgess adds: "While applying this kind of biometrics to overseas existence checking is clearly transformational, we believe biometrics can play a much broader role through all parts of the process, revolutionising the way pension schemes communicate and interact with their members. The key is the way the tools are integrated into the wider member journey."

Snowdon says the issue of adopting biometrics will become more critical in the future as competitive and cost pressures begin to bite.

"Schemes have more pressing problems, like getting their current data to a fit state before running to more sophisticated communications, but it will come to the fore in the next few years as FinTech grows and the need for competitive edge grows too," she says.

And with fraud on the rise, the use of biometrics should be higher on the development agenda than it currently is, she says.

Pensions communications firm AHC's head of web consulting and development Sam Charles says biometric security was going to continue to improve over time, with the biometric identity being paired with machine learning and other user characteristics such us using the accelerometer and GPS on a phone to monitor a user's 'normal' behaviour.

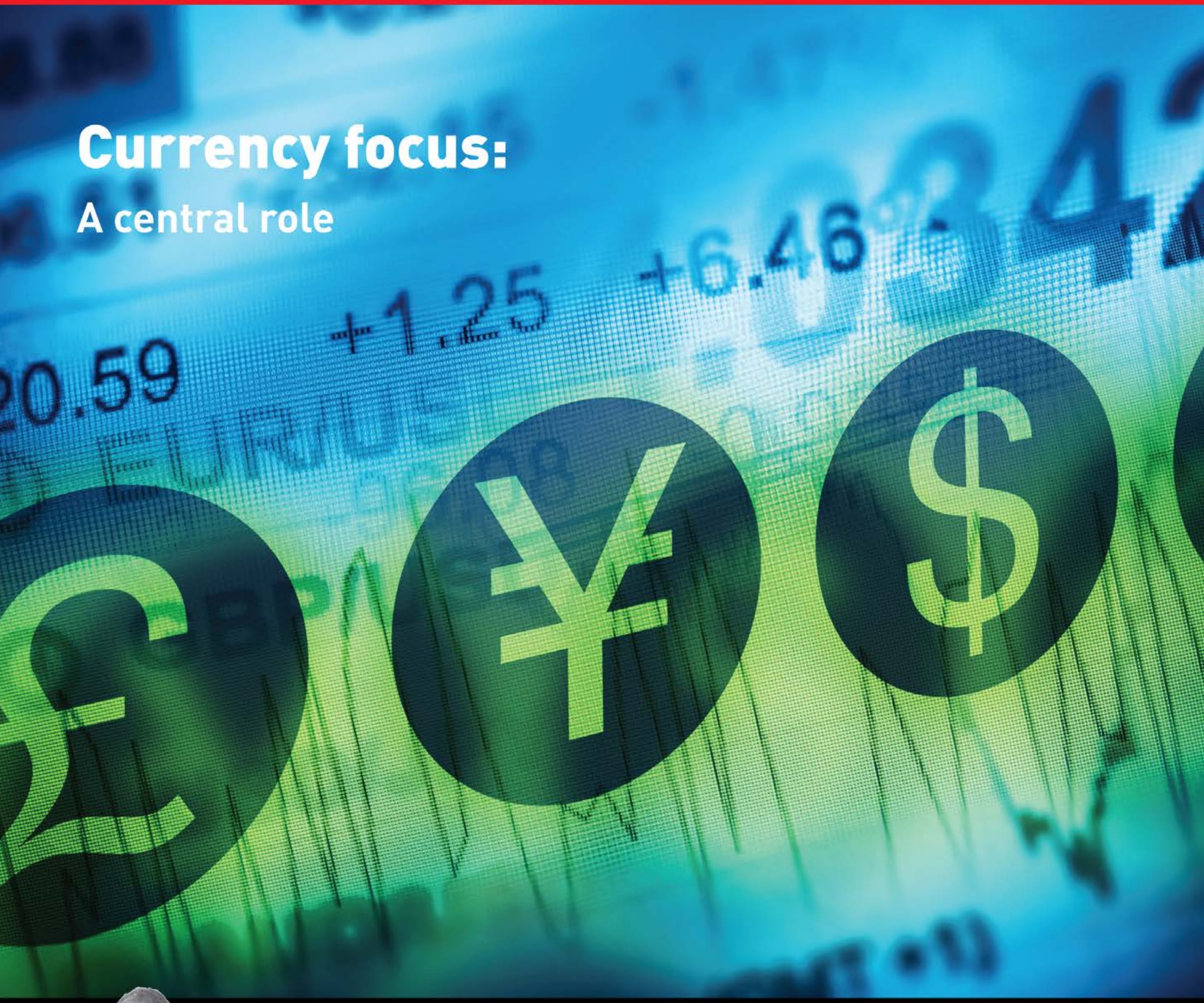
Charles says that for administrators, the most reliable way at present was to make biometric authentication available for members is through a mobile app.

Duncan says: "As the application of biometrics evolves, what will be interesting to see is how schemes communicate with deferred members for example, who tend to be largely unengaged. That will be the real revolution for us – making a reactive industry more proactive. That is the holy grail for us."

Written by Raji Menon, a freelance journalist

Currency focus:

A central role



Bob Noyen, CIO, Record Currency Management

Currency – in an (asset) class of its own

Bob Noyen explains the advantages of currency investment within a pension fund portfolio

Risk premia targeting return
Widespread discussion in the investment world focuses on the low-return environment, with the causes typically attributed to declining demographics and slowing productivity growth. While this analysis is both interesting and important, what pension funds and other institutional investors really need are solutions to this problem. One area that is attracting ever increasing attention from pension funds is risk premia investing. This aims to distil those underlying factors driving investment returns in markets, thereby saving investors from relying on opaque, elusive and often costly sources of alpha. The trend started with 'smart beta' in equities and has steadily grown through the addition of factors and into new asset classes, namely fixed income (or rates), commodities and currency.

Currency – apart from the crowd
Currency stands out for four reasons in particular: firstly, because a currency contract has two sides, it is inherently market neutral – in order to buy a currency (e.g. euros), one must sell another currency, (e.g. pounds sterling).

The second is that the majority of turnover in the foreign exchange (FX) market is not speculative or profit-seeking. The vast majority of the transaction volume serves other needs such as international trade, cross border investing and currency risk management.

Thirdly, for most pension funds in the UK, currency is already present in their portfolios but typically doesn't form part of the primary investment thesis. The reason for this is that funds gain exposure to foreign currencies when they make international asset allocations – thus foreign exposure is determined by the securities selected and not on the merits of the currencies themselves. Unlike certain asset classes, maintaining a fixed currency allocation in this way is not expected to add value over the long-term. Rather it is through exposure to risk premia – carry, momentum, value and emerging market (EM) growth – that currency can be exploited to target consistent returns. Each of these premia has a long, proven track record of positive excess returns and a sound fundamental economic rationale (see table overleaf).

Finally, currency investing is cost effective; strategy implementation costs are among the lowest of any investment strategy and the currency market is the most robust and liquid of all markets. Even during crisis periods, currency transacting typically continues in a predictable fashion at minimal dealing costs. Currency's advantage when considering risk premia investment is that a fund neither needs to double down on risk they already have (i.e. yet more equity), nor do they have to broach a completely uncharted asset class – it is more a recalibration of an investment they already own.

Diversification
As each of the risk premia exploits a different phenomenon (see table overleaf), they are expected to have different return profiles and to exhibit low correlations between one another. Additionally, each targets a different investment horizon – with momentum acting over the short term, carry performing in the medium term, and value and EM delivering long term – further adding to the diversification. This is borne out over a long history backtest where they show differing correlations with one another. While typically risk-on premia (i.e. growth in EM and carry) are moderately correlated, value appears independent of risk sentiment showing low correlations with other strands. Momentum improves diversification further showing negative correlations to both EM and carry.

While considering long term correlations is important, it is also vital to look at how a risk premia portfolio performs in times of market stress, such as during an equity sell-off. While carry and EM strategies typically react badly in times of crisis, large 'safe-haven' currency moves typically favour trend-following allocations like momentum and can often accompany strong corrections to fair value, which tend to be picked up in a value strategy. This highlights the benefit of diversification amongst a variety of risk premia.

Individually, currency risk premia show widely differing correlations to traditional asset classes. However, when taken together in a balanced portfolio, the correlations are typically marginally negative to global bonds and only moderately positive to equities, meaning that a diverse allocation to currency risk premia typically improves the risk return ratios for a fund.

Investability (see box)
Given that the low yield environment

Strategy		Economic Rationale	Characteristics
Developed markets	Carry	Countries with higher current account deficits offer higher real interest rates to attract capital investment	• Long high interest rate currencies • Short low interest rate currencies.
Developed markets	Momentum	Behavioural inefficiencies such as the tendency for herding and hoarding cause currencies to trend in the short- to medium-term	• Long upwards trending currencies • Short downwards trending currencies
Developed markets	Value	Currency pairs are typically anchored to 'fair value' causing them to mean revert over the long-term	• Long currencies that are undervalued • Short currencies that are overvalued
Emerging markets		High growth currencies tend to outperform low growth currencies through real exchange rate appreciation as productivities converge. There are carry and value opportunities as well.	• Long EM currencies • Short developed market currencies

In the EU, incoming regulation in the form of EMIR (European Market Infrastructure Regulation) will affect the treatment of derivative contracts. For deliverable FX forwards this means that pension funds and other financial counterparties will have to place daily variation margin from January 2018 which tracks the open market value of a contract. Nonetheless a currency risk premia program is likely implemented with a cash pot of only 5-10 per cent of the notional investment.

typically requires that investors put more risk on the table, it is ideal for investments to be capital efficient. Since currency programmes are typically implemented with FX forward contracts (deliverable for the most part, and non-deliverable in the case of capital restricted emerging markets) which settle at maturity, they currently require no upfront payment.

Liquidity

Since the FX market is the largest in the world, currencies are highly liquid, even those of emerging market economies, meaning there are very few capacity constraints. This high market turnover means that transaction costs are low and these two factors combine to result in highly liquid portfolios, which can be redeemed at short notice, even under stressed market conditions. This contrasts with private market investments which take advantage of the illiquidity premium and form another key part of the toolkit to increase return.

How can currency fit into a portfolio?

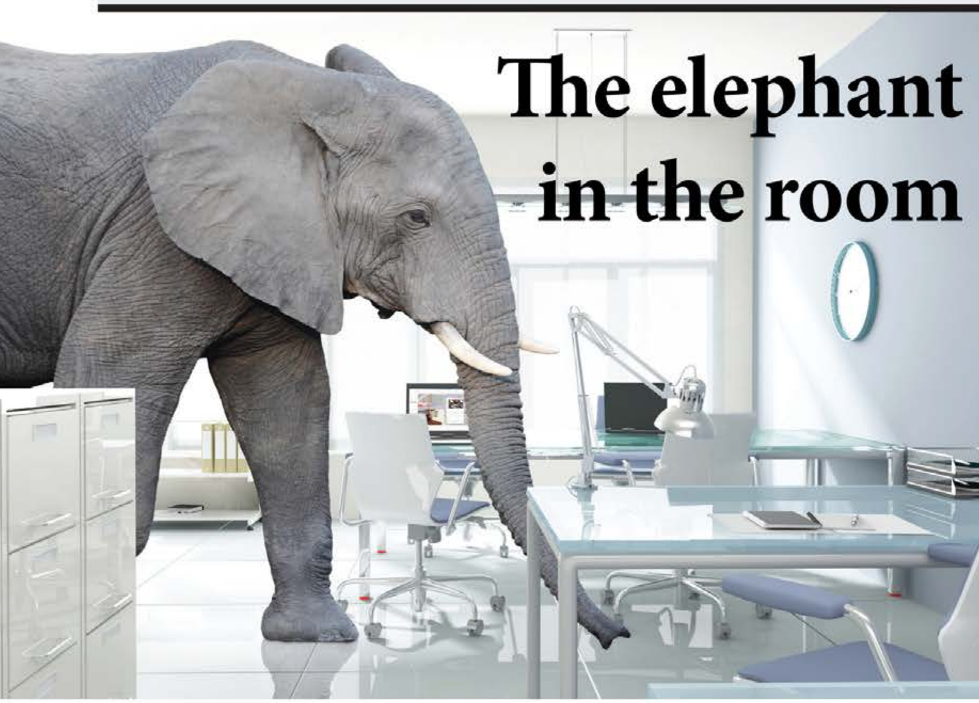
We see three common ways to integrate a currency risk premia programme into a portfolio. The first is simply to allocate a portion of an alternatives allocation to it. Another approach, taken by a US public pension plan client is to port an unfunded (overlay) programme onto an existing portfolio allocation. In this case the currency risk premia allocation sits on top of their global equity allocation, which already implicitly allocates to currency, to target some incremental, lowly-correlated return, with no further capital allocated.

A different approach in which we are seeing interest is the combination of a risk premia programme with a currency hedging programme whereby portfolio risk is reduced through currency hedging which removes unrewarded currency volatility. This extra risk budget can then be allocated to rewarded currency in the form of a risk premia programme.

Written by Bob Noyen, CIO, Record Currency Management

In association with

Summary
- Any pension fund investing globally has exposure to currency and can be affected by currency fluctuations.
- There are two types of currency management, strategic hedging, where the aim is to eliminate some or all of the currency exposure, and active management, which aims to add value.
- Currency hedging can help smooth equity returns.
- Currency as an asset class is extremely liquid with low transaction costs.
- One of the issues with currency is that returns materialise in cashflows, be it positive or negative.
- Active hedging with variable hedge ratios has generally been for sophisticated investors who have an in-depth understanding of currency.



The elephant in the room

While currency exposure may be in the background of pension funds' investments, Sandra Haurant explains why it should be at the forefront of investors' thinking

Currency is a bit of an elephant in the room for pension funds. It is there in a portfolio, taking up a substantial amount of space, but not always attracting all that much attention. "If you work on the assumption that a pension scheme is investing globally in various assets, then whether they like it or not, they get *[exposure to]* currency. Because if you decide to buy shares in Microsoft, those shares are priced in dollars," says Record Currency Management director, client team Carl Beckley.

Of course, currency fluctuations can have an enormous effect on returns. Movements in global currency can give portfolios a boost with minimal effort. Essentially, if sterling is down against the dollar, those Microsoft shares will increase in value without the share price moving at all. But, clearly, the opposite is also true – if the dollar plummets against the pound, US equities lose their shine for UK pension funds.

And with today's turbulent economic and political environment, the recent past has had some important lessons in this area. "The past year has highlighted the importance of carefully managing currency risk in a portfolio. During the latter half of 2016, following the Brexit referendum, we saw the sterling depreciate by over 10 per cent against the US dollar. This had a significant impact on many pension schemes funding levels," says GSAM head of the global portfolio solutions group for EMEA and Asia Pacific ex-Japan Shoqat Bunglawala.

Currency management

That elephant needs a little attention after all. "There are two types of currency management that pension funds are interested in," explains Aon Hewitt multi-asset investment manager Lucinda Downing. "Those are strategic hedging, where the aim is to eliminate some or all of your currency exposure, and the other is to try to add value from active management."

For many pension funds, the former type of management is often the most prominent, says Bunglawala. "Most commonly, we see pension schemes viewing currency as a 'risk management' function, rather than a 'return-seeking' function," he says. "It is considered mainly in the context of managing risk associated with overseas investments, particularly given the growing trend towards global diversification of portfolios."

Beckley adds: "Traditionally, pension funds and investment consultants in the UK looked on currency as a risk that needs to be hedged. Most bond managers investing in overseas bonds would automatically currency hedge, because a bond is effectively a currency with some duration attached. As such, it becomes very important for a bond manager to get their currency right. Equities are different, because they have higher volatility than currencies; theoretically, when you currency hedge equities, there will be a reduction in volatility, although since the financial crisis that hasn't happened, for a number of reasons," says Beckley. "When we look at the currency exposure in equities, from a tactical perspective it makes sense to currency hedge if sterling is expected to be stronger, but equally it would make sense to reduce hedge ratios or not hedge if sterling is expected to be weak and your overseas currencies are gaining in strength versus sterling."

In order to reach a happy medium, he explains, a kind of halfway house is often established.

"It has become a standard to say we will hedge 50 per cent (the position of least regret) of our overseas equity exposures – then if foreign currency strengthens, that's great – you will receive half of the increase and if sterling increases, you will receive half of the increase in value of sterling as a positive cashflow. Either way, you are participating in half the currency movement. The 50 per cent passive equity hedge has been the standard for most UK pension funds for many years."

Reducing volatility

This approach is not about gaining returns, but about reducing volatility. "Currency hedging can be very beneficial when a pension fund gathers together trustees on a quarterly basis. It helps smooth the equity returns and this in turn makes the decision making around other assets slightly easier. Many trustees and investment consultants think that is very worthwhile to have. The issue for some is, that it is not generating returns," says Beckley. "This means that historically a lot of time and effort has been spent on the hedging side if things, and very little on investing in currency and getting a return from it. Currency has not been looked at as an asset class in its own right – which it is."

The approach taken towards currency is, of course, different with each pension fund. "In some instances, more sophisticated pension scheme portfolios may take currency risk as a means of generating returns, for example as part of a dynamic asset allocation process, systematic currency carry strategies or as part of a hedge fund manager's toolkit to generate returns," says Bunglawala. "In these cases, these return-seeking currency positions will typically be modest in size, and form part of a portfolio diversified across several asset classes and strategies."

Currency as an asset class

On the face of it, currency as an asset class has several things going for it. For one thing, it is extremely liquid. Indeed, Beckley argues: "Currency is the most liquid market in the world. Currency trades multiples of global equity markets every day, so there is no issue with liquidity – settlement is two days." What's more, says Record Currency Management associate director, client team, Tom Arnold, it comes with low costs. "We find that, because currency is such a large market, the transaction costs are very low."

Funds, then, are accessible quickly and cheaply, as Bunglawala says: "Major currency markets are generally highly liquid and deep, and as such costs may be relatively low, making currency markets a good forum for expressing dynamic market views."

Of course, many argue that pension funds are well-equipped to withstand currency fluctuations, thanks to their frequently long-term nature in any case. "I believe that over time currency can ride out and complete economic cycles," says JLT Employee Benefits senior investment consultant Aniket Bhaduri.

And there are challenges – some investors may have been put off by previous experiences. "A lot of pension schemes have been burned from losses from currency managers from the carry trade," explains Downing. This form of strategy essentially involves borrowing currency in countries with low interest rates and converting it to currency with a relatively higher rate, with money being made on the difference between the two, and has risks attached. But, perhaps most challenging is the matter of cashflow. "One of the issues with currency is that your returns materialise in cashflows, either positive or negative," says Beckley. "It's not like equities, where you quite possibly intend to keep them for many years and receive dividends. With currency, if you are losing money, you have to pay money out; which can impact overall cashflow in a fund, there is no way to escape that, although it can be smoothed and it is possible that this will continue for some time. It is one of those things where you really have to believe in what you are doing and know that ultimately, over the years, you can get a positive pay off," he says. "It is not for everybody; many clients are happy with a 50 per cent passive hedge. Active hedging with variable hedge ratios has generally been for more sophisticated clients who have a more in depth understanding of currency and when they will get their positive returns."

Downing concurs. "That is something we are acutely aware of and we are address with pension fund clients up front. It's important to realise that a strategic currency hedge will require you to write cheques – you will make losses and add value and you have to have the governance in place to absorb this."

It's important, then, to not only learn to give currency, that elephant in the room, the attention it requires, but also to encourage it to perform. Because while it is almost unavoidable to have currency in a portfolio with global reach, it may be possible both to manage the risks and seek out ways to benefit from them. "Putting on a currency hedge is a nuanced decision that will be different for each pension fund. But I think there is room for the industry to take more dynamic approaches," says Downing. In fact, she adds: "I think currency is the next big thing."

Written by Sandra Haurant, a freelance journalist

The robotic revolution

Summary
- A recent report found one in three jobs are at risk of automation by 2030.
- Within the pensions industry, robotics could be used for low-skilled admin tasks.
- Robotics should not mean fewer humans in the industry, just a division of labour based upon the skills required.
- Robo-advisers have already entered the pensions industry, along with 'chatbots' for customer service roles.
- Another area where robots could be expected to play a role is in that of risk and fraud detection.
- Anutomation may result in people being able to retire earier.

Nick Martindale considers the impact of robotics and automation of the pensions industry

For decades there has been talk of robots taking over the world, as generations of children brought up watching *Dr Who* will be able to testify. Up to now, such developments have largely been confined to the manufacturing and industrial sector, but the potential of big data, artificial intelligence and machine learning mean this is now infiltrating other sectors. A recent report by the Bank of England and PwC estimates that one in three jobs are at risk of automation by 2030.

Automated processes

Within the pensions industry, there are a number of areas in which robots – or, more specifically, robotics – could impact both the number and nature of existing positions. Administrative tasks are perhaps the most obvious case, says PASA chair Margaret Snowdon, as computers tend to be faster and cheaper at carrying out relatively low-skill tasks.

"Logical and repetitive tasks can be done entirely by machine and that can include checking and quality control," she says. "We hold on to the notion that only humans can check and verify but, in reality, machines can do this far more reliably, provided they are properly configured. Machines can carry out calculations; produce and send letters; verify member identity; value schemes based on data, rules and assumptions; display benefits; offer options, request information; pay benefits, and report on activities."

At the moment it is only a lack of investment in such systems, compounded by poor data held by pension schemes and providers, that is holding this back. "Automation is not worth a candle if the data is wrong or missing," she warns.

Working together

Yet this doesn't necessarily mean jobs will disappear altogether. "In most cases this has not resulted in headcount reductions but more a labour shift into more technically demanding knowledge-based roles," says Trafalgar House director Daniel Taylor. "Machines excel at repetitive boring tasks, while humans excel as knowledge-based creative thinkers. If that equation holds, we are unlikely to see overall headcounts fall."

Further down the line, it's possible to see valuations, trading and policy amendments being carried out by robotics, as well as the more basic administrative tasks, says evestor.co.uk CEO Anthony Morrow. "However, there will always need to be some form of oversight of the systems that are being used," he says. "What we will see is that the oversight becomes higher up the organisation as the risks of things like artificial intelligence become better understood and therefore better managed."

It's likely that entirely new positions will be created, too, says at Voyager Solutions lead consultant Paul Taplin. "Humans will be needed to manage a robotised process, with tasks involving training and operational management of robots," he predicts. "A robot will also proactively require human involvement for advanced analysis, interpretation and decision making at certain steps, where insights and subjective assessment is required."

Robo-advisers

Increasingly, robotics is now starting to enter the advice space too. "Robo-advisers are live now, giving regulated advice on how much to contribute and where to invest based on client goals and personal circumstances, which product to choose, whether a blend of annuity and drawdown is a good match for their circumstances, and how to navigate the taxation landscape," says Wealth Wizards CTO Peet Denny.

With more people requiring financial advice in the wake of the pensions freedoms reforms, automated advice could help fill the gap for those with smaller pots. "Firms providing human advice will continue to focus on higher-

net-worth individuals, but it will become crucial to become more responsive as clients start to expect turnarounds of hours or days instead of weeks or months," adds Denny. "There will always be too few human advisers to service all of the need."

The use of 'chatbots' can also help with some customer service roles, offering responses to the more basic enquiries. "The robot is able to understand the intent of questions asked and convert a relevant answer back into a natural language response," says AHC head of web consulting and development Sam Charles. "For many people, this provides a more approachable means for software interaction – particularly as many chatbot interfaces mimic or use common text messaging services, like Facebook Messenger."

It's even possible that the use of artificial intelligence could extend to starting personalised conversations with customers or investors, creating a more efficient way of staying in touch without losing the personal element. "Automation in the client space is typically most advantageous when it maximises client engagement without as much human labour involved, for example, configuring persona-driven content that is served up in an investor's client portal," says InvestCloud EVP, Europe and innovation, Will Bailey. "The thinking is done by humans ahead of time to profile the investors, but the execution is done by machines."

Yet some form of human interaction is likely to be necessary when approaching customers or dealing with their enquiries, both to supervise any advice given out or to step in if customers want to speak to a human. "Some of the purely digital propositions recognised early on that customers – at least for now – still want humans involved, to help, to validate, to reassure," says Altus principal consultant Simon Bussy. "The key for firms is to work out which parts of the process, or which particular customer needs, can be automated without a problem, and which parts still need the human touch."

Risk management

Another area where robots could be expected to play a role is in that of risk and fraud detection. "One exciting and yet untapped development are the opportunities robots can bring to a risk-based operating model," says Taylor. "Currently, most administrators process work based on some broad universal principles. Robots, however, can be used to analyse, prompt and escalate cases based on a set of progressive, intelligent algorithms." Here, too, however, humans will be required to oversee decisions, and make the final call on any potential risks.

The rise of robots in society more generally will impact some sectors more than others. "The list is already long: from online travel agents to car factory bots to automated checkouts in every supermarket, even to journo-bots writing articles for the media," says Bussy. "In time, self-driving cars, lorries and other transport could take as many as 20 per cent of jobs in the transportation sector, while many service industry jobs are easy to automate. That could wipe out tens of millions more jobs."

Work impact

In turn, this could create issues around the volume of work humans are required to do, as well as raising the spectre of people in certain sectors not having – or being able – to work as long as they may once have planned. A recent report by the TUC called on the government, businesses and trade unions to work together to respond to the challenge of increased automation, including using the proceeds of higher productivity to reverse changes to the state pension age, raising the spectre of people spending longer in retirement.

This was also the subject of a recent conference hosted by Hymans Robertson. "If employment is limited to fewer people, it's not hard to imagine a scenario whereby the state pension is scrapped," says Hymans Robertson partner Calum Cooper. "If there is no work there is no pension." He moots the idea of a means-tested universal living allowance, where people of all ages receive a minimum level of income from the state.

Such a scenario, though, would have implications for employer and private pensions, too. "Pension firms must adapt their models, investments, risk analysis and internal processes to plan for very different time horizons," says Bailey. "Firms need to consider both the period of one's contribution to a plan, but also the ongoing commitments of the plan to pensioners."

Snowdon, though, believes that, in the pensions space at least, jobs are more likely to evolve into higher-level posts than disappear; something which could then allow people to tackle any more fundamental societal shifts. "Skilled pension professionals, freed up from boring, low-value tasks will be able to focus on service and the help that members want and this could be key to restoring confidence in the industry and in saving for retirement," she says. "It could help avoid the spectre of pensioner poverty. Now that's a future I would like to see."

Written by Nick Martindale, a freelance journalist

An automated helping hand

Investment automation is steadily playing a greater role in the pensions industry, as providers encourage older members of workplace pension schemes to go online for advice and guidance, reports Graham Buck

Summary
- Scheme members approaching, or in, retirement are being actively encouraged to overcome any 'tech-phobia' and go online to engage with their pension.
- However, workplace pension schemes still lag behind the advised/ wealth management retail pension sector in adopting investment automation.
- The launch of the pension dashboard in 2019 should provide automation with a major boost.

Since early 2016, TV and poster adverts have invited consumers to 'Just Nutmeg It' when seeking guidance on investment, savings and pensions. Behind the campaign's animated characters lies an online investment management app, promoted as a "smart new way to invest… in an industry renowned for being complex, expensive, opaque and intimidating".

As artificial intelligence (AI) and robo-advice move from the realm of science fiction to play a major role in financial services, investment is becoming increasingly automated. Online services such as Nutmeg and Scalable Capital offer online only-switching, real time valuations, managed portfolios and cost transparency on an app. However, as sellers of SIPPs these companies are absent from the workplace and their investment management services – including advice – are provided directly to customers rather than employees.

The term 'investment automation' encompasses a range of activities across the wealth valuation chain that includes supporting the advice – or guidance – process; a straight-through processing (STP) application; transferring money between parties; and managing the investment process and trades, says digital advice specialist Altus principal consultant Simon Bussy and his colleague Jon Dean.

They note that in the retail space, to date most digital/robo-providers have focused on automating individual savings account (ISA) and general investment account (GIA) new business.

"Only a handful of providers – such as Nutmeg and PensionBee in the direct to consumer (D2C) sector and EValue as a business to business/ business to consumer (B2B2C) supplier – have managed to develop a pensions proposition," says Bussy. "However, several providers are now developing retirement propositions as part of their robo-offering.

"Some focus on the accumulation phase while others are more interested in the consolidation/at-retirement and in-retirement phases, which will provide 'scale at speed' if they get it right."

Bussy adds that workplace pension schemes still lag behind the advised/ wealth management retail pension sector in adopting automation "although take-up of systematic transfer plan (STP) investment instructions via financial messaging service SWIFT is high between employee benefit consultants (EBCs)/third party administrator (TPA) firms and fund managers".

"The regulatory environment in the UK makes it challenging for digital wealth managers to launch a workplace pension," explains Scalable Capital's founder and CEO, Adam French. "The auto-enrolment legislation wasn't exactly written in a way that made it easy for new pension providers to get involved in that market."

The comparative lack of innovation also reflects the fact that scheme trustees are tasked with satisfying the employer they are running the scheme for the best possible value. So, for DB schemes, typically saddled with serious underfunding issues, managing down administration costs and asset/liability matching take greater priority than investing in the member experience.

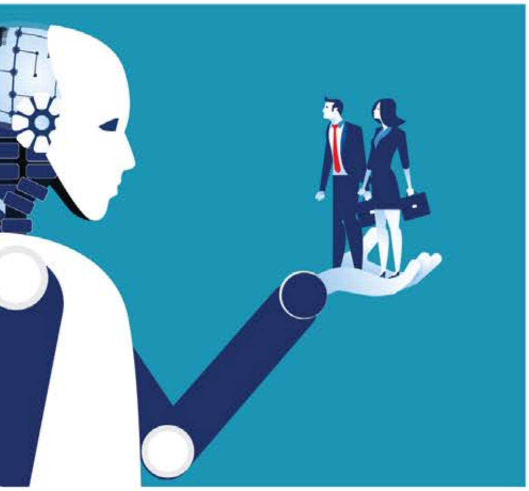
"That said, optimising the use of technology will help manage down the costs of operations and investment management," suggests Bussy. "If trustees can be convinced that an improved online experience with self-service, automated planning and guidance et al can significantly reduce headcount in the admin back office, this could be a major selling point to take to scheme sponsors.

"But with IT projects often absorbing significant budget, a disciplined approach and framework to developing or sourcing these improved services is required."

Promoting online

Investment automation is already revolutionising what was once the complex task of forecasting, as a typical worker has held 11 different jobs by the time retirement arrives. By using a series of algorithms a suitable asset allocation plan can be created for the individual.

"With individuals rarely working for the same company for their whole career, it is increasingly common to have pension pots with several workplace pension



schemes," says IG Smart Portfolios portfolio manager Oliver Smith. "Online operators offering SIPPs as well as retail investment products such as ISAs and the newer LISAs stand to gain market share as individuals look to consolidate their investments.

"Robo-advisers take into account an investor's goals and risk tolerance in a way that workplace DC schemes do not."

Aegon's head of pensions, Kate Smith, agrees: "Automation is now very much the name of the game, in encouraging more people to go online or onto an app and check how their savings are performing, how much they can expect to receive based on current projections, decide whether they wish to increase their contributions and perform other tasks."

Aegon's own Retireready is a precursor of the pensions dashboard that is due to be launched in 2019. It enables users to check on performance and contributions, with a retirement readiness score and income projections to aid their planning.

However, both Aegon and other providers have to address the fact that older workers approaching or in retirement may be more tech-averse than their younger colleagues.

"We try to encourage as many people as possible to go online and make things as simple as possible to help the process," says Smith. "However, we recognise that convincing them to do so is a challenge and there are still many unengaged individuals, so we actively promote the service in the workplace and get employers to do likewise."

LV= director of advice David Stevens agrees: "With workplace pension-saving increasingly being the mainstream environment for the long term, it's important people are encouraged to take control of their pension savings and get the best value from their pot when it comes to retirement. So it's vital that consumers engage with their pensions throughout both the accumulation and decumulation phases of retirement."

LV= launched its Retirement Wizard robo-advice service in 2015. This and other sophisticated advice solutions represent "the start of a financial intelligence and technology innovation that will empower consumers with better decision-making power and in doing so reduce risk to them as well as giving them confidence in their long-term savings decisions," adds Stevens.

Hymans Robertson head of workplace savings Paul Waters reports that employers and scheme trustees are starting to adopt robo-solutions. The firm's own DC pensions solution, Guided Outcomes, uses robo technology to guide members to a specific pension target, adjusting their contribution rate and retirement age as necessary, while LV='s Pension Compass range of tools is used by trustees to help DB members understand their options with regard to retirement flexibilities and links through to full advice where a member needs it.

Knowledge and nudging

Fintech companies focused on workplace pensions include Wealth Wizards, which has successfully carved out a distinct space for itself by providing more complex digital advice on a B2B basis. Abaka, an AI-powered mobile app, aims to assist employers with employee wellbeing by improving their financial knowledge and providing timely financial guidance.

"Trustees of DC schemes bear an added responsibility in ensuring that its members are able to maximise their retirement income and should do all they can to facilitate education," says Abaka's founder and CEO Fahd Rachidy. "With the demise of DB schemes, there is also recognition by employers of their social responsibility for ensuring their employees are well prepared for retirement.

"AI gives individuals the ability to create something that is personalised and engages them. However, the pensions industry is still too fragmented and creates technology barriers, which need to be removed so it's possible for them to connect with multiple platforms." Rachidy welcomes the upcoming launch of the pension dashboard initiative and would like participation to become compulsory for all pension providers.

"Greater pension freedom and choice has made the individual responsible for making choices on when and how much they want to receive, so access to affordable advice is vital," he adds. "People typically have received little in the way of financial education and sources of advice, beyond the money advice service, have been limited. Financial education should really become part of the basic school curriculum."

Added to improved financial knowledge, increasingly-sophisticated fintech can help those approaching retirement in calculating just how much money they need and will become even more refined in the years ahead, suggests Altus' sales and marketing director Howard Finnegan.

"To give one example, robo advisers ask individuals a series of questions, but their response might differ from one day to another, depending on factors such as the mood they're in at any particular moment," he says. "However, interesting new technology has been devised, which makes it possible to derive a much more precise reading for Millennials from their activity on Facebook and other social media."

Written by Graham Buck, a freelance journalist

In association with Capital Cranfield, MERCER, RBC Global Asset Management, LGM

EM roundtable

CHAIR

Andrew Cheseldine, Client Director, Capital Cranfield Trustees

Before joining Capital Cranfield, Andy acted as an adviser to trustees and employers at Watson Wyatt, Hewitt Bacon & Woodrow and latterly as a partner at LCP. Using his experience of over 30 years in consulting on both DC and DB pension arrangements and liaising with regulators throughout the pension and financial services industry, he is able to use his wide knowledge and understanding for the practical benefit of trustee boards. He has served on the PLSA DC Council since 2013.

PANEL

Jan-Hein van den Akker, Portfolio Manager, Mercer

Jan-Hein joined Mercer's investment management division as a portfolio manager in 2006. He is responsible for the management of all equity strategies, including fund manager selection, blending and monitoring. Jan-Hein also assists some of Mercer's large clients in the management of their bespoke investment strategies. Prior to his current role, Jan-Hein was a fund manager and subsequently director and head of manager research at Irish Life International Multi-Managers, which he joined at the start of 1999.

Richard Farrell, Associate Portfolio Manager, Emerging Markets Equities, RBC Global Asset Management

Richard joined RBC Global Asset Management as an equity analyst in 2013. Prior to joining the firm, Richard worked at Aviva Investors providing fundamental equity analysis in the energy and materials sectors within global emerging markets. Richard began his career in the investment industry in 2006 as an analyst in HSBC's corporate finance department. Richard is a CFA charter-holder and a regular contributor to the pensions and investment press.

Claire Franklin, Portfolio Manager, LGM Investments

Claire is a fund manager, emerging market equities, focusing on EMEA and Latam. She originally joined BMO Global Asset Management in 2006, and was one of the five emerging markets team members to become part of the LGM team in late 2014. Prior to joining the group, Claire spent three years with Sloane Robinson Investment Management. Claire graduated from Cass Business School, London with a BSc (Hons) in banking and international finance.

Clive Gilchrist, Deputy Chair, BESTrustees

Clive Gilchrist has over 40 years' experience of the pensions and investment industries and was, until 2010, managing director of BESTrustees plc. His early career was in stock broking and investment management, including 10 years as investment manager/director at the Post Office S.S.F./PosTel (now Hermes). He was a member of the PLSA council and investment committee for many years including two years as investment chairman. He has also chaired the pension committee of TACT.

Nicholas Hardingham, Portfolio Manager, Emerging Markets Debt, Franklin Templeton Investments

Nicholas is a portfolio manager and analyst within the Franklin EMD opportunities strategy group. Previously Nicholas worked as quantitative research analyst within the global fixed income group, having joined Franklin Templeton in 2002. He is a Chartered Financial Analyst (CFA) charterholder and earned a BSc. in pure mathematics from Imperial College, London and is a regular contributor to the pensions and investment press.

Donny Hay, Client Director, PTL

Donny is a qualified chartered accountant, with more than 25 years' experience in the pensions and investments industry. Prior to joining PTL, he was head of clients at Kempen Fiduciary Management, leading the client management team and working to develop the overall fiduciary management offering in the UK market. Before that, Hay spent three years as a professional trustee, where he represented a bank of 10 clients – ranging from £35m to £4bn – and has held various other roles, across a range of pension funds.

Ajeet Manjrekar, Co-Head, P-Solve

Ajeet focuses on working with trustees to understand their specific investment and governance needs in order to design innovative solutions to achieve their funding objectives. As a qualified actuary with extensive experience in both investment consulting and asset management, Ajeet is part of the senior management team with responsibility for the quality and evolution of P-Solve's client-driven services. He has extensive experience bringing together teams from different backgrounds to address unanticipated but emerging client needs.

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EM roundtable

Emerging markets: Seeking out the value

This month our panel of experts looks at what UK pension funds can gain from looking into the emerging markets investment space and how they can best access those opportunities

Chair: Can we start with a generic question about where we see emerging markets (EM) going over the next three to five years?

Hay: I'm quite positive – emerging markets had a terrific run up to 2012 and have really gone sideways until recently, both on the debt and equity sides. That seems to be changing, so I'm interested to hear what the managers around the table have to say today. In terms of putting some less correlated exposures into your diversified growth funds, which you need for pension funds and other uses, they've definitely got a place and I think active management is an area that aligns itself well here.

Farrell: I would echo that. The emerging market equities team at RBC turned positive in the middle of last year based on the indicators that we look at. There are two key aspects that particularly influenced our view. First, we were increasingly confident that the Chinese authorities had managed to retain control and that the Chinese economy had stabilised. That's obviously very much focused on the capital account and what we were seeing with regards to capital flight in China, inter-bank rates, and general liquidity.

Second, we were becoming considerably more positive in terms of returns for the overall asset class which were being driven by a recovery in margins. From 2010 to 2015 EM equities underperformed relative to developed markets; this was driven by a deterioration in the overall return on equity, which in turn was mainly driven by margins which we believe in the long term is mean reverting.

Certainly the recovery that we've seen in ROE last year has been very much driven by margins, and when we consider the supply side reforms in China last year and continuing this year, this gives us more confidence that this trend will continue.

Hardingham: I would also echo similar positivity in the longer term. In the short term, emerging-market debt is obviously highly influenced by what's going on with the global central banks as it's a long duration asset class, and 'the pull for yield' is potentially creating what we had in 2013, where you had that sharp exodus out. In some senses, we're back to that stage again. There are reasons to be optimistic and people have learned their lessons and they aren't going to be as surprised as before, but there is certainly an element of non-core EM money that is in the asset class, which is one area of concern.

But, from a longer-term perspective, you can look at the fundamentals and say that, generally, they are going in the right direction. There's been a lot of noise about individual countries – Russia, Brazil, they get the headlines. But when you actually look at where the general trend has been, there has been an improvement in the fundamentals: the debt levels, how countries are financing themselves and so on. So, in the longer term, it is certainly something that you want to maintain exposure to. It's just the short-term valuation at the moment that is a little bit questionable.

Franklin: We're slightly concerned about the short term and expect greater volatility in alpha. Equity markets, both EM and globally, have significantly benefitted from free money in search of higher returns. Passive money especially has driven markets higher. This can't go

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on indefinitely. So, slight caution in the short term but longer term, the reasons for owning EM equities remain the same. The core structural themes and the tailwinds are still there and it's about finding those companies that will provide the best exposure to that.

Manjrekar: There is clearly a long-term trajectory that continues to be in place if we dig down. With all asset classes like these, however, there are questions around when you want to go in, how much exposure you want to have and, given the market environment today – and certainly given the growth we've seen in the last 12 months – how sustainable that growth is. It's also important to assess what's driven that growth, ask where does it go from here, and ask how sustainable that growth is today, vis a vis the flow that's come into the asset class. So, we need to consider EM against a backdrop of where we are today and ask whether now is the right time to be ramping up exposure.

Gilchrist: I agree with all of that. The long-term arguments about growth – growth in population, growth in general well-being and wealth – all suggest that the emerging markets are the place to be in the very long term. In the shorter term, notwithstanding the performance that we've seen in the recent past, by and large, they're still cheaper than developed markets. So, if I have a concern, it's about markets as a whole, that everything's expensive. Within that, emerging markets offer value.

Van den Akker: I echo some of those comments as well – we have become more positive on emerging markets too. Over the long term, there's no dispute that emerging markets are very attractive from an economic perspective, but we all know that markets and economies don't correlate necessarily that well.

But nevertheless, it gives a significant tailwind to emerging assets and that's why we've become more positive in an environment where, compared to history, there are very few asset classes that look compelling from an evaluation perspective. Emerging-market equities is probably our favourite asset class at the moment.

Chair: Is EM just a leverage play?

Van den Akker: A certain part of emerging markets is somewhat a leverage play on developed market growth. But it's also clear that domestic development and emerging economies, because of the increased growth we've seen there, are becoming significant in their own right and that helps a lot of the more domestically-focused corporations within those areas.

Gilchrist: If you look at the markets as a whole, they still are a leveraged play on growth in the West and that is changing as domestic demand increases. If you're talking about stock pickers rather than index pickers, then there's a lot more to go for in terms of looking for the domestic biased stocks.

Manjrekar: Within emerging markets there is a lot of variation at a country level in terms of the environment within each of those countries, those countries' reliance on commodities or otherwise, or China and the linkage from that perspective. It's important then to dig down and ask: where is the opportunity you're trying to capture here?

We're all in agreement on the underlying drivers of growth productivity across emerging markets as a collective. But actually, you need to dig down, take a more granular approach both at a country level and actually ask: how can I access that local growth?

There are certain areas one might say in the past 12 months where exposure to energies, materials and technology from an EM perspective have been key drivers, particularly at an equity level, in terms of what's powered emerging market equity growth. But actually, how relevant is that to the underlying trends from a local perspective and how can we actually better access that? There are certain governance challenges in going more granular but that's an area we see as a key focus.

Franklin: You just can't look at EM as one broad asset class. The countries are so different, take Korea versus the Philippines. The sectors are so different, take consumer vs mining. And across the market cap spectrum the companies are so different – at the smaller end, more domestic oriented companies, at the larger end more state-owned enterprises or those that could be more affected by politics.

Drilling down to the companies, it's about finding the companies that actually give you exposure to the structural themes – favourable demographics, improving productivity from technology adoption and infrastructure development. It's about getting the right companies, those that are generating a robust cash flow that you can see being sustained over a five to ten-year period, and that have the right management that you can trust to deliver returns and increase shareholder value.

Hardingham: Those themes are also relevant to emerging-market debt. In particular, the growth that we've seen in the past 10 years has been on the corporate side – so debt issued by private companies. And here we find a very similar theme to what the equity-focussed managers are talking about: this growing importance of the domestic EM economy. The diversification that brings to EM corporate debt issuers is an important and positive development.

Something that may only be relevant for emerging market debt is the macro buffers that are being put in place to protect against potential future shocks including a growth slowdown in the West. Obviously there's been a lot of work done with the IMF and the World Bank about the correct policies to do this. So that's something which gives investors comfort because, yes, ultimately there is a huge influence coming from the West, but EMs are now able to withstand a negative influence better than before.

Farrell: The largest theme across all of our funds is domestic consumption. As a team we've been arguing for a while that emerging market equities are decoupling from developed markets. I think that this has accelerated in the last few years, perhaps even more so than people realise. If you look over the very long-term, going back to the mid-90s, using the MSCI index as a proxy for the market, Latin America made up over 60 per cent of the universe and that was very much a commodity-driven story.

As recently as 10 years ago, the energy and materials sectors combined made up around 40 per cent of the index. That's now under 15 per cent. So there's been a significant change in the composition of the universe. The sectors that have been growing have been the consumption sectors, financials and, especially in the past couple of years, IT.

So on that basis, certainly when you look at commodities, there's much less of an influence on the overall asset classes. When we did see the large fall in commodities, there was obviously an immediate negative impact on the listed companies in the commodities space. However, we argued at the time that Asia is a net beneficiary in economic terms of low commodity prices and I think we've started to see that coming through in terms of better economic growth.

The other thing I would say is that even when you look at the export part of the universe, what's been interesting over the last few years is that in global terms trade volumes have been pretty much flat and stagnant. However, if you look at intra-EM trade, it has continued to grow at a fairly rapid rate – high single digits or low double digits. Even when we talk about exports and trade flows, we seem to be seeing a decoupling beyond the shifting composition of the universe towards more domestic consumption.

For those reasons, as well as the increased flexibility in a lot of these economies – most now have free-floating exchange rates for example – we are more confident that, as an asset class, it will be less correlated to global markets and we think that will be a positive in the long term.

Hay: What I like are the economic and financial arguments. We've seen a move from West to East in terms of manufacturing and production. We're seeing the consumer playing a bigger role in those very large economies and valuations are attractive as well. When it comes to stock selection, you need to separate out the beta and the alpha. How much am I getting from the market? How much can a good active manager add on top of that?

The developed market is full of very well researched stocks where larger

stocks tend to dominate, making it hard to be a good active manager. You can capture those returns well by just replicating the index. But emerging markets are different. They're under-researched and there are plenty of opportunities for active stock pickers to make a difference whether that is selecting the right markets or stocks.

Gilchrist: There is an important debate to be had around whether one should be passively investing in emerging markets which, I think everyone agrees, is a collection of countries with totally different characteristics; or whether it's an area of the equity market where active investment can add value.

Chair: To take that a step further, should we be thinking of emerging markets as an opportunity for a smart beta type approach?

Van den Akker: Smart beta in many cases will be putting pressure on a lot of players within the investment management industry. There is pressure on fees for a lot of investment managers because of the development of smart beta products. Is it a valid way to go? I think we are in the relatively early stages of smart beta development. I'm not sure that the combination of a range of standalone smart beta plays will actually lead to good investment results for clients in the long term. We're still in the early stages and we still have a good way to go.

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Having said that, smart beta is clearly a valid development and it can assist individual corporate plans, individual investors, to assess where they want to have their exposure. It can help with risk management but we're still in the relatively early stages of that development.

Franklin: I would have thought that smart beta just displaces active managers that are closet index trackers. If a client is paying an active fee, they should get real alpha potential and that comes down to knowing your manager – how they invest? Do they do what they say they do?

Manjrekar: The role of smart beta has clearly grown massively in the last five to ten years or so. But there is a difference, to be blunt, in what is theoretical smart beta versus what is actually investable. That's particularly pertinent if you try and apply it to a universe like emerging or frontier markets in that context, from the practicality aspect, and the liquidity aspect. So, I do find the concept useful in terms of understanding where the value is being added from – let's call it a theoretical benchmark. But I would advise caution from an implementation perspective.

Hardingham: The whole notion behind smart beta is the correlation in the statistical modelling and one of the things I found in emerging markets is that they're prone to these big, one-off multiple-standard deviation events having shown very different characteristics leading up to that. So, that makes me a little bit concerned about how a smart beta process might deal with that. Certainly, from our perspective, using a quantitative approach to emerging-market debt has never really worked out. You can have steady correlations for so long but then the model could fail, and it could fail quite spectacularly if it's an emerging market.

Farrell: I think the rise in passive investment and smart beta in developed markets has happened partly because it's been difficult for active managers to outperform. However, I think emerging markets are different. One thing that's very clear is the large number of companies that have very little research coverage. Emerging markets small caps is an area that we like very much because as an active manager, we think there are a lot of opportunities to make large active bets there.

Also, when you aggregate the data on EM active managers, and if you try and remove the closet indexers that tend to drag down the average, you find that funds with fewer than 100 holdings and those with high active share and low correlation do outperform the benchmark and do also show persistency. From our point of view, this makes sense because we don't believe the index is a particularly good reflection of the overall universe and the market as a whole is very inefficient. If you take the EM universe and look at stocks above $100 million market cap, you're looking at 8,000-9,000 names. There's a lot of scope there if you're able and willing to take large active bets and also have a long enough time horizon for those bets to come through.

Chair: The analysts that you use to support your various products or work, are they more political analysts or economic analysts?

Franklin: Firstly, we use the sell side and external analysts in a very limited way. We focus very much on the bottom up – is it the right company, at the right price, does it have good corporate governance; a strong alignment of interests and a sustainable business model? And of course a good balance sheet. That's generally where we start and there has to obviously be an economic part to that. If we think the currency is going to significantly devalue, then that needs to be considered, or if inflation is going to be exceptionally high, we need to understand whether that company can pass through that inflationary impact on to their pricing? Do they have a strong brand and pricing power?

Just going back to China, we sometimes struggle to find the right companies from a bottom up perspective in China, even though everyone knows there's a huge opportunity there. There are very few companies where we find good corporate governance with alignment of interest and where they haven't got a significantly leveraged balance sheet.

Gilchrist: Talking about governance here, nobody's mentioned ESG or any of the other issues aligned to that which are becoming more relevant.

Franklin: ESG has always been relevant, hasn't it?

Gilchrist: Yes, but it's coming more to the fore and arguably is an even bigger issue in emerging markets than it is in developed markets. Given that we're talking about investing for the long term, because it's very difficult to make short-term calls, it then becomes more relevant. So how is it taken into account?

Franklin: We look at it in terms of the long-term sustainability of the business model; so, could environmental or social risks impact the business model long-term? Governance is just the underpinning of investing in the business in the first place.

On the consumer side, there can be environmental and social issues within the supply chain, for example high employment in agriculture. We think the best approach is engagement with the company. It's a huge learning curve sometimes for these emerging market companies. They don't have the same resource as in the developed markets to produce a huge 200-page sustainability report, especially if you're looking down the market cap spectrum. Engagement is needed on what practices they could be considering.

Van den Akker: I absolutely agree with those comments. A critical part of any investment manager's assessment of where to invest is what a company's attitude towards ESG factors is. In developed markets that's an accepted part of companies. Most companies will have their own ESG type charter or statement but, in emerging markets, it's a little bit more of an educational process. Our research shows that a focus on ESG issues or companies with higher ESG awareness in general leads to better returns. So it's an integral part, I believe, of investment managers' attitudes towards investments.

Manjrekar: Ultimately, where you have less analyst coverage, it's imperative that if you invest in a company you really understand the dynamics that are driving it. Good and effective consistent governance is key at the end of the day because there is, in certain cases anyway, less transparency, less disclosure and so forth, because they're on a learning curve themselves.

Therefore, it's imperative when we're talking to managers for us to find out what the dialogue is that they are having with each of the holdings that they have in their portfolio. That way, we can see how that's influencing their positions and their thinking.

Farrell: ESG has certainly become more topical. ESG has always been part of our investment process but was referred to as 'quality' in the past and the way we look at ESG is that it is an important element of the overall quality of a company. If you have a long-term investment horizon, then a management that is focused on ESG and the risks around that will develop a business model that's more sustainable and more robust in the long term.

The way we've looked at it and broken it down has changed over the years, but the overall concept is the same in terms of regarding those companies that focus on ESG as higher quality companies.

There was a research report recently that showed that while companies that are focused on ESG outperform, more important than that, those companies that gave specific targets on various metrics also outperformed companies that simply had a standard ESG policy. That's where active managers really need to engage with companies and talk to management to try and discern between those companies that are just saying what they think they should say and those that are genuinely working on it.

Hardingham: From a fixed income perspective, it's coming in through the corporates channel and I agree there is a lot more interest in it, especially on the governance side of things – understanding the ownership structure and so on.

Going back to our original question which was around economics versus politics – there you would look at the political governance aspect. These are emerging markets and some of the reason that they are higher yielding assets

is because of these problems or potential problems that you have there. That's something that, as an emerging market investor, you have to be aware of but you also have to think that you can't have everything. These are emerging markets and therefore ESG scores will be lower.

Hay: From a trustee perspective, a spotlight has been shone on costs and charges recently and there's a lot of work going on at the moment to make this area more transparent. Investors and trustees are very quickly learning there's a lot of things they didn't understand that they should have understood. I think it's the same with ESG. There has been a tick-box approach in the past but there's an expectation from members that asset managers are going to be investing with social responsibility factors in mind. So rather than just being a hygiene factor it can become a factor that differentiates managers. Companies that have very clear goals that link social responsibility to long term investing will be well placed to outperform as a result of that.

Gilchrist: The point is that it's an integral part of what is being done for long-term investment. That's always been my stance on ESG. I have never been in favour of tick-boxes and I believe it really is about understanding the businesses that you invest in. If ESG actually means something, and I think it does, it should

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be an integral part of investment analysis and it should come through in the financial numbers, not just a tick-box alongside that you can say, right, I've done that, I can forget about it now.

Van den Akker: One final point, I don't fully agree that there's no differentiation between investment managers. I think there is. There are some investment management firms that have best practices in this regard. Traditionally, you've probably seen bigger differences between active managers and quantitative or systematic type managers, where the latter might not have had the same level of engagement or focus on ESG related issues because they were harder to capture in the quantitative process. But even among quantitative managers, we've seen differentiation between the good and the not so good. It's the same with traditional fundamental active managers. In general, managers who have a longer term and lower turnover type investment approach tend to have a greater focus on ESG factors because they tend to be much more longer term in nature, and ESG is very much a long-term kind of process.

We've seen it even with more quantitative managers; even among index managers – there are clear differences in attitude towards how we implement ESG related and responsible investment type issues. So, I think there is a differential that you can find. Is that going to persist? I don't know. There's obviously going to be pressure for the ones that are not so good to improve their processes and I that's in everyone's benefit if that happens.

Chair: What do we think the impact of rising US interest rates will be on emerging markets generally?

Hardingham: The question is: will the rise be slow and measured or is it going to be quite aggressive? So far this year we've experienced the former and now people are becoming much more comfortable with the slower increase, but they are still going to go up.

A key point is that emerging markets have been extremely successful in terming out their hard currency sovereign debt – look at the Mexico 100-year bond and the Argentina 100-year bond for example. These are becoming more prevalent and therefore when you actually look at the asset class, it does have that long duration characteristic, and rising interest rates would obviously be bad news for that.

So, from a benchmark, headline perspective, yes, it's going to be a negative. But it really comes down to active management and managing around that and it's more about the pace of the adjustment that comes in. Everyone's very aware that this is going to happen. It's really just how fast it is going to be and whether or not that will tip investment growth.

Franklin: There are probably have a huge number of companies that have benefited from practically free money, even in EM. And for many this has been on the back of business models that aren't sustainable over the long term. So, higher rates will start to impact them. Maybe not near term but long term. That again comes back to my point that you've got to be finding those companies that require little or no capital to grow. They can finance their growth internally or require minimal debt. It's about identifying, companies with long-term potential, generating robust cash flows, less impacted by interest rate cycles.

Farrell: To a certain extent for emerging-market equities, it's already played out. When we've looked back to see other hiking cycles, what we've found is that emerging markets equities underperformed in the lead up to the first hike in anticipation of a new hiking cycle. After that, actually, emerging markets did okay. The last example of that was in 2004 when the Fed started hiking rates.

We've been talking for the last few years about the Fed hiking rates and it's now started happening. But certainly the underperformance that we had in 2015 was partly down to expectations of US rates increasing and the negative effect on emerging market equities. So, I think a lot of that is already priced in.

Also, we've had a large number of companies, particularly in China, that have switched their US dollar debt into local currency debt. So there seems to be a lot more resilience to rising rates if we compare to previous hiking cycles or the late 90s with the Asia crisis.

Manjrekar: For us good active management is the key in order to understand where you are taking risk, particularly when it comes to issues such as rising interest rates, so macro effects such as these really highlight that need to have effective active management.

Van den Akker: Emerging markets in many parts of the world are actually in quite good health, both from a corporate perspective as well as from a country perspective. The correlation with rate

In association with

hikes might not necessarily be as strong as in the past because of the position that many of those emerging markets are at this point in time. Policies have changed over the years. It's not the case everywhere but in many markets, it is and hence correlations may not be today as strong as they have been in the past.

Hardingham: Can I just add two points to that? One is that the technical position is much better. When you went into 2013, you had a straight line upwards for performance of emerging market debt and no-one was ready for what then happened. Now you've had a lot of variable performance and that bodes well.

The other point I would like to make relates to the corporate sector. A lot of people have made the comment that what's different this time is that you've got a far greater portion of these corporates which are funded from the bond market as opposed to the bank market. They've now got access to long-term, low-coupon debt as opposed to debt concentrations within the banking system. So that's actually one of the positives that suggests, again, that the fundamentals are improving and that they will be able to withstand rising interest rates.

Hay: It's not about whether interest rates are going to rise, it's whether they're going to rise more than the yield curve currently predicts. So, what's important are the expectations for interest rate rises and what we've seen is those coming back. The other side is that developed markets have accumulated a huge amount of debt as a result of quantitative easing and this needs to be unwound, which will hold back their economic growth rates. So, there is an opportunity for emerging markets to reassert themselves from both a growth and currency perspective As an investor, you'd want that to be relatively unhedged if you're investing in emerging markets to get that benefit from a return and diversification perspective.

Chair: Why use emerging markets in general in a pension fund portfolio and for those that manage money, why equities or why bonds?

Franklin: Emerging markets provide access to long-term growth. We'd expect them to grow faster than developed markets. This is underpinned by population growth – for example there are going to be around 200 million more people in India by 2030. Also, there should be tremendous growth in the middle-class population. Take Asia for example, its middle class population is approximately 600 million and that's expected to be 5x larger by 2030. That middle class is buying consumer goods, opening a bank account, and spending more on healthcare. Currently, 60 per cent of the world are living in rural areas, but in moving to the cities, income generally is three times higher. These are just a few of the reasons.

Chair: Why equities or debt?

Franklin: For me equities make the most sense if the goal is to participate in the long-term structural growth potential in emerging markets. There will always be instances where, from a risk perspective, perhaps owning a bond will make more sense, perhaps Brazil is a good example where the hurdle discount rate is extremely high for equity, but in general equity offers the best long-term return potential.

Hardingham: I would look at it from the portfolio holistic point of view and just having that different type of risk factor in a portfolio is key. So, if you've got a large pension fund, you should have an allocation to emerging markets because it's going to behave differently under different market conditions.

On the debt side, you're playing much more into the macro story and that's really why pension funds should consider debt as it provides a vast opportunity for diversification away from developed market cycles. It also gives you the interest rate factor and the currency aspect. I would add that you should invest un-hedged in local currency. By hedging you're just giving up most of the potential return there. So, in answer to the question, I would say 'bonds' – for that exposure to the macro side of things.

Farrell: I would suggest two reasons for pension funds to invest in emerging market equities in particular. One is valuation, at least on a relative basis, valuation is still compelling in our mind.

The second is what we talked about in terms of correlation and decoupling. We think that the correlation of emerging markets equities to the world is actually falling because of the reasons we have already discussed – falling exposure to commodities and increasing domestic consumption.

Furthermore, if you move down the market cap scale, the risk-return characteristics are very attractive. Small caps have had a higher return but actually lower absolute risk and correlation to global markets. So we would argue that having exposure to an EM all-cap strategy in a pension fund is important from an efficient frontier point of view.

Turning a crisis into an opportunity

Pensions Age asks: 10 years on from the start of the financial crisis, what lessons have been learnt by the pensions industry?

During the financial crisis models were blamed for creating the financial stress, but 10 years on I think it had more to do with wrong use of those models. DB pension funds are not investment banks and they should not rely on investment bank models to manage their risk. Pension funds are supposed to be able to absorb risk under normal market conditions within certain scheme-specific Value at Risk (VaR) limits.

It is the risks beyond the VaR that require contingency planning. The crisis has shown that pensions deals were incomplete in the sense that risk was not fully accounted for and bearers of risk were unaware of what risk they owned. In a period where trust in the financial system was already low, this dealt a lethal blow to DB pensions. With the move to DC, pension providers should avoid repetition by making sure they steer towards the true objectives of the members, which are very much DB-like. Their products should help members to balance savings, investments and ambitions over their entire life-cycle, pre and post-retirement, and including more life events than pensions alone.

Ortec Finance managing director Lucas Vermeulen

The financial crisis demonstrated the need to look more closely at the correlations of asset classes within pension portfolios. The diversification benefit pension funds thought they had, simply wasn't there when they needed it the most. As such, we've seen a greater focus on risk management within portfolios and a move to investment strategies that offer capital perseveration and returns uncorrelated to traditional asset classes. Given continued market uncertainty, investors increasingly see value in trying to build in asymmetric profiles into their portfolios to provide protection in the case of market drawdowns. As defined contribution pension funds grow and we start to see the first employee cohorts retiring with only DC pension provisions, ensuring that portfolios are protected against market shocks but still able to generate strong returns, will be of great importance.

Invesco institutional sales manager – UK, Dean Heaney

It's a natural human reaction to overcompensate for past mistakes when things go wrong, like a driver who oversteers when correcting a drift out of line. The financial crisis and continued low-yield environment highlighted the risks for pension schemes of traditional investment strategies leading to a massive move towards matching assets to protect funding levels. Schemes are now being a little more imaginative in their choice of asset classes but advisers and trustees are still being extremely cautious having had their fingers burned. My concern is that there is still a herd mentality and the industry as a whole is repeating the same underlying mistake of following accepted wisdom without real challenge. We need to be faster to respond to changing circumstances.

Society of Pension Professionals president Hugh Nolan

Pensions suffered reputational damage following the financial crisis, partly by association with the financial industry in which they operate. I'd like to see the pensions community focus more on rebuilding its reputation among its beneficiaries by differentiating itself more clearly from the financial giants that have been widely blamed for the crisis.

Ensign Retirement Plan CEO Andrew Waring

Ten years ago, there were more static allocations that relied on diversification and time as the sole approaches to managing risk. The crisis highlighted that diversification can fail you when it is needed most. Today, there is a better use of information and scenario testing to understand risk and a greater willingness to change portfolios to reflect market conditions and investment needs.

Russell Investments head of client strategy and research David Rae

One thing we have not learnt is that a period of austerity and mistrust is the very time you need to invest in making it easier for people to see, touch and feel their pension savings and to be transparent about costs and charges. We should have been investing in efficiency (digitalisation, consolidation and reducing friction in processing) to ensure that scarce resources go towards things that create better member outcomes.

PASA chairman Margaret Snowdon

There are modern laws against cartels, but the pensions industry can look like a cartel in its notorious tendency towards herding and adoption of narrowly defined conventional wisdoms. Similar behaviour by the banks was a cause of the financial crisis. The widespread loss of faith in 'jam tomorrow', exacerbated by ultra-low interest rates and gilt yields cemented by quantitative easing, makes fertile ground for disruptors. Creative new approaches for saving require incentivisation to succeed. Negative disruptive activity that drains the pot for tomorrow's income needs to be restrained.

Aries Insight director Ian Neale

The simple answer to this question is "None"!
There are signs that pension providers are slowly trying to deliver but legislation, especially on tax incentives, remain firmly in the dark ages. The term 'pensions' has never resonated with the younger generation. Tax incentives are still squandered on the very wealthy with 50 per cent of the £40 billion per annum in tax relief falling into the hands of high rate taxpayers. Eight per cent of taxpayers earning above £50k pa receive almost 50 per cent of the entire tax relief budget. This is HMT not learning lessons of course. We have not seen too many lessons learnt at default fund level,with the difference between top performing funds at circa 11.73 per cent annualised and the bottom being 2.8 per cent annualised suggesting there is more to do. I cannot ignore the little matter of how the income stream is taken. Annuities have been thrown away although they might be right in some situations.

Salvus Master Trust managing director Graham Peacock

One of the biggest impacts on the pension industry was the lowering of interest rates. This led to increased liabilities for DB pension schemes and the consequent increase in Cash Equivalent Transfer Values. Another lesson learnt was that communication is key. Clients need reassurance that investing is for the long term and they should not sell their investments when markets fall.

The Pension Review Service managing director Mark Abley

The belief that consultants (or anyone else) can construct an asset allocation across global or local equities, emerging markets, bonds, real estate and alternatives, and at the same time fully understand the correlations between all of these markets was severely shaken in 2009. As a result, investment styles have started to change and we have seen the creation of new types of products. Pension funds have been moving away from benchmark led products as a way to access individual markets and there has been a shift back towards absolute return and multi-asset solutions. Changing regulation, which followed the crisis, has also been the catalyst for the realisation that there are a wide range of new and interesting investment opportunities for pension funds that were once the preserve of banks only.

M&G Investments director for alternative credit Jo Waldron

One key development is the higher standard of due diligence undertaken on investment managers, more specifically, operational due diligence. Whilst this is an appropriate and necessary development, a subsequent consequence is that pension funds have tended to deepen their relationships with existing investment managers in order to narrow the range of counterparties they are dealing with. Investing so much more time in due diligence, the natural preferences is to do more with those managers that pass muster rather than broaden the number.

Robeco UK head Peter Walsh

Financial crises throughout history should really have taught that excessive leverage invariably ends badly. A decade later we may not have learned enough. Economic conditions have failed to revert to anything that approximates a 'normal' environment, with advanced economies still overly dependent on liquidity and leverage (rather than productivity gains) to deliver economic growth. Instead of the private banking system, this liquidity and leverage is now mostly supplied by central banks.

Insight Investment CIO, active management, Adrian Grey

Society of Pension Professionals president Hugh Nolan

What is your pensions career CV?
It began as actuarial student, consultant and administration manager at Clay & Partners (eventually part of Aon) from the late 1980s to 2000. I then spent a couple of years as an actuary at Mercer in Watford before joining HSBC Actuaries and Consultants Limited (later JLT). Then I spent 14 years at HSBC/JLT, culminating in a role as chief actuary. After that I joined Spence & Partners in early 2016. Also, I am the current president of the Society of Pension Professionals.

What is your greatest work achievement so far?
I negotiated an absolutely fantastic pensions deal in an acquisition once, but then the deal fell through for other reasons and totally ruined that achievement. My greatest satisfaction comes from helping clients through a tricky situation and especially when I see the excellence of some of the people I've recruited and trained over the years.

What do you still wish to achieve?
I would love to persuade the general public how wonderful pensions are. That's a real challenge at the moment with so little trust in experts and financial institutions.

What is your biggest regret within your career?
Literally none. There are lots of little things I could have done better but it's hard to have any major regrets when I still love what I do every day after almost 30 years.

Excluding your current role, what would be your dream pension job?
Secretary of State for Work and Pensions.

Fun and games

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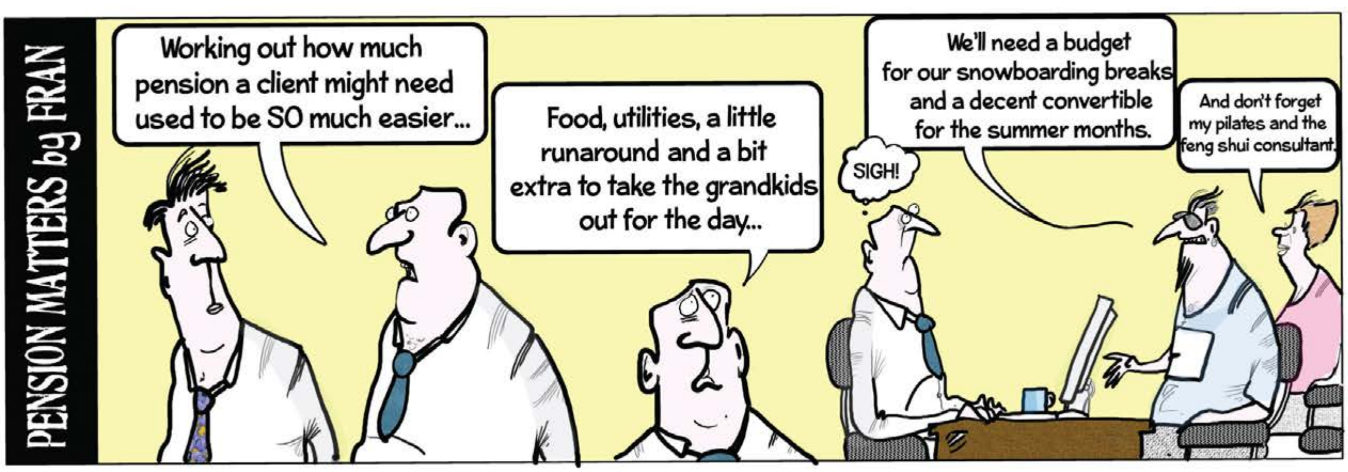

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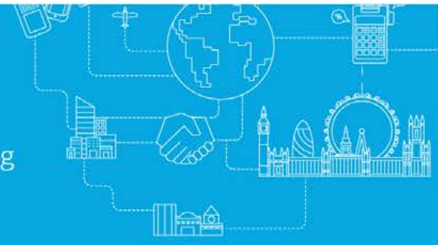

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Day rates London CE14074

In-house Pension Manager
Up to £60k Midlands DB13952

In-house Pension Admin Manager
Up to £65k London DB14062

In-house Pensions Specialist
Up to £70k London DB14033

Pensions Administrators
c.£26k Worcs. TD14071

Part / Nearly Qualified Actuary
£DOE Berkshire TD14039

Pensions System Analyst/Coder
£DOE Essex TD13980

Pensions Administration Manager
£DOE Tyne & Wear TD14068