Freedom and choice
Trying to prevent members from making poor choices

Cashflow-driven investing
The different ways to undertake cashflow-driven investing

Vulnerable customers
How the pensions industry can assist its vulnerable customers

Pensions Publication of the Year 2019!*

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September 2019

PENSIONS Age

The leading pensions magazine

Default funds: *The problems with default funds and how they can be improved*

Bulk annuities: *Will the trend for record levels of activity within the bulk annuities market continue?*

A difficult balance

The ratio between dividend payments and deficit contributions

Case study: Schneider Pension Plan's switch from using a traditional manager mix to a fiduciary manager

Editorial Comment

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

It's said you regret the risks you didn't take in life.

There will likely be plenty of regrets haunting those currently/recently in government when they reach their death beds and ruminate on Brexit negotiations. But will current Chancellor of the Exchequer, Sajid Javid, also look at this time as a 'missed opportunity' to fix the pensions tax issue that is causing staffing issues in the NHS?

The pensions industry certainly thinks so.

Several industry voices have criticised Javid for not using his Spending Review on 4 September to fix the problem of the tapered annual allowance, which is particularly affecting many working in the public sector.

Commenting after the Spending Review, Royal London director of policy, Steve Webb said: "NHS services are now being seriously impacted by GPs and senior doctors choosing to retire prematurely or cut hours because of tax relief limits. This issue needs to be addressed as a matter of urgency. Today's statement was a missed opportunity to address that urgent problem."

This sentiment was echoed by Aegon pensions director, Steven Cameron, who said the additional funding for the NHS [*as announced in the Spending Review*] will be welcomed but Javid didn't fix the pensions taxation issue, which is causing a "dangerous drain on talent".

"While the NHS needs money, it also needs to retain its talent. It can't be right that a little-known technical pensions rule is putting that at risk," Cameron stated.

Indeed, we in the industry value the importance of pension saving more than most, but it isn't right one pensions regulation should put the running of the NHS at risk.

However, small details do often have a big impact.

Take the Universities Superannuation Scheme (USS) and University and College Union (UCU) conflict. A very small number, less than 1 per cent in fact, may generate strike action and contribute to the average USS member being £240,000 worse off in retirement.

According to First Actuarial, the multiple small changes made to the scheme since 2011 – the increased contributions, from 6.35 per cent in 2011 to 9.6 per cent from October 2019, the closure of the final salary element and the introduction of a salary cap for defined benefits – would make the average member £240,000 worse off in retirement.

The UCU will ballot its members on whether to proceed with strike action from 9 September over the latest increases to member contributions, from 8.8 per cent to 9.6 per cent.

In response to the findings, a Universities UK (UUK) spokesperson said that "winding the clock back to 2011" and "freezing the scheme in time" was not a credible measure to scheme members.

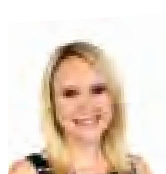
Winding the clock back may not be possible, but the benefit of hindsight can help prevent future risks.

For instance, the government may at least be learning the lessons from high-profile company sales, such as Bernard Matthews and Johnston Press, which involve a pre-packaged administration.

The government recently stated that it is considering introducing regulations regarding pre-packaged administration sales amid fears they could be abused to pass on pension liabilities to the Pension Protection Fund (PPF).

So, while this month's issue looks at many various risks within the pensions industry and how they could be mitigated, it's also worth remembering that risk can have a beneficial role to play and shouldn't always be avoided. As one of the modern sages of our time, Oprah, advocates on her website, regrets over missed opportunities can actually be turned into an advantage, if it is then used to spur on positive action in the future.

So when next considering whether to make the 'risky' decision of tackling the tapered annual allowance problem, here's hoping Sajid David is an Oprah fan.



Laura Blows, Editor

COVER FEATURE

Theme: Risky business

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A difficult balance

Many schemes with pension deficits continue to pay shareholders dividends that vastly outweigh the amount they pay into their DB schemes to try to bring them out of deficit. Jack Gray investigates whether there should be stricter regulations to narrow the ratio between dividend payments and deficit contributions

Highlighted features

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

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News, views & regulars

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

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ISSN 1366-8366
www.pensionsage.com

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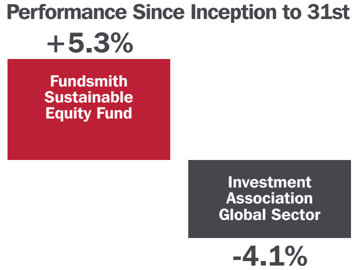
Performance Since Inception to 31st Dec 2018



Performance % Total Return

	Year ending 31st Dec 2018	Since inception on 1st Nov 2017 to 31st Dec 2018
Fundsmith Sustainable Equity Fund[1]	+4.6	+5.3
Investment Assoc. Global Sector	-5.7	-4.1
Quartile Rank	1st	1st

[1] I class accumulation shares, priced at midday UK time.
Source: Financial Express Analytics.

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Dateline - July/August 2019

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

2 July Proposals on how to reduce the number of badly-run schemes and improve the trustee model are outlined by **The Pensions Regulator** (TPR) in a consultation. *The Future of Trusteeship and Governance* poses questions to the industry about how to increase trustee knowledge and understanding, how to improve diversity on boards, what the role of accreditation should play and whether sole trustees can govern effectively.

4 July The **Pension Protection Fund** recorded investment returns of 5.2 per cent in the year to 31 March 2019, while assets under management grew from £30bn to £32bn. Despite the strong returns, the lifeboat's reserves fell from £6.7bn to £6.1bn, reducing the funding ratio by 4.2 per cent to 118.6 per cent.

9 July Labour Shadow Pension Minister, **Jack Dromey**, says having a member-nominated trustee on all pension boards is "of the highest importance". Speaking at the Association of Member Nominated Trustees Summer Conference, Dromey says that a Labour government would push for stronger member representation, in a time of "increasing regulatory focus on professionalism".

10 July The number of savers that have sought guidance from **Pension Wise** in 2018/19 increased by more than 55,000 year-on-year, to 167,726. Government figures reveal that the amount of people using Pension Wise increased by 37 per cent from 2017/18, and showed a more than three-fold increase from the 61,000 people seeking advice in the year of its inception (2015/16).

12 July Collective defined contribution (CDC) pension schemes are "the most intergenerationally fair" type of pension if buffers are not used, **Royal Mail** says. Speaking at the Westminster Business Forum, Royal Mail chief risk and governance officer, Jon Millidge, says that he felt the firm's CDC plan had been miscommunicated to the industry.

16 July The **government** confirms that the Court of Appeal ruling that changes it made to judges and firefighter's pensions were discriminatory on the grounds of age, applies to all public sector pension schemes.

22 July The Railways Pension Scheme (RPS) has been on **The Pensions Regulator**'s watchlist since 2016, its chief executive Charles Counsell reveals. In a letter to the Work and Pensions Select Committee chair, Frank Field, Counsell says that RPS has been on its 'watchlist' since it started monitoring schemes in June 2016, assessing the covenant, funding and investment of the scheme.

24 July The total value of defined benefit pension scheme transfers since 2016 has reached £60bn, **Royal London** reveals. In a Freedom of Information response, The Pensions Regulator disclosed that 390,000 people had used pension freedoms to access their DB pots since 2016.

29 July The **government** launches a consultation seeking opinions on changing regulations regarding pension schemes and fiduciary management (FM), in response to a final order from the Competition and Markets Authority (CMA). It is looking for views on altering regulations to integrate the CMA's final order, which would require trustees of workplace pension schemes to carry out a tender process when requiring FM services.

1 August The Pensions Regulator publishes research highlighting what it calls the "unacceptable" scale of under-performance in small pension schemes. It is using the research to promote its goal of greater scale and better governance for the UK's defined contribution schemes.

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

5 August The **Work and Pensions Committee** calls on the government to compel all pension schemes to show how they are providing value for money, as it is 'unconvinced' the industry can rise to the challenge itself.

7 August The government has scrapped plans to introduce a 50:50 system for **NHS** staff pensions, instead offering full flexibility over the amount clinicians can put into their pensions. The government also says that HM Treasury will review how the tapered annual allowance supports the delivery of public services such as the NHS. The Department of Health and Social Care says it will publish a consultation on a new set of proposals shortly.

9 August The government plans to extend **The Pensions Ombudsman**'s (TPO) powers to include a function for early resolution before a formal determination. In response to its TPO consultation, the government says that early resolution by TPO would "offer a route for resolving complaints that are less complex in nature" and that an early resolution would be quicker and more cost-effective than a full determination.

13 August Drinks company **Britvic** is seeking court approval to begin using the Consumer Prices Index (CPI) in place of the Retail Prices Index (RPI) for measuring inflation on its final salary pension scheme. The changes could see the UK defined benefit pension scheme's 6,000 members receive lower annual increases in pension benefits, as CPI is typically lower than RPI.

15 August The number of pension scam reports submitted fell by 75 per cent between 2015 and 2018, from 1,353 to 345, a freedom of information request from **AJ Bell** reveals. The figures, obtained from the National Fraud Intelligence Bureau, also finds that financial losses through pension fraud fell by 85 per cent during the same period, from £47.3m to £6.9m.

19 August The number of information requests **The Pensions Regulator** sent to pension schemes increased by 133 per cent in the five years to June 2019, compared to the previous five-year period. There were almost 1,000 requests for information over the past 10 years, with the highest number of requests coming in 2018, when there was 162.

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21 August Work and Pensions Secretary, **Amber Rudd,** has ruled out raising the state pension age (SPA) to 75, as proposed by think tank The Centre for Social Justice (CSJ). Rudd says that there was "no prospect" that the proposal to increase the SPA to 70 by 2028 and 75 by 2035 would be actioned.

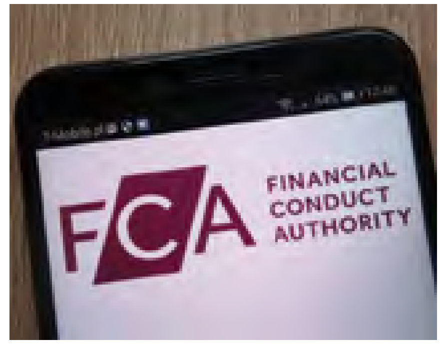
27 August The **government** could be facing legal challenges from teachers and doctors who were transferred into less beneficial pension schemes. Law firm Leigh Day believes that teachers and doctors have grounds for a legal challenge against the government for age discrimination, in a case similar to the one won by judges and firefighters against the government in December 2018.

28 August Defined benefit transfer values hit an all-time high in August, reaching £258,200, according to the latest XPS Transfer Watch. Publishing its monthly figures, **XPS Pensions Group**'s Transfer Value Index jumped sharply to an all-time high of £258,200 on 21 August 2019; up from £247,400 at the end of July 2019. The increase was largely driven by a significant fall in gilt yields during August, partially offset by a small fall in inflation expectations.

News focus

FCA shakes up pensions with package of changes

The regulator has confirmed the introduction of investment pathways for drawdown products, and proposed a ban on contingent charging for DB to DC transfers



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The Financial Conduct Authority (FCA) has shaken up pensions with a package of changes and proposals, designed to increase protection for vulnerable customers.

Publishing its final policy statement for the *Retirement Outcomes Review*, the FCA confirmed the introduction of investment pathways for drawdown customers, stating that the introduction is a "significant intervention" that will help consumers who enter drawdown to make investment decisions that meet their needs in retirement. As part of the proposals, drawdown providers must give consumers that haven't been advised and are entering drawdown, four options for how they might want to use their drawdown pot.

"Small providers can rely on an easement so that, while they have to present the investment pathways, they do not have to offer investment solutions – the 'pathway solutions' – themselves. While our current rules do not prevent drawdown providers from offering investment pathways, our research suggests that few do so. So, our proposals will change the options available to most non-advised consumers entering drawdown," the FCA stated.

Furthermore, drawdown providers will have to ensure that non-advised consumers entering drawdown invest wholly or predominantly in cash only if they have taken an active decision to do so. They must also give warnings to those consumers who do decide to invest in cash, as well as those already in cash when the rules and guidance come into force. Pension providers must also give consumers in decumulation annual information on the costs and charges they have paid on their pension pot, expressed as a single pounds and pence figure.

The pathways have been largely welcomed by those in the industry. Smart Pension director of policy and comms, Darren Philp, said it is a "timely and important step". Zurich's head of retail platform strategy, Alistair Wilson, noted that shining a light on the true cost of drawdown will encourage people to shop around and make the most of their pots in retirement. Meanwhile, Quilter head of retirement policy, Jon Greer, said: "The logic behind pathways is hard to argue with." However, he said a central issue with pathways is that it may become the path of least resistance and people go for a default instead of engaging.

The final policy statement was published alongside a consultation on banning contingent charging by advisers on defined benefit to defined contribution transfers. Publishing its consultation, *Pension transfer advice: Contingent charging and other proposed changes*, the FCA proposed a number of measures to change how advisers manage and deliver pension transfer advice. As well as banning contingent charging, the FCA proposed limiting firms' ability to recommended transfers that incur unnecessarily high ongoing adviser and product charges. In some cases this can be for 20-30 years after the transfer.

It wants the advisers to empower consumers to make better decisions by improving how charges are disclosed and requiring checks on consumers' understanding as part of the advice process. Under the proposals, the FCA will also be introducing "continuing professional development specific to pension transfer advice". The FCA also wants to establish new data collections from advice firms to improve its ability to regulate the sector. It also proposes amending technical areas of its rules and guidance to clarify and extend existing requirements.

The FCA estimates that the harm created by unsuitable DB transfer advice is up to £2bn each year. Commenting, FCA executive director of strategy and competition, Christopher Woolard said: "The FCA's supervisory work has revealed continued problems in the pensions transfer advice market. By making changes to the way advisers are paid for transfer advice and the other changes to transfer advice we are proposing today, we want to ensure people receive suitable advice and drive down the number giving up valuable defined benefit pensions when it is not in their interests to do so."

The issue of contingent charging came about following the scandal with members of the British Steel Pension Scheme, where it was found that some advisers had given inappropriate advice to transfer out, whilst operating a contingent charging structure. The Work and Pensions Committee later launched an inquiry into contingent charging and suggested that the practice should be banned.

Commenting on the proposal, Hargreaves Lansdown, senior analyst, Nathan Long, said it was a "sensible" suggestion. However, Aegon pensions director, Steven Cameron, noted that the market is divided on whether banning contingent charging is a good idea.

Research by Aegon has also found that 51 per cent of advisers are concerned that the proposed ban will lead to a fall in the number of people taking advice. The ban has also been criticised by the Personal Finance Society (PFS), who described it as "flawed" and "misleading".

The professional body has an issue with a cost template set out in the FCA's consultation paper. The template helps consumers compare the costs of advice from a pension transfer specialist with the cost of advice from a pension scheme or employer. PFS chief executive Keith Richards said that while he supported the FCA's aims for improving transparency and better managing of conflicts of interest, the proposal is flawed. "For clients to enjoy the benefits of full transparency, they have to be able to compare different options on a like-for-like basis," he said.

He cited the fundamental principle of the retail distribution review as separating the purchase of advice as a service from the purchase of a product. "We are concerned that the FCA's template does not live up to these principles, and could be misleading. It implies that the cost for ongoing advice in a workplace pension is provided free of charge by the pension scheme or the employer, whereas in practice the scheme member is usually required to obtain ongoing advice separately", he said.

"This is especially true for transfers from a defined benefit scheme to a workplace defined contribution scheme, since some level of ongoing advice will be essential for the vast majority of clients."

On the same day, the FCA also published a discussion paper on effective competition in non-workplace pensions. The FCA found that many consumers are not engaged in pension decisions or aware of charges they are paying. Products and charges are often too complicated to compare – leading to a lack of price competition.

Therefore, the regulator has outlined a package of potential measures to protect consumers – these could include requiring providers to offer one or more investment solutions, reducing charge complexity and increasing transparency, so that consumers better understand the impact of charges on their savings.

Written by Natalie Tuck and David Rowley

NEWS IN BRIEF

Kas Bank has partnered with asset manager **LGPS Central Limited** for cost transparency collection and reporting services. LGPS Central is currently responsible for around £20bn worth of assets for nine midlands-based LGPS schemes. LGPS Central will be leveraging Kas Bank's cost transparency solution and data analytical expertise to assist with collecting cost information across its range of investment mandates.

SEI Master Trust and the **National Pension Trust,** which is part of XPS Pensions Group, became the 14th and 15th DC master trusts to be granted authorisation by The Pensions Regulator (TPR). The authorisations follow confirmation of the industry-wide DC section of the Railways Pension Scheme's and Aon's master trust approvals.

A pensioner who thought he wasn't entitled to a state pension has been awarded a backdated windfall of £132,800. Peter Williams missed out on 11 years of state pension and had to live on two small workplace pensions. However, after meeting with an equity release provider, he was encouraged to call the **Department for Work and Pensions**. It was only then that he discovered he was entitled to £274 a week, along with a £132,800 back payment.

L&G has completed over £6.3bn global bulk annuity transactions in the first half of 2019, out of a publicly-announced total market of £14.4bn. In June, L&G agreed the UK's largest bulk annuity transaction, a partial buyout in excess of £4.6bn with the Rolls-Royce UK Pension Fund.

VIEW FROM TPR

A report recently published by The Pensions Regulator (TPR) features a case study where a business had a £350,000 fine because it failed to take action when it should have.

The employer, which has 5,000 staff, allowed an Escalating Penalty Notice to grow before correctly re-enrolling staff into the company pension scheme and paying in the right contributions.

This case is a stark warning that failing to address problems early can lead to hefty fines that can be avoided. We don't want to fine businesses, we want them to do the right thing for their staff and we are here to help them do that.

Following TPR's intervention, the London-based company has now re-enrolled more than 40 staff and paid more than £100,000 in back dated pensions contributions, as well as ensuring ongoing contributions are correctly calculated and paid. The backdated payments, which are in addition to the fine, cover both the re-enrolment failure and incorrect contributions affecting more than 2,000 staff.

This case demonstrates that it is vital to carry out both ongoing duties and re-enrolment correctly. We will take action to ensure that not only are staff put into a pension, but they continue to receive the correct contributions on an ongoing basis and that those who opt out are re-enrolled correctly so that they receive the pensions they are entitled to.

TPR director of automatic enrolment Darren Ryder

Govt scraps 50:50 NHS pension proposal for 'full flexibility'

The proposal of full flexibility is a change from what was offered before Boris Johnson's government took over

The government has scrapped plans to introduce a 50:50 system for NHS staff pensions, instead offering full flexibility over the amount clinicians can put into their pensions.

Publishing a statement on 7 August, the government also said that HM Treasury will review how the tapered annual allowance supports the delivery of public services such as the NHS. In July, Theresa May's government put out a consultation proposing a 50:50 system, which would have allowed clinicians to reduce their pensions accrual by 50 per cent, as well as paying 50 per cent lower contributions. This was not welcomed by the British Medical Association.

However, Boris Johnson's government has scrapped those plans and is instead offering full flexibility over the amount NHS staff can put into their pension pots. The new rules will be introduced in the next financial year, and will allow senior clinicians to set the exact level of pension accrual at the start of each year.

For example 30 per cent contributions for a 30 per cent accrual rate, or any other percentage in 10 per cent increments depending on their financial situation. This would give them room to take on additional work without breaching their annual allowance and facing tax charges. Employers would then have the option to recycle their unused contribution back into the clinician's salary.

Health and Social Care Secretary, Matt Hancock, said doctors should not have to worry about tax impacts if they choose to take on extra shifts.

"These comprehensive proposals will give doctors the pension flexibilities they have called for and need to make sure they are rewarded for extra work. We are taking immediate action and I hope these flexibilities will encourage our top NHS staff to fulfil the dedication of their mission: to care for their fellow citizens in time of need," he stated.

Editorial credit: Marbury / Shutterstock.com

Since the introduction of the annual allowance taper in April 2016, and the lowering of the tax relief threshold from £1.25m to £1m, many consultants are penalised for continuing to pay into their pension fund. As a result, one in five (19 per cent) general practitioners have quit the NHS pension scheme to avoid tax penalties for exceeding the tapered annual allowance, according to a survey from *GP Online*.

Chancellor of the Exchequer Sajid Javid said the "government is committed to ensuring that British people see a real difference in public services". Despite this, the government has been told to go further by Association of British Insurers head of taxation, Mervyn Skeet. It has also been told to stop its 'whack-a-mole' approach to pensions taxation by Hargreaves Lansdown head of policy Tom McPhail, who also added that the situation with NHS staff being discouraged from working overtime due to tax charges is 'plainly bonkers'. This sentiment was echoed by AJ Bell senior analyst, Tom Selby, who said the government has got itself into a 'real mess' over the pension tax taper.

Written by Natalie Tuck and Jack Gray

VIEW FROM THE PLSA

The recent Work and Pensions Select Committee report for pension costs and transparency made for interesting reading.

On the surface the media focused on headline-grabbing quotes from committee chair, Frank Field, who is 'calling on the government to shine the searchlights into that part of the financial industry that has settled down to misinforming, mischarging, overcharging and making a fat living off the hard-earned savings of pensioners'.

Yet what they didn't cover was that the committee does actually support work from the Cost Transparency Initiative for the disclosure templates developed and launched in May.

However, the committee's report fell short when recognising the very strong engagement so far between industry, regulators and government in adopting the work of the Cost Transparency Initiative.

Initial download figures– after only the first two months of the templates being live on the Cost Transparency Initiative webpage – and the level of detail in the technical queries for the templates has been a clear sign that the industry is deep into the build to get the framework up and running. Importantly, the feedback is that asset managers are rising to and, in many cases, embracing the challenge of providing this information to their clients.

The Financial Conduct Authority, The Pensions Regulator and government ministers have all provided welcome drive and direction. Each has sent very clear messages to the industry about their expectations and we are confident this will help to ensure the success of the Cost Transparency Initiative.

PLSA chair, Cost Transparency Initiative, Mel Duffield

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

Number of non-AE employees increasing faster than AE workers

The government is being urged to widen the policy by scrapping the earnings trigger and bringing in the self-employed

The number of workers in auto-enrolment (AE) pension schemes has continued to steadily increase, with another 17,000 workers being auto-enrolled in July 2019.

However, the rise in the number of workers not auto-enrolled in a scheme rose by 29,000 to almost 9.46 million, outweighing the increase in automatically enrolled employees. According to the latest figures from The Pensions Regulator (TPR), the amount of eligible jobholders auto-enrolled into a scheme rose to 10,124,000, after hitting the 10 million mark in January 2019.

Since hitting the milestone, auto-enrolled workers have been increasing in number by at least 15,000 each month.

However, since January 2019, the monthly increase in non-AE workers has been at least 20,000. TPR's figures also showed that the number of employers declaring their statistics increased by 14,182 to approximately 1.56 million, while the total number of workers employed at the companies declaring their statistics increased by 68,000, up to around 31.6 million.

In the report, TPR stated: "While the information is the actual data received by us, there will be employers that have reached their staging date, who have automatically enrolled their eligible jobholders and who have not yet completed their declaration. The figure for eligible jobholders that have been automatically enrolled is therefore likely to be higher than that shown in this report."

TPR stepped up its use of AE powers in the first quarter of 2019 by 15 per cent, due to an increasing number of employers reaching their three-year re-enrolment date and who must re-declare compliance to TPR, as well as the continued enforcement activity against employers after the first increase of combined minimum contributions in April 2018 to 5 per cent.

With the numbers of workers that aren't auto-enrolled rising faster than those that are being enrolled, the industry is urging the government to review the policy. For example, the trade union Prospect is urging the government to scrap the earnings trigger for auto-enrolment, currently set at £10,000. Research by the union found that a 39 per cent gender pension gap could be reduced by scrapping this trigger and bringing more women into the auto-enrolment policy.

Furthermore, given that the number of self-employed workers is nearing five million, the industry is putting pressure on the government to come up with a solution to self-employed pension saving.

As a result, Royal London pension specialist, Helen Morrissey, said: "The government can no longer ignore the needs of almost five million people and it must look at how to bring the self-employed into the auto-enrolment regime so they can safeguard their future by saving into a pension."

In addition, Aegon pensions director, Steven Cameron, said: "Finding an attractive and accessible retirement saving solution that works for the self-employed must remain a government priority so they in future reap similar retirement rewards as those who are auto-enrolled through their workplace."

Written by Jack Gray and Natalie Tuck

VIEW FROM THE ABI

It seems incredible that the last regulatory review of trustees' knowledge and understanding requirements took place a decade ago, given the significant changes in the industry in this period. More change will come, and it is critical that trustees are ready for it and adept at addressing the numerous challenges. The Pensions Regulator's focus on the future of trusteeship and governance is therefore welcome.

However, it is important that any new regulatory requirements are proportionate and risk-based, and reflect the circumstances schemes are in. Clearly, there are risks in small schemes without any effective oversight. There is a strong need for new and largely untested DB consolidators to be required to have independent and professional trustees in place. In addition, emerging collective DC schemes will bring a different set of risks to pension scheme members, and the knowledge and experience of their trustees will be crucial to their success. In contrast, fully-insured pension schemes with access to good and effective governance through their provider are less likely to be at risk. This therefore requires a more nuanced and pragmatic approach by the regulator.

So, a word of caution: An ambition to improve trustee skills is admirable, but pension schemes are varied and complex. Universal legislative requirements will not act as a silver bullet.

ABI policy adviser, long-term avings, Hetty Hughes

W&P Committee 'unconvinced' of industry's cost transparency ability

The committee is recommending that regulators should be given powers to compel schemes to demonstrate value for money

The Work and Pensions Committee has called on the government to compel all pension schemes to show how they are providing value for money, as it is 'unconvinced' the industry can rise to the challenge itself.

In a strongly-worded statement, the committee said it was 'unconvinced' that the industry would voluntarily rise to the challenge of providing clear, transparent information about the costs and charges of investments.

Instead, it said regulators should be given the power to compel pension schemes to demonstrate a value for money measure, which could be compared across the industry and is accessible to the scheme members.

Committee chair, Frank Field MP, said: "The select committee is calling on the government to shine the searchlights into that part of the financial industry that has settled down to misinforming, mischarging, overcharging and making a fat living off the hard-earned savings of pensioners," he said. "Ripping off pension savers could be eliminated."

Field added that better scrutiny of value for money in defined benefit schemes will either justify or avoid the need for the often difficult decisions being taken about the future of those schemes.

Alongside a measure of value for money, the committee called for the FCA to explore the creation of a public register of asset managers' record of compliance with reasonable data requests. It described asset managers as being unwilling to disclose all the explicit and implicit costs attached to each investment.

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The committee said it found that some trustees are making investment decisions when they did not know the true scale of the costs that they were incurring.

The committee also made recommendations on the charge cap for defined contribution schemes, pension scams, the pension dashboard, tax relief and financial advice. On the charge cap, it noted that while average charges lay between 0.38 and 0.54 per cent depending on the scheme type, not all charges are covered by the cap. It called for a review of the charge cap, permitted charging structures and to revisit measures to proactively consolidate smaller pots.

The committee said a non-commercial pensions dashboard will be a welcome, if overdue, additional tool to provide transparency to individuals and help them plan how to use their pension funds.

Also, the committee called on the FCA to implement a 0.75 per cent charge cap for the investment pathways, as well as a "robust monitoring programme" for the effectiveness of the investment pathways, including value for money comparisons with other available products.

Written by David Rowley


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VIEW FROM THE PMI

Summer has come to an end, and it's been a season of change for DC master trusts. The Pensions Regulator has had a busy summer in Brighton, combing through pages of applications for authorisation from around 40 master trusts.

We have seen several of the smaller master trusts gracefully exit the marketplace. It has been reassuring that, to date, there have not been any of these smaller master trusts that have failed to find another scheme to take on their members. This had been flagged by some as a potential risk, so it is encouraging that it hasn't come to fruition.

The landscape that has started emerging over these summer months sets a high bar for standards, which is very welcome in the DC space, and arguably overdue. We are now looking at a clearer DC master trust market, in which core areas such as financial stability, governance, and systems and processes have had to evidence a credible standard.

The market has moved out of its adolescence and has grown up. We are entering the next phase of its life - supervision by The Pensions Regulator. The PMI is supporting this continued evolution via our master trust working group. This is a group of over 25 organisations across the industry, which aims to provide a collective voice for those running master trusts and for their service providers. As the industry enters the era of master trust supervision, it is as important as ever that a strong forum exists for collaborating in this way to make sure the market goes from strength to strength.

PMI vice president Tim Phillips

TPR 'can do more' to stop scams, Counsell admits

His comments follow a renewed effort by the regulator and the Financial Conduct Authority to increase awareness of scams

The Pensions Regulator CEO Charles Counsell has accepted that his organisation can do more to prevent scams, but said the regulator is "fighting back" against scammers.

Publishing a blog on TPR's website, Counsell highlighted the regulator's latest public awareness campaign, to highlight the threat of scammers.

"It is shocking that five million people in the UK are at risk of being scammed, and that victims of pension fraud reported in 2018 that they had lost an average of £82,000," he stated.

Counsell noted that the pension freedoms mean that it is "inevitable that scurrilous criminals hellbent on stealing people's retirement pots are circling". Rather than just "petty thieves", Counsell described them as "sophisticated fraudsters" that use clever tactics to appear legitimate.

He believes that through a joint effort, scammers can be beaten, and added that it is right that regulators, government and other agencies are held to account on the action we take to prevent scams and punish offenders.

"We are 100 per cent committed to taking firm action to hit scammers where it hurts – in their pockets," he said.

His comments follow the relaunch of its joint Scamsmart campaign with the Financial Conduct Authority.

Research undertaken on behalf of the two regulators as part of the campaign has found that people actively looking to boost their retirement income who are presented with a pension scam are 60 per cent more likely to be drawn in by it.

The source of the scams originate from cold calls, offers of free pension reviews, early access to cash before the age of 55, plus access to investments with guaranteed high returns and time-limited offers.

A common approach is to offer high returns in exotic or unusual investments such as overseas property, renewable energy bonds, forestry, storage units or biofuels. Nearly a quarter (23 per cent) of the 45-65 year olds questioned said they would be likely to pursue such opportunities if offered them.

The research found that those who consider themselves smart or financially savvy are just as likely to be persuaded by these tactics as anyone else.

High-profile TV psychologist Honey Langcaster-James is being used as part of the campaign to help explain how people fail to spot scams.

Minister for Pensions and Financial Inclusion, Guy Opperman, said last year's campaign had prevented 370 people from losing as much as £34m. He said: "We know we can beat these callous crooks, because getting the message out there does work."

Written by Natalie Tuck and David Rowley

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Britvic asks for pension inflation measure change

In other pension fund news, Mondelez has agreed on a £520m buy-in for the Cadbury pension scheme, and Balfour Beatty has posted a DB surplus of £153m

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Drinks company Britvic is seeking court approval to begin using the Consumer Prices Index (CPI) in place of the Retail Prices Index (RPI) to measure inflation on its final salary pension scheme.

The changes could see the UK defined benefit pension scheme's 6,000 members receive lower annual increases in pension benefits, as CPI is typically lower than RPI.

Initially reported by *The Times*, trade union Unison estimated that Britvic's proposed change could see its members missing out on up to £12,000 over the course of their retirement, with RPI currently at 2.8 per cent and CPI at 1.9 per cent.

Commenting on the announcement, a Britvic spokesperson said: "We are currently reviewing an aspect of our pension provision. In doing so, we are engaging with all key stakeholders, and have remained in close consultation with the funds' trustees throughout.

"As part of this ongoing process, we are now seeking the court's consent to move this forward."

Britvic's DB scheme was closed to new members in 2002 and to future accrual for active members in April 2011.

BT has previously attempted to make a similar index measurement change, with their initial request being rejected by the High Court in January 2018, before losing subsequent appeals at the Court of Appeal in December 2018 and at the Supreme Court in July 2019.

Elsewhere, Rothesay Life has agreed a buy-in with the Cadbury Mondelēz Pension Fund, insuring £520m of defined benefit liabilities. This is the second tranche of de-risking for the Cadbury scheme and takes the scheme's insurance to around 20 per cent of its £4.6bn liabilities, following a £500m buy-in completed in 2009.

It covers payments for around 1,900 scheme members and the bulk annuity will be held as an asset of the scheme. Cadbury Mondelēz Pension Fund chairman of the trustees, Greg Chick, described the deal as a "significant step to de-risk the scheme" and said they will continue to de-risk in the future.

And finally, the funding surplus of Balfour Beatty's pension schemes has fallen by £162m year-on-year to £22m, as of 28 June 2019, its half-year report has revealed. The decline was driven by a decrease in the schemes' total assets, from £283m to £153m, and an increase in their liabilities, from £99m to £131m during the same period.

Balfour Beatty operates several schemes, the largest of which are the Balfour Beatty Pension Fund and the Railways Pension Scheme. The Balfour Beatty Pension fund posted a surplus of £153m, down from £283m, while the Railways Pension Scheme's deficit increased from £46m to £83m.

Its other schemes' deficits fell slightly, from £53m to £48m, while the firm made deficit contributions of £16m, up from £14m in June 2018.

Written by Jack Gray

Appointments, mandates and moves


Jerry Gandhi

2020 Trustees has announced the appointment of Jerry Gandhi as a trustee director.

Gandhi brings over 40 years of pensions industry experience to his new role. Most of his career has been spent as a freelance pensions consultant, supporting trustees and employers through change scenarios. Most recently, he has held roles at RSA Insurance Group, Now Pensions and Schneider Electric. Gandhi has extensive experience and involvement in diverse environments and change scenarios, including DB accrual closure, outsourcing pensions administration, effective asset management and de-risking.

Commenting on the appointment, 2020 Trustees managing director Naomi L'Estrange said: "Jerry joins us during an exciting growth period at 2020 Trustees. His experience in being able to understand and support the need for change, and designing solutions to complex situations, to deliver the best outcomes for all involved will be invaluable to our clients."

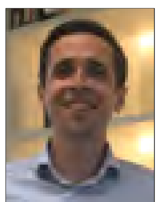
The trustee of the **Greene King Pension Scheme** has appointed XPS Pensions Group as actuarial and investment advisers.

The scheme has nearly £400m of assets providing pension benefits for around 2,500 members. The trustees sought an adviser to help them effectively work with the sponsor to ensure all members' benefits can be paid. Greene King Pension Scheme chair of trustees, John Smith, said: "We are really pleased to have chosen XPS to work with us to help us design and manage a combined funding and investment strategy."


Karen Cham

Nest has named Karen Cham, professor of digital transformation design at the University of Brighton, to its board, following her appointment by the Secretary of State for Work and Pensions, Amber Rudd.

An expert in user experience design and engineering behaviour change, Cham is also the professorial lead for connected futures research and enterprise, including digital economy, digital health, immersive and simulation.


Nick Gibson

Lincoln Pensions appointed Nick Gibson as a director.

Gibson joins from PwC's covenant advisory practice. He brings over nine years' experience advising trustees, companies and private equity sponsors on employer covenant and related matters. He has advised schemes ranging in size from £10m to some of the largest in the UK. Prior to PwC, Gibson spent three years at Gazelle Corporate Finance as an assistant director.


George Emmerson

Capital Cranfield has appointed George Emmerson as a professional trustee.

Emmerson has seven years of trustee experience and has a background in investment. He joins Capital Cranfield following 17 years with Aberdeen Standard Investments. His appointment means that five out of the firm's 40 professional trustees currently work with its Scottish arm, Scottish Pension Trustees.

Schneider Electric has chosen Aon to provide it with fiduciary management services. *[see page 75]*

Aon has been appointed by the trustees of the Schneider Pension Plan (SPP), which is valued at nearly £400m. The professional services firm won the mandate following a formal tender process and it will be the sole fiduciary manager for the pension scheme's total investment portfolio. SPP trustee chair, Rodney Turtle, said Aon's "commitment and support" during the tender process convinced the trustees that Aon was the best for their objectives.


Alan Pickering

Best Trustees has announced that its chairman, Alan Pickering, will step down from his role on 30 September and has hired Julie Stothard as chief executive.

Pickering has served a 10-year tenure at the firm and will fulfil an ambassadorial role as president. He also chairs several pension scheme boards, including The People's Pension and The Plumbing and Mechanical Services Industry Pension Scheme. Pickering has served as a non-executive director at The Pensions Regulator, and was previously chairman of the National Association of Pension Funds, now known as the Pensions and Lifetime Savings Association.

Stothard joins from Capita Employee Benefits, where she is director of actuarial, investment and defined benefit consulting, and will begin work on 23 September in the newly-created role. Stothard has held various roles, such as head of actuarial consulting at Bluefin, where she worked for nearly two years until 2012, and partner at Watson Wyatt from 2003 to 2009.

VIEW FROM THE AMNT

David Epstein's recent book, *Range: How Generalists Triumph in a Specialist World*, contrasts the benefits of specialisation with that of generalisation.

To show the effects of both methods, he uses as examples the upbringing of Tiger Woods and Roger Federer; world-renowned sportsmen in different disciplines. The former as a toddler was pictured using a putter and by 4 was having golf lessons.

Meanwhile, at similar ages, Roger was playing a multitude of sports, not settling on any particular sport until he was a teenager. Even then he refused to move up a tennis grade as he was having 'fun' playing tennis with his mates at the level below.

Pension trustees have to employ a wide range of knowledge and skills to enable them to effectively manage their funds, ranging through investment decisions, administration, pension legislation, staffing resources and the various members needs and concerns. Pension trustees buy in 'specialists' to provide advice and expertise in specific subjects, allowing the trustees to make informed choices, but each piece of specialist knowledge is only part of the picture. As David Epstein says: "We need more Rogers: people who start broad and embrace diverse experiences and perspectives while they progress; people with range." Sounds like a description of a member nominated trustee.

AMNT member Stephen Fallowell

AMNT Association of Member Nominated Trustees

Market commentary: Boris and no-deal prep threatens economy

Following the appointment of Boris Johnson as Prime Minister, the prospect of leaving the EU without a deal is becoming increasingly likely. Johnson has admitted that the chance of a no-deal Brexit is now no longer "a million to one" and that the longer negotiations go on, the more likely it is.

Editorial credit: Michael Tubi / Shutterstock.com

Markets have responded accordingly, with uncertainty and anxiousness. The UK's economy shrunk in the second quarter of this year. If the economy does not recover and shrinks again next quarter, the country will slip back into recession.

DeVere Group founder and chief executive, Nigel Green, explains that the British pound is now "the second-worst performing currency in the entire world".

He continues: "Sterling has taken another pounding after the UK's economy was shown to have contracted in the second quarter, adding to the economic woes on top of no-deal Brexit concerns.

"The pound has fallen more than 4.5 per cent against the dollar in July and August over fears Boris Johnson's government is pushing the country towards a no-deal Brexit.

"Should the UK leave with no-deal, the pound is likely to remain weak for several years until the country and the EU readjusts."

Principal Global Investors chief strategist, Seema Shah, agrees that the value of sterling will probably fall in the event of an increasingly likely no-deal scenario. She states: "Boris Johnson's approach is pushing the UK inexorably towards a no-deal Brexit.

"Sterling is finally making its delayed arrival at the no-deal Brexit party. It is likely to fall towards the $1.18 level in the run-up to 31 October.

"There will be no Brexit U-turn from this government and if the House of Commons cannot find a mechanism to ensure any obstacles to a no-deal Brexit are binding, expect the pound to push firmly through that threshold in the immediate aftermath.

"A no-deal Brexit will present investors and businesses alike with unfamiliar conditions, regulations and trading rules, weighing heavily on the UK growth outlook."

Mercer's *Pensions Risk Survey* revealed that the pension deficit for FTSE 350 companies increased by £3 billion in July 2019, and Mercer actuary Charles Cowling, believes that the fall was at least partially driven by Johnson's appointment and the possibility of leaving the EU without a deal.

"July's increase in deficit can be partly attributed to recent political developments, including the election of Boris Johnson as Prime Minister and preparations for a no-deal Brexit," he says.

"A fall in the value of sterling has the potential to create a spike in inflation and now there is also an increasing likelihood of an interest rate cut by the Bank of England. Taken together with the possibility of a no-deal Brexit, the combination of political and financial volatility could result in a precarious perfect storm for trustees and pension schemes in the autumn.

"Trustees should therefore urgently evaluate the potential impact of political and economic uncertainty on their sponsors and pension schemes and be in a position to capitalise on de-risking opportunities as they arise."

Written by Jack Gray

VIEW FROM THE PPI

Since the introduction of pension freedoms in 2015, the decisions people make about how to access their retirement savings at and during retirement have become more complex.

As well as the many financial factors that need to be taken into consideration, people are faced with trying to plan for the unpredictable health transitions they may experience in later life.

The risk of experiencing health declines at younger ages is correlated with levels of wealth.

By age 70 more than half of those in the bottom 20 per cent of the wealth distribution have at least one severe physical limitation, compared to just 16 per cent of those in the wealthiest 20 per cent.

These inequalities can be traced back to pre-retirement, with those who have lower levels of wealth more likely to feel pressure to continue working even after they have developed physical limitations, which further drives this gap.

Once coping with physical limitations, those in lower wealth quintiles are likely to need more support if they are to avoid having particularly poor later-life experiences, as many of the risk factors associated with social exclusion in later life are also correlated with having lower levels of wealth.

In October, the PPI will be publishing the second report in its *Living Through Later Life* series, which will explore the ways in which people can be supported to achieve more positive later life outcomes.

PPI senior policy researcher, Lauren Wilkinson

PENSIONS POLICY INSTITUTE
PPI

In my opinion

On the need for the government to compel schemes to show value for money

"The select committee is calling on the government to shine the searchlights into that part of the financial industry that has settled down to misinforming, mischarging, overcharging and making a fat living off the hard-earned savings of pensioners. Ripping off pension savers could be eliminated."

Work and Pensions Committee chair, Frank Field

On why the government should produce an annual report on the gender pensions gap

"The gender pension gap is arguably an even bigger problem than the gender pay gap, because it's over twice as big and women usually only realise they are impacted by the time they have retired when it is too late to do anything about it. The first step in tackling the problem is to require government to present an annual report on the gender pension gap and its causes to parliament when its policies for addressing it can be debated."

Prospect senior deputy general secretary, Sue Ferns

On the need for the government to find a solution to self-employed pension saving

"This movement to becoming self-employed is not going away. The self-employed are a core part of the workforce and unlike employees, they are excluded from the government's flagship auto-enrolment policy. Finding an attractive and accessible retirement saving solution that works for the self-employed must remain a government priority so they in future reap similar retirement rewards as those who are auto-enrolled through their workplace."

Aegon pensions director, Steven Cameron

On The Pensions Regulator's £350,000 fine it handed to an employer that didn't comply with its auto-enrolment duties

"This size of fine is rare as the vast majority of employers now consider automatic enrolment to be an everyday part of running their business and helping workers to save.

"However, this case is a stark warning that failing to address problems early can lead to hefty fines which could be avoided. We do not want to fine businesses, we want them to meet their legal duties and we are here to help them do this."

TPR director of automatic enrolment, Darren Ryder

On the suggestion that the state pension age should be increased to 75 by 2035

"Forcing everyone to wait longer for state pension on basis of average life expectancy is unjust: Stark pension age rises would create significant hardship for many Britons.

"Such misguided policy proposals suggest little understanding of the role and impact of state pensions and the differentials within our society. This must not be allowed to happen"

Former Pensions Minister and current life peer, Ros Altmann

JUST.

RETHINK RETIREMENT

Speakers for the day include (more trustees to be announced):

Chair for the day: Richard Butcher, Managing Director, PTL
Helen Beckinsale, Panel Manager, PPF
Fred Berry, Lead Investment Consultant, The Pensions Regulator
John Oldland, Director, Pi Pension Trustees, Founder, Pi Partnership
John Baines, Head of Bulk Annuities, Aon
Adrian Cooper, Head of Direct Distribution, TPT Retirement Solutions
Tim Coulson, Director DB Solutions, Just
Nick Johnson, Chief Actuarial Officer, Clara Pensions
Jane Kola, Partner, ARC Pensions Law
James Mullins, Partner and Head of Risk Transfer Solutions, Hymans Robertson
Myles Pink, Partner, Lane Clark & Peacock
Jay Solanki, Head of Trustee Secretarial Services, Premier
Andrew Ward, Partner, Leader Risk Transfer and DB Journey Planning, Mercer
Richard Willets, Expert Longevity Consultant, Just
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VIEW FROM THE SPP

Stakeholder regulations require an annual declaration that the scheme continues to meet the rules for stakeholder schemes. With advances in the industry, most notably auto-enrolment, I believe the need for a specific declaration has become outdated and no longer required.

In the 2000s the introduction of stakeholder schemes promised greater access to pension savings for people with low minimum contributions, low charges and default investments.

One of the controls introduced was the annual declaration confirming compliance with the regulations. A 'reporting accountant' is appointed and they review the declaration, making comment on the management of the scheme. Once complete, the signed declaration is kept on file should a member ask to see it, though I'm pretty sure no-one ever has.

Stakeholder products still provide simple, affordable access to pensions but do we still need to prove their compliance in this way? Trustees/managers are well versed in managing schemes with lower charges and specific access requirements now. Some reporting is required and there is oversight by Independent Governance Committees. However, if this is a stakeholder scheme, the declaration still needs to be produced and reviewed by the reporting accountant. A lot of duplication at significant cost.

Stakeholder schemes helped us turn a corner from the high-priced personal pensions of old but are being left behind now and trustees/managers are being forced to use vital resources to produce what seems to be an outdated declaration.

SPP's Administration Committee member Stephen Williams

THE SOCIETY OF PENSION PROFESSIONALS

Soapbox: ESG needs an attitude change

Several years ago, when I was still very new to the intricacies and politics of pensions, a consultant told me that "trustees don't care about environmental, social and governance (ESG) issues".

At the time, that comment wasn't allowed to go any further, because, for the consultant in question, it would have been rather damaging from a client perspective. Since then ESG has been bubbling away in the background, gaining traction certainly in areas such as investment management, but I'm still not entirely convinced that trustees, or even consultants, really care enough yet.

It's probably still too much of a sensitive issue for a consultant to say trustees don't care about ESG, but Pensions Minister, Guy Opperman, isn't shying away from any issues trustees have with ESG. Last month, he wrote in *Conservative Home* that there is a "perception by too many trustees that the environmental practices of the firms they invest in are purely ethical concerns that they do not need to worry about".

"This is utterly wrong and cannot continue," he stated.

It's always important not to tarnish all trustees with the same brush, as some recognise the issues amongst their peers. However, in *Pensions Age*'s July issue, Dalriada Trustees senior trustee representative, Vassos Vassou, argued that too many trustees are "not yet fully focused on ESG" and the support they do receive from investment consultants is "generally poor".

"Some sceptical voices on trustee boards say that 'we can't do anything about climate change', 'we don't really know what members want', 'we have passive investments so ESG doesn't apply' or 'we are one of many investors in a pooled fund so can't influence the manager,'" Vassou stated.

I also had the pleasure of speaking to John Graham, a trustee for the Royal British Legion pension scheme, earlier this year, who had been struck by the message from The Pensions Regulator that it is paying attention to ESG because it believes ESG has financial impact.

There are many though that still haven't woken up. So what is the problem? Vassos highlighted that the demographics of trustee boards, generally older white men, could be an issue, as "younger generations seem to worry more about ESG".

Perhaps so, but the 'ignorance is bliss' card can no longer be played. The message is out there – in speeches at conferences, in reports, and will one day likely be seen in investment returns.

There are so many different issues at play when it comes to changing trustee behaviours, but I'm happy to see the new regulations being introduced from 1 October 2019 that will require trustees to take ESG into consideration in their pension scheme's Statement of Investment Principles. Further down the line, in October 2020, trustees will need to report on how they will comply with sustainable investing.

It's a good start, and the nudge that trustees need, but trustee attitudes also need to change.

Written by Natalie Tuck

Advantages of using a multi-factor approach

Factor-based strategies are increasingly being used not only for equities, but also for bonds. It is crucial for investors to look closely at the details, because the various systematic approaches can vary considerably

Why is factor investing in corporate bonds becoming increasingly popular?
An important incentive in the use of factor-based strategies in the fixed-income markets is that of risk reduction, which is achieved by diversification over a number of factor classes which have low correlations with one another. Another reason is the prospect of a higher extra return.

A systematic, factor-based evaluation of the corporate bond universe not only allows the usual large issuers to be considered, but also enables investment opportunities to be seized more effectively among smaller issuers who have less research coverage. Manager diversification is another argument in favour of using multi-factor investing. The distribution of outperformance for a factor-based approach differs from the distribution experienced with regard to a traditional investment approach, in terms of size and timing. The former thus also complements the latter in a meaningful way in the management of institutional fixed-income investments.

What are the best factors, and how are they combined?
Academic studies have shown that there are many hundreds of factors that have systematically led to excess returns in the past, compared to traditional indices based on market capitalisation. To simplify matters, however, the vast majority of factors can be grouped into a few superordinate styles. In contrast to equity investments, the correct modelling of downside risks is particularly important in the case of bonds, which is why fair value models that relate valuation and risk to one another are suitable. Enhanced by the 'Carry' and 'Sentiment' (Momentum) factor categories, a balanced multi-factor approach results. On the one hand, the complexity of the calculation of the factors has a decisive influence on the result, and this is where a detailed approach – with enhanced data input – is advantageous. On the other hand, the way in which factors are combined is also relevant: in principle, investors can choose between a mixture of portfolios made up of single factors (portfolio blending) or a mixture of factor signals at single-issue level as part of an integrated multi-factor approach (signal blending). The factor exposure of the overall portfolio in the portfolio blending approach is low due to negative correlations between the individual factor groups: it must therefore be obtained through very distinct positioning within the individual portfolios.

Therefore, it seems that the portfolio blending approach is not very practicable, particularly in fixed-income, as such extreme single-factor portfolios are unlikely to be implementable. With an integrated multi-factor approach, the factor signals are combined at the level of single securities, taking into account duration and yield curve risks. Such an active factor investing approach focuses on utilising issue-specific information inefficiencies, and not just on simply replicating risk premia.

Sustainability is becoming increasingly important. To what extent can this be reflected in factor investing approaches?
We now manage more than 40 per cent of our total assets on the basis of sustainable investment criteria. The prerequisite for the efficient integration of sustainability aspects into quantitative factor strategies is to have a high-tech infrastructure for processing data, with suitably reliable data sources. In principle, sustainability aspects within quantitative approaches can be integrated in two ways. First, negative screening identifies issuers with problematic business practices, such as child labour, or problematic business activities – involving the production of weapons of mass destruction, for example. The second way allows quantitative sustainability measures such as ESG scores or the carbon footprint of issuers to be integrated as risk factors into the portfolio construction. However, this approach also emphasises the importance of ensuring that the primary investment objectives, such as risk-adjusted performance, are not compromised. The way in which sustainability aspects are considered also depends to a large extent on individual client preferences – for example, there are major country-specific deviations in respect of the use of nuclear energy.

Interview with Andrea Dacquin, head of fixed income, Quoniam Asset Management

In association with
Quoniam
QUANTITATIVE INVESTMENT ENGINEERING

Laura Kuenssberg

Jack Dromey

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16-18 October, Manchester

This October sees the pensions industry gather together in Manchester for the PLSA's Annual Conference & Exhibition. The event, which attracts over 1,500 trustees, pension administrators and managers, and finance directors, is the largest in the UK – the only place where a £2 trillion industry that looks after the financial futures of everyone in the UK meets to gain new perspectives, practical tools, and the opportunity to build new relationships.

The three-day conference will explore how we create a world-class pensions system and examines large DB and DC schemes from around the world – including those of the UK – to understand and share information on best practice in funding, administration, saver engagement and more.

Programme highlights include hearing from **Laura Kuenssberg**, who has become one of the media's most recognisable broadcasters after covering Brexit and UK politics over this remarkable period. **Nigel Wilson**, Group Chief Executive, Legal & General will discuss how the pensions industry can embrace the power of pensions. The conference will also debut a *Question Time*-style session, chaired by **Fiona Bruce**, journalist and presenter. The debate features Shadow Pensions Minister **Jack Dromey**, and millennial financial journalist **Iona Bain**, among other notable names.

The programme consists of speakers from the worlds of pensions, finance, government, and media to provide insights from all angles.

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Adrian Aguilera, GMPF

Keynote speakers not to be missed:
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- **Helen Dean**, Chief Executive, NEST
- **Martin Fahy**, Chief Executive Officer, ASFA
- **David Fairs**, Executive Director for Regulatory Policy, TPR
- **Bill Galvin**, Chief Executive, USS
- **Paul Lewis**, Financial journalist
- **Gregg McClymont**, Director of Policy and External Affairs, The People's Pension

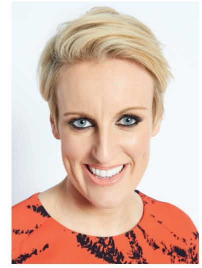
Inga Beale

Helen Dean

David Fairs

Paul Lewis

Steph McGovern



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• **Steph McGovern**, Business broadcaster
• **Margaret Snowdon OBE**, President, Pensions Administration Standards Association

The conference will also see the unveiling of the PLSA's latest project following its *2018 Hitting the Target report – Retirement Living Standards*. The introduction of automatic enrolment has seen more people putting money away for their retirement. PLSA research has shown that understanding how much money people need in retirement, and how it compares with where they are now, would go a long way to persuading them to engage with their financial futures. The standards have been designed to plug the gaps in current approaches and provide a practical starting point for savers to consider what lifestyle they can plan for. Like the 'five a day' healthy eating maxim, it is hoped the standards will one day become a rule of thumb for retirement planning.

GREAT SPEAKERS, GREAT VARIETY OF TOPICS TO DISCUSS OVER DIFFERENT FORMATS - SUPER EXHIBITORS, EXCELLENT NETWORKING OPPORTUNITIES

Stuart McLean, London Business School

As well as this launch, attendees can also look forward to:
• A Trustee Learning Zone, exclusively open to trustees as a forum to share and connect with peers;
• Specialist sessions;
• An array of networking opportunities available during extended refreshment breaks, drinks reception, and conference run;
• Four stream sessions running through the programme on DB, DC, New Horizons, and new for 2019 – Engagement Tech; and
• Products and services offered by over 80 exhibitors.

Network with other industry leaders.
Discover new thinking.
Gain the expertise to make a difference.

For more information and to book, please visit **www.plsa.co.uk**

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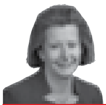


VIEW FROM THE ACA

Over the summer, we commented that we were glad to hear that the Treasury will be 'reviewing how the tapered annual allowance supports the delivery of public services'.

We hope that the new Chancellor will follow this up by making clear proposals on changes to the tapered annual allowance and that there is a proper opportunity to consult on changes to the pension taxation regime, with an objective of genuine simplification so both individuals and schemes find themselves in a better place. We also trust that any changes treat public and private sector workers with DB benefits equally and fairly.

The tapered AA is of course targeted at high-earning individuals' pension benefits, but it is unutterably complicated, both for the individuals impacted and for pension schemes, which carry much of the burden of trying to make the system work. The complexity is exacerbated for defined benefit schemes, like the NHS scheme. The complexity means that in many cases the wrong tax will be paid – which is not the right way to design a tax system.

HM Treasury will know from the work they did in the last exploration of pension taxation launched in 2015 (which led to no clear consensus) that there is a real challenge in coming up with a method of taxing the accrual of DB pensions in a fair and practical way. We look forward to being able to feed in views.

ACA chair Jenny Condron

ACA

ASSOCIATION OF CONSULTING ACTUARIES

Diary: September 2019 and beyond

Pensions Age Autumn Conference 2019
19 September 2019
Waldorf Hilton Hotel, London

This must-attend event in the UK pensions calendar offers pension funds and those working in the pensions sector the opportunity to learn and network alongside their peers at one of the most dynamic yet challenging times in UK pensions history. This one-day conference, which is open to pension scheme managers, trustees, FDs, advisers, pension and HR professionals, will offer delegates the up-to-date knowledge and guidance they need to help them run their pension schemes and meet their members' needs, whether in the DB, DC or hybrid space.

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

DC Workplace Pensions Symposium
10 October 2019
Leonardo Royal Hotel London City, 8-14 Cooper's Row, London, EC3N 2BQ

The event focuses on auto-enrolment and DC governance best practice, and draws on the current issues and challenges facing employers, trustees, and DC pension fund members. Subject areas include DC governance, investment choices, wellbeing and member engagement.

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

PLSA Annual Conference 2019
16-18 October 2019
Manchester Central Convention Complex

Attracting 1,500 top industry professionals and with over 80 exhibition stands, the PLSA Annual Conference and Exhibition is a must-attend event for anyone involved in pensions. From trustees, pension managers and finance directors to HR specialists responsible for workforces of thousands of people, the delegates are made up of some of the most important pension decision makers in the country. The conference includes keynote speeches, streamed focus sessions, specialist sessions, a Trustee Learning Zone, exhibition and a conference drinks reception.

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

Pensions Age Western Conference 2019
31 October 2019
Bristol Marriott Hotel City Centre

The Pensions Age Conference is back in Bristol for 2019. Following its huge success last year, the Pensions Age Western Conference will aim to meet the needs of pension managers, pension trustees and all those working in the pensions sector in Bristol and the surrounding areas.

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

Visit www.pensionsage.com for more diary listings

Month in numbers

£40 billion

The total value of bulk annuity deals that Aon predicts could take place in the UK by the end of 2019. It could surpass the record set in 2018, when over £35bn worth of buy-ins and buyouts were completed. In the first half of 2019, bulk annuity transactions totalled £17.6bn as schemes continue to de-risk. This included the largest-ever bulk annuity deal completed in the UK by Rolls-Royce. More large-scale deals are expected by the end of the year, which could carry the total amount of deals to between £35-40 billion.

120,000

The number of people receiving state pension benefits fell by 120,000 year-on-year to 13 million, as of February 2019, according to the latest Department for Work and Pensions statistics.

20

The number of authorised DC master trusts has risen to 20 following a further nine approvals in August 2019. The Cheviot Pension, The People's Pension, and Atlas Master Trust were three of the nine to be approved by the regulator in August.

Avoiding pitfalls

Jonathan Watts-Lay suggests how to help scheme members avoid the pension pitfalls of freedom and choice

Figures published by HM Revenue and Customs have revealed that individuals have withdrawn more than £28 billion from their pensions since the freedoms were introduced in 2015.

Whilst freedom and choice in pensions is popular with individuals, the downside is that due to an array of risks, it can be easy for pension scheme members to make poor decisions that can create a permanent dent in their retirement income. Some of these risks are outlined below, as well as what employers and trustees can do to help.

1. Paying unnecessary tax

Pensioners are paying £4 billion a year more in income tax on their pension than what the government had previously estimated, indicating that individuals are often paying tax when it could be avoided with careful planning. Ultimately, tax planning should be at the heart of any pension transaction and many will need support around how to do this effectively.

2. Underestimating how long retirement savings may need to last

Scheme members need to think about if they will have enough money to last the duration of their retirement. Research has found that most people live longer than expected, so this needs to be considered when doing the sums. However, it's no easy task working out how long it needs to last and how to best achieve this, so support around this is crucial.

3. The risks around DB pension transfers

Since the pension changes, we have seen a rise in individuals wanting to transfer their defined benefit (DB) pension schemes into more accessible pensions. Regulated financial advice must be sought to transfer a DB pension if its value is £30,000 or above. However, the FCA has warned that DB pension transfer advice is often substandard. Caroline Rookes also carried out a review for The Pensions Regulator on the communications and support given to British Steel Pension Scheme members, and found that members who acted on an uninformed or ill-informed basis, were exposed to unscrupulous advisers and were swayed by the size of the transfer figures rather than the value of the benefit.

Rather than leaving employees and members to go it alone when sourcing an adviser for DB transfers, many forward-thinking employers and trustees are now putting robust processes in place to ensure that individuals have access to reputable advisory firms.

4. The pension scam epidemic

Individuals getting scammed out of their retirement savings is a real issue. Our research found that a vast majority of trustees (88 per cent) fear their members nearing retirement will face predatory attention from scammers.

The amounts lost to pension scams can be significant, with the FCA revealing that victims of pension fraud had lost £91,000 on average each, with some even losing more than £1 million to fraudsters. More needs to be done to highlight how this can be avoided.

5. The value of regulated financial advice

Many don't realise that when they buy retirement products such as annuities, through for example online brokers, there are charges deducted that can cost just as much, if not more, than getting regulated financial advice. Studies have shown that those who take regulated financial advice are more likely to increase their wealth than those who do not.

To help their employees and members avoid these pension pitfalls, many employers and trustees are now seeing the benefits of putting robust processes in place. This includes offering support such as financial education seminars and one-to-one financial guidance over the telephone, in the months or even years before retirement, as well as facilitating an introduction to a regulated financial advice firm that has been through a thorough due-diligence process. This approach should ensure an improved retirement process, leading to better outcomes.

Written by Jonathan Watts-Lay, director, WEALTH at work

Tackling pension scams

Matthew Swynnerton (who is a member of the Pension Scams Industry Group) looks at some of the steps that are being taken to deal with pension scams

The risk that members who request a transfer out of their benefits may be the victim of a pension scam, and dealing with this in the context of the statutory right to transfer, has been a difficult issue for trustees for some time. This article looks at some recent steps that have been taken to tackle pension scams and changes that are on the horizon.

Industry Code

An industry Code of Good Practice on *Combating Pension Scams* was published in March 2015 and version 2 followed in June 2018. This is a voluntary code that sets out an industry standard for dealing with requests by members for transfers from a UK registered pension scheme to another UK registered pension scheme or Qualifying Recognised Overseas Pension Scheme. Version 2.1 of the Code was launched in June 2019. It took effect from 10 June 2019 and reflects recent regulatory and legislative changes and the evolving nature of pension scams.

The developments reported in version 2.1 include Pensions Ombudsman determinations considering due diligence completed by schemes before making a transfer. These include a complaint that was upheld because the transferring scheme had not conducted adequate checks in relation to the receiving scheme or sent The Pensions Regulator's (TPR) warning leaflet to the member. Another complaint reported in the Code, which was also upheld, related to delays in making a transfer. Comments by the Deputy Pensions Ombudsman in that case included that the enhanced due diligence conducted by the transferring scheme was disproportionate given that the receiving scheme was a large well-recognised scheme.

Other updates to the Code include: amendments to reflect the launch of the Money and Pensions Service; information published by the Pension Scams Industry Group about the findings of a study on the scale of scam activity affecting members and practitioners; and additional case studies.

Awareness campaign

In August 2018 TPR and the Financial Conduct Authority (FCA) launched a ScamSmart advertising campaign, and on 7 August 2019 they issued press releases reporting that they are joining forces again this summer to warn the public about pension scams, with the latest ScamSmart advertising campaign having been launched on 1 July 2019 and running on television, radio and online. The press releases report on new research which suggests that 42 per cent of pension savers could be at risk of falling for at least one of six common tactics used by pension scammers such as cold calls and free pension reviews. The press releases also set out four steps recommended by TPR and the FCA for people to protect themselves from pension scams including rejecting unexpected pension offers and checking who they are dealing with before changing their pension arrangements.

Looking ahead

In 2017 the DWP and HM Treasury confirmed that new measures would be introduced in three areas to tackle pension scams. This has already resulted in legislative changes so that HMRC can refuse to register or can de-register schemes with dormant sponsoring employers and the introduction of a ban on cold calling in relation to pensions. Further change is expected to follow the roll out of the master trust authorisation regime in order to limit the statutory right to transfer to cases where the receiving scheme is a personal pension scheme operated by an FCA authorised firm, the receiving scheme is an authorised master trust, or a genuine employment link to a receiving occupational pension scheme can be evidenced.

Version 2.1 of the Code states that, as some regulatory changes have not yet been put in place, it is anticipated that version 2.2 will be published within 12 months and the Pension Scams Industry Group will take the opportunity to further improve the ease of use of the Code at the same time.

Actions for trustees

The ombudsman determinations reported in the Code demonstrate the importance of having appropriate due diligence processes in place for transfers. Trustees should consider whether any updates are needed to their and their administrators' processes in light of the changes in version 2.1 of the Code and also be aware that further updates may be needed following changes to the statutory right to transfer.

Written by DLA Piper pensions partner Matthew Swynnerton

Uncertain times

Laura Blows explores the recent government confirmation that the landmark McCloud court ruling will apply to all public sector schemes and what can be done to prepare for unknown changes

Summary
- The Court of Appeal's McCloud case ruling that changes the government made to judges and firefighter's pensions were discriminatory on the grounds of age, does apply to all public sector pension schemes.
- The changes made are expected to cost around £4 billion a year from 2015, so making the cost £16 billion to date.
- One element of the valuations of public service pensions, the 'cost control mechanism', is delayed until the solution to the McCloud court ruling is revealed.
- The ruling is likely to particularly impact LGPS contractor services.
- No decisions have been made regarding the timeline for change.
- In preparation, administrators can identify and ensure they have accurate data for potentially affected members.

July saw confirmation that the Court of Appeal ruling, that government changes to judges and firefighter's pensions were discriminatory on the grounds of age, applies to all public sector pension schemes.

In a written response to the ruling, following the decision by the Supreme Court to deny the government an appeal, Chief Secretary to the Treasury, Elizabeth Truss says: "The court has found that those too far away from retirement age to qualify for 'transitional protection' have been unfairly discriminated against.

"As 'transitional protection' was offered to members of all the main public service pension schemes, the government believes that the difference in treatment will need to be remedied across all those schemes. This includes schemes for the NHS, civil service, local government, teachers, police, armed forces, judiciary and fire and rescue workers."

Firefighters and a group of 230 judges won their legal case against the government that changes made to their pension schemes were discriminatory back in December 2018, known as the McCloud ruling, with the government being denied the right to appeal. The two cases were ruled on together due to overlapping similarities, and earlier conflicting outcomes at Employment Tribunals.

Changes were made to the firefighters' pension scheme in 2015, and the Fire Brigades Union (FBU) argued that the protection imposed on younger members was unlawful on age discrimination grounds.

The 2015 changes meant that older members could stay in the existing and 'better' pension scheme, and younger members had to transfer to a new and 'worse' scheme, causing financial losses. The FBU initiated over 6,000 Employment Tribunal claims alleging that the changes amounted to unlawful age discrimination.

The challenge from the 230 judges, involved similar circumstances when they challenged the government's decision to force younger judges to leave the Judicial Pension Scheme.

The judges argued that this was discriminatory on the ground of age. Because of recent drives to increase diversity in the judiciary, many more of those in the younger group of judges are female and/or from a BAME background, and so claims were also pursued for indirect race discrimination and a breach of the principle of equal pay.

In her statement, Truss defended the changes made to the schemes in 2015.

She said: "The reasons for the 2015 reforms remain: that public service pensions are a significant cost for the taxpayer, now and in the future. The judgment does not alter the government's commitment to ensuring that the cost of public service pensions are affordable for taxpayers and sustainable for the long term."

Impact

Truss may be standing firm by the 2015 reforms, but the recent ruling confirms that the protections put in place for some members when the pension benefits were changed in 2015 amounted to unlawful age discrimination. So changes have to be made, and they're likely to have a considerable impact. Truss herself states that initial estimates of the cost for government to be around £4 billion.

According to ITM consultant Virginia Burke, it is likely that the remedy, when it is announced, will likely lead to retrospective benefit changes for members, so Truss' estimated £4 billion a year, backdated from 2015, will see costs of approx £16 billion so far.

A further financial effect it has already generated is that relating to the 'cost control mechanism'.

"Because of the 'real risk' that the government would be unsuccessful in its application to the Supreme Court to appeal the Court of Appeal's judgment, and thus more pension contributions would be required from public sector employers, the government announced it was to 'pause' one element of the valuations of public service pensions, the 'cost control mechanism' introduced by the Public Service Pensions Act 2013," Aries Insight director Ian Neale explains.

"In September 2018, the government had announced that provisional results indicated that the cost control mechanism would be engaged. Where the value of the pension scheme to employees has changed from the levels set when reformed pension schemes were introduced in 2015, steps must be taken to return costs to that level. This meant that because costs had fallen as a result of reforms in 2015, automatic improvements to member benefits follow.

"Meanwhile, however, employer contribution rates to unfunded public sector schemes from 1 April 2019 have been implemented as if the cost cap pause had not happened, meaning significant increases anyway (43 per cent in the case of the Teachers' Pension Scheme). This is to address deficits that would otherwise follow the reduction in the Superannuation Contributions Adjusted for Past Experience discount rate to 2.4 per cent plus CPI, announced at Budget 2018 (in line with established methodology to reflect OBR forecasts for long-term GDP growth)."

Aon principal consultant, Madalena Cain, warns that the judgment could also cause real issues for organisations using the Local Government Pension Scheme (LGPS), whether they are companies providing outsourced services or others, such as charities and universities. "Unlike other public sector schemes, the LGPS is a funded arrangement where the cost of any benefit improvements would be passed onto participating employers – and at a time when pension costs are already high," she says.

Due to the nature of the LGPS, there is likely to be a divergence in experience across different employers, Cain explains, depending on which employees are eligible for membership and whether any arrangements are in place to share pension risk with public sector bodies. Contractors who are anticipating exiting the LGPS in the near term are likely to face considerable uncertainty on any exit payments due – and should review their contract terms as a priority.

"It's also possible that contractors could be in the position of bidding for contracts with no clear understanding of the nature and cost of benefits. This could mean higher loadings in the bids and hence poorer value for government," she adds.

To put a somewhat positive spin on the uncertain situation, Neale adds that this has at least exposed the 'elephant in the room'; the "gargantuan estimated £1.5 trillion public sector pensions deficit, to wider scrutiny".

Preparation

But what can those managing public sector pension schemes, with their £1.5 trillion deficit, do to prepare for the upcoming turmoil?

According to Aon, as yet no decisions have been made regarding the timeline for change but all organisations who employ staff with a right to pension benefits through the public sector pension schemes should at least be prepared for additional cost pressures and a further period of prolonged uncertainty about staff benefits.

"Whilst we await details of the remedy for the various public service pension schemes, we know that there must be some form of uplift for those who have been discriminated against," Burke says.

To prepare, Burke recommends that administrators identify members that are likely to be affected, such as active members who may need to have benefits recalculated on their old scheme basis (or with an underpin in the case of the LGPS), members who were switched to a new benefit basis under the reforms and who have since taken benefits from the scheme, and members whose options were changed by the introduction of the new schemes.

"Carrying out this step sooner rather than later will help administrators understand the size of the task facing them and to plan data collection and resourcing ahead of time," Burke says.

It then may be possible to estimate, based on the data already held, whether or not a member who has already taken benefits would have been better off under the remedy, Burke adds. This could avoid the need to obtain data or carry out full calculations for members where it can be demonstrated that the remedy would not have a positive impact based on reasonable assumptions.

Administrators can then calculate benefits using the remedy for those affected, including any underpayments for those who have already taken benefits. For members who are still active this will mean system changes to ensure that future benefit calculations are performed on the remedy basis for the appropriate period.

Finally, looking at comms, Burke highlights that the message that benefits are being remedied due to government discrimination against younger public servants needs to be carefully handled in order to protect member confidence in their pension scheme.

"Whilst there are many uncertainties, schemes can put in place the project framework and carry out an estimate of the members in scope, saving time and effort once the McCloud remedy becomes clearer, allowing the changes to be implemented quickly," Burke says.

Written by Laura Blows

A delicate balance

Nico Aspinall considers how to balance both financial and environmental outcomes when investing

In a May 2019 report, the governments of the UK, Wales and Scotland published a report called *Net Zero*. It calls for zero UK greenhouse gas emissions by 2050 – although swift and significant policy changes are required if these recommendations are to be met.

From an investment perspective, the Bank of England Governor Mark Carney has been consistent in saying that climate change poses a clear and present danger to financial stability. And Pensions Minister Guy Opperman has called on pension schemes of every hue to collaborate and help tackle it.

At The People's Pension, newly authorised by The Pensions Regulator, we absolutely agree that climate change presents a very real risk to the returns sought by pension schemes in future.

Our strategy on how best to address climate change risk – and spot the opportunities from it – is informed by listening to two reputable organisations. After all, we're investors, not climate scientists, and we need expert opinion and input here.

One is the United Nations body for assessing the science related to climate change: the Intergovernmental Panel on Climate Change (IPCC). Its latest landmark report looks at a world where average temperatures sit 1.5° C above pre-industrial levels – and what can be done to stay within that limit.

The other is the Committee on Climate Change – the advisory body to the UK government on Climate Change and author of the *Net Zero* report.

The first action we took was lowering our exposure to fossil fuels. We did this last year by bringing in new funds to The People's Pension's default and we're going to carry on tilting the portfolio away from 'old tech' fossil fuels and towards assets with a better chance of growth.

Secondly we have updated our statement of investment principles with a specific explanation of how we address environmental, social and governance (ESG) risk – available late September.

Every DC scheme has to do this, not just because it's part of broader government policy to corral resources towards tackling climate change, but also because there should be a growing acceptance that Mark Carney is right – climate change is a clear and present danger, which should have a response. I'd say that's good for advisers in two ways.

First, it should provide more confidence that the pensions sector is addressing the issue and indeed meeting member expectations of them.

And on that point, we're surveying our own members to find out more on which responsible investment issues concern them most: *www.thepeoplespension.co.uk/responsible-investment*

Second, these updated statements should highlight more points of difference between schemes – because each will have their own view on how best to arrive at the correct destination.

Over time, we'll be making more assessments about the companies we're exposed to with a reliance on fossil fuels – and acting on them. So we'll look at, say, exposure to car manufacturers to see if they're delivering on promises to electrify their product range and decarbonise their supply chains.

As a shareholder with scale, we can influence that in a number of ways, and one of the things that's front of mind is whether a given company's plans to change align with our own timing.

This is a forward-thinking approach based on the assumption that more information on climate risk will become available from companies, stock exchanges and data providers – the people who provide the reams of information investors rely on.

At the moment, climate data is patchy – some of it is clearly useful, other data are mere estimates.

For example, I'd like to be able to tell you that all international utility companies publish regular reports on the greenhouse gases emitted by their buildings, supply chain and consumer product use. I can't because only some do – but we're seeing improvements and, as datasets improve, we can make more positive decisions about climate risk, whether that means excluding companies with reliance on fossil fuels or including companies ahead of the curve.

As a master trust authorised by The Pensions Regulator, we believe master trusts have the opportunity to lead the whole pensions sector on climate risk.

The structure of a trustee board, with a legal duty to act in the best interests of scheme members, means they have the ability to do innovative things – with a requirement to publish that approach for others to see.

To find out more about what The People's Pension can offer your clients, go to www.thepeoplespension.co.uk/responsible-investment/PA or please get in touch on tel. 0333 230 1310.

Written by Nico Aspinall, chief investment officer, The People's Pension

Shape shifters

Darren Ryder reveals details of The Pensions Regulator's investigation into companies rebranding to avoid their auto-enrolment duties

A new name and logo can help a business to refresh and refocus on what it wants to achieve and how it wants to do it.

There is nothing wrong with genuine rebranding. It has no impact on an employer's automatic enrolment duties. However, a trend we are investigating involves employers changing their name in an attempt to avoid their workplace pension responsibilities.

A rebranded business remains the same entity and would be liable for enforcement action if there was an attempt to deny staff the pensions they are entitled to, for instance failing to pay in pensions contributions.

Employers who set up 'shell' pension schemes to appear compliant but never pay contributions are a key target for us and employers shouldn't think they can pull the wool over our eyes. We have sources of information coming to us that readily identify those who are evading their duties. These include information from HMRC and from pension schemes alerting us to missed contributions.

Some employers claim that they have no workers, and yet we can see from our data that they are paying wages, while some others claim that they are no longer employers – despite the fact that we can see from our records that there are still staff on their payroll.

And then there are those who appear on our radar because they set off alarm bells on more than one of our systems at once. Examples of this are where we can see they have very high opt-out rates, which may prompt us to suspect that they are inducing workers to pull out of their pension scheme, such as by offering them cash upfront instead.

Business advisers should report to us if employers they are working with are breaking automatic enrolment laws. They should also be able to show they've not been involved in the offence. We know of advisers that have assisted employers to breach the regulations. They've not just encouraged employers to break the law, they've facilitated the offence.

A glance back at some of our recent prosecutions shows that we will pursue such third parties to justice. However, we want to make it easy for advisers to help employers to comply with the law. We need advisers to ensure that employers continue to stay on top of their automatic enrolment duties.

Now that saving into a workplace pension is the norm, employees are becoming more aware of their rights. We are increasingly seeing that workers are willing to blow the whistle on their employer if they think they are not being given the pensions they are entitled to.

We also detect employers failing in their duties through our compliance validation inspections. We've moved away from visiting employers based on geographical location and target employers where we strongly suspect noncompliance – no matter where they are in the UK. Employers who are breaking the law can expect a knock on the door.

Despite the small minority of employers who break the law, most employers want to do the right thing for their staff and successfully comply. However, it's important they continue to stay on top of their ongoing responsibilities so they don't risk a fine. Ongoing duties include assessing staff and ensuring the correct pensions contributions are made.

Every three years, employers must also complete re-enrolment. So far, more than 200,000 employers have successfully completed this task, which includes re-assessing staff who opted out and putting them into a pension scheme if they are eligible. Re-enrolment is an important task because it gives staff who opted out a fresh chance to start saving. We've created a new re-enrolment duties tool on our website to help employers quickly work out what they must do. Re-enrolment is a two-stage process and employers must be sure to carry out their re-declaration of compliance as failure to complete this can lead to a fine.

Written by The Pensions Regulator director of automatic enrolment Darren Ryder

Cautious optimism

Craig Scordellis considers the opportunities in credit markets

We continue to see great long-term investment opportunities in credit markets. Whilst economic conditions are less favourable, we do not see global recessionary conditions and subsequent systemic defaults in the medium term, but rather lower growth for longer. Parts of the credit market do not depend on high levels of growth, but investor concerns regarding the global economy have led to dispersion in valuations and performance within credit sectors, providing opportunity for fundamentally-based active investment managers.

Yet we must not be complacent and, if investors are to take full advantage of the opportunities and mitigate market risks, we continue to believe that the flexibility of a Multi Asset Credit (MAC) approach is needed.

Rising short-term volatility in markets

Today's credit markets are characterised by increased levels of volatility in the short term, driven by a number of factors including geopolitical uncertainty and central bank policies, as well as by the growth of daily liquidity products and exchange traded funds in areas which were previously dominated by institutional and bank capital.

Changing consumer behaviour and new technologies are also driving profound secular change across a wide range of sectors and industries. The result is increased dispersion of investment returns, including pockets of potential defaults. Thorough research must continue throughout the life of the investment.

More recently, credit investors face another new challenge, low levels of income with heightened sensitivity to short term interest rate moves. This has been caused by the rapid compression of government bond yields. Indeed, recent estimates suggest that $15 trillion of outstanding bonds now trade at negative interest rates. These moves have been exacerbated by the influence of central bank asset purchase programmes and the growth of passive credit strategies, algorithm strategies and the influence of currency hedging for global asset managers.

The advantages of a flexible approach

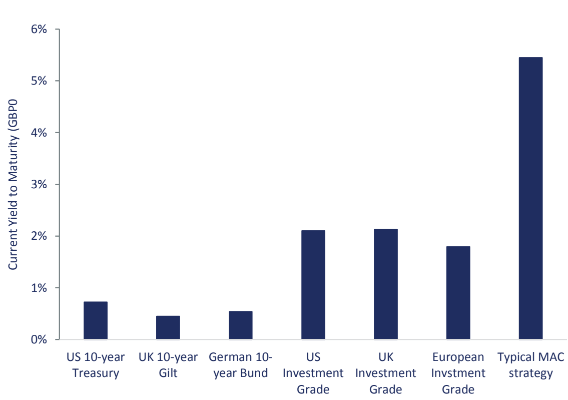
We are optimistic about the selective investment opportunities available in credit markets in the current environment. These changes present opportunity. However, to paraphrase Harold Wilson, we are optimists who like to carry raincoats too. In investment terms, that raincoat is the flexibility which comes from a MAC investment approach.

Today, for example, to protect investors from the effect of minimal and even negative yields in part of the investment grade bond market, we seek to capture visible secured income and to offset interest-rate sensitivity in sub-investment grade assets such as like European loans and in investment grade Collateralised Loan Obligations, with rate floors which are increasingly valuable to investors. These asset classes have been less affected by the yield compression and can be combined with tactical allocations to diverse sub investment grade opportunities, which have lagged recent rallies.

Thorough, disciplined and ongoing ESG-aware fundamental analysis is needed if asset managers are to be able to lend to the right companies in a fast-changing business environment, to mitigate defaults and realised losses, and, increasingly, to capture tactical opportunities in unloved individual investments. We believe it is possible to find good-quality companies in the UK, in lagging sectors in the US, and in the financials sector in Europe, where regulatory capital requirements act like traditional maintenance covenants to the benefit of investors.

In the end, we believe that long-term material outperformance of broader credit markets can only come from disciplined fundamental investing.
In our view, the broad universe of investment MAC provides investors with the flexibility needed to avoid realised losses on defaults through fundamental research, and a sufficiently diverse investment universe by asset class and geography, to build a portfolio with the potential to outperform the underlying market with lower levels of fundamental risk and volatility.

Comparing yield



Source: CQS, ICE, as at 14 August 2019.

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

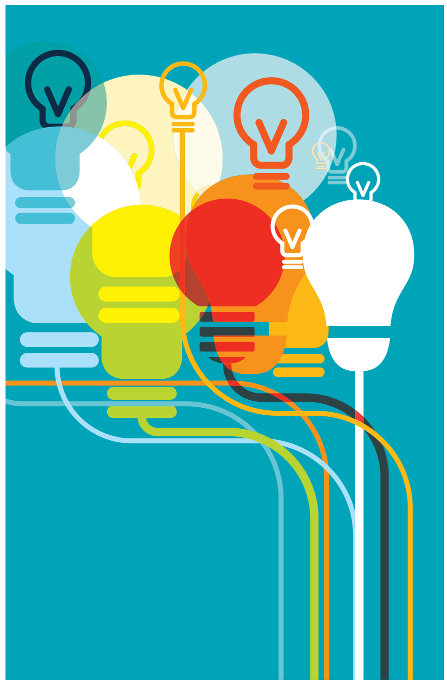
In association with CQS

What is the end game?

John Herbert discusses different views on what the 'DB end game' could look like and whether it is much closer than many people think

Traditionally most people have considered the 'DB end game' to be a full settlement of the liabilities with an insurance company through a buyout. This removes all liabilities from the balance sheet and transfers the pension risk to a third party through a single transaction.

However, the discussion and debate around DB consolidation has resulted in the emergence of further options such as 'superfunds' and 'DB master trusts', which may provide alternative strategies to a full buyout. More recently The Pensions Regulator has asked trustees to consider a long-term funding target, which could lead to a sustainable, low risk, pension strategy much sooner and without the additional cost of a buyout.



So the DB end game could become a low-risk solution within the existing governance structure. Therefore, the desire (or objective) to fully settle the liabilities through a buyout may become less important and fall away from the agenda. The costs of achieving this alternative target are likely to be significantly lower and consequently the timescales for achieving this are likely to be much shorter.

The long-term funding target could become a much more important funding objective than achieving buyout once a pension plan has achieved full funding against its Technical Provisions.

Lower funding cost, shorter time scales and less administrative work (at least in the short term) are all key advantages and it would not prevent a buyout at some point in the future.

In practice this is already happening where pension plans are fully funded against their Technical Provisions, as trustees have turned their focus towards risk management in order to protect the funding position, rather than retain existing levels of risk in order to achieve a buyout as soon as possible.

Often this involves increasing the allocation to matching assets and increasing the level of protection against changes to market conditions.

The road to a sustainable low risk solution is just a natural development once Technical Provisions have been met. In fact, it may be a natural course in any event because many pension plans (particularly with a strong covenant) target a higher investment return before retirement and a lower investment return after retirement. Consequently, as more members retire and the proportion of pensioners increases, the target investment return in the funding plan will naturally decrease. Once there are only pensioners, there will probably be a low-risk funding and investment strategy in place. Over the medium term (as benefits are paid and liabilities run down) there is likely to be convergence towards the buyout position.

Perhaps the most pressing immediate question for trustees is to reach a consensus view on the long-term funding target. This is also likely to include a journey path and timescale to achieve this objective.

Whether this represents the DB end game or not will probably depend on the economic position at the time, the remaining levels of risk and the overall objectives for each pension scheme.

It is likely that larger pension schemes will have the resources and skills to continue to operate efficiently and meet the governance requirements over the long term but smaller pension schemes may look to reduce operational costs and governance risks through consolidation in order to achieve economies of scale. For smaller pension plans moving towards their long-term funding target, the availability of sufficient choice of suitable, accessible and affordable consolidation options from superfunds, DB master trusts or insurance companies is likely to have a significant impact on how the DB end game will play out.

Many pension plans may be able to achieve a low-risk solution within a few years with only modest amounts of additional funding. If they decide to run off the liabilities rather than pay the additional premium to achieve buyout they will be entering the DB end game much sooner than they expect. That said the DB end game will then take quite a long time to play out in full.

Written by John Herbert, chief actuary, Premier

In association with premier

In data we trust

With projects such as GMP equalisation, the pensions dashboard and the rise in de-risking, having good data is imperative for pension schemes. Natalie Tuck reports

As far back as 2010, The Pensions Regulator (TPR) published guidance on data reporting, with trustees encouraged to review their data regularly. Since then, issues such as GMP equalisation and the creation of the pensions dashboard have pushed the issue into the spotlight. However, that spotlight has also highlighted the cracks in pension scheme data.

At an event earlier this year, TPR director Margaret Snowdown said that "good data is not only essential for the day-to-day running of a scheme, it will be required to comply with the pensions dashboard initiative and the scheme's ability to de-risk".

So what does the picture look like? Squire Patton Boggs partner Matthew Giles throws out the idea that the bigger the scheme the better the data quality – an idea that has become common place in terms of overall pensions governance standards.

Instead, he says that the quality of the data largely depends on the importance that scheme trustees place on accurate data; the quality of the administration service (current and former); and how willing trustees and administrators are to work together to identify and address problem areas.

"If a large tick can be placed against each of these points, the chances are that the data standards will be high, irrespective of the size of the scheme," he says. But compared to other sectors, where data is "collected, stored and made available in different flexible, easy to digest ways," ITM director Matt Dodds says, "pensions are playing catch up".

Furthermore, 75 per cent of trustees themselves note that more investment is needed to improve member data, according to XPS Pensions Group.

Dodds explains that DB provision and a low-tech world meant in years gone by there was plenty of time to review individual records in detail and make sure everything was ok. "This doesn't work in many cases now – data needs to be standardised, reliable and portable, not just to be able to do things like deliver benefit statements efficiently, but to react to members' needs and wants," he explains.

Having bad data is certainly a hindrance; Aon client relationship manager, David Pharo, notes that it "impedes paying the right benefits to the right people on time and it prevents or slows the delivery of strategic projects – and so, progress to the scheme's ultimate endgame objective". Not only that, he adds that negative press for both the trustee and the sponsoring employer if data quality issues impact member services, resulting in complaints.

The good news is that data quality is improving, says Dodds, but "the older the scheme the more likely they will have legacy systems with restricted and or missing data fields with multiple systems and records for one member".

How can data be improved further? Pharo advises schemes to work in partnership with their administrators and other professional advisers to set out clearly the schemes' objectives and understand both the importance of data to these and where any issues with data could impact on realising these objectives.

"As part of this, I would expect schemes to consider both short and long-term objectives and then planning and setting out budgets to realise these. Short-term objectives would typically include common and scheme-specific reporting requirements, and the data required to enable success of key projects, such as GMP rectification and equalisation, member options or risk settlement," Pharo says.

For those schemes that are on top of their data, Dodds says it can act as an enabler. "It can help you achieve short, medium and long-term strategic goals. Good data will keep you compliant, allow for technology enabled engagement and efficiencies and be a key part of de-risking."

Written by Natalie Tuck

Five ways in which UK pension schemes are using ABS

Frank Meijer discusses the attractions of asset-backed securities

Over the past two years we have welcomed a growing number of UK pension clients into our European ABS strategy, managed by our specialist team in The Hague. In this article we discuss the attractions of asset-backed securities, before highlighting the different ways in which our UK clients are incorporating them within their portfolios.

For those readers who are new to this asset class, asset-backed securities are fixed income investments secured with reserved asset pools, such as residential mortgages, consumer loans (credit card and auto), commercial mortgages and loans to corporations.

The European ABS market is large and diverse. At over £1.1 trillion, it is comparable to the European investment-grade corporate credit market and offers a broad range of countries and underlying sectors.

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

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

It has been interesting to see the different ways our UK pension clients are incorporating European ABS within their asset allocation. Below are five of the most common themes.

1. Seeking a yield pick-up

Many schemes have been drawn to ABS because of the yield pick-up it offers over traditional credit and cash. UK credit yields have been compressed for a long time, while schemes have increased their fixed income allocations through LDI, buy-and-maintain and CDI strategies. This has left some clients looking elsewhere for fixed income investments that offer a similar risk profile as investment-grade credit. ABS is helping to meet this demand.

2. A temporary allocation

Many schemes are seeking to build allocations to illiquid asset classes, such as private debt and infrastructure. They often need a place to invest the capital before it is draw down. European ABS is a relatively liquid alternative fixed income strategy that compares favourably with other potential options such as equities (too volatile) and traditional fixed income (insufficient yield). In some cases, clients have set a new strategic benchmark and want an immediate allocation to alternatives, a categorisation that includes European ABS.

3. Minimising interest-rate sensitivity

European ABS bonds are almost always floating rate, in contrast to the US, where most ABS bonds have fixed-rate coupons. This makes European ABS particularly attractive to clients who do not want to take on additional interest-rate risk.

4. Diversifying credit exposure

At times of stress, similar asset classes tend to become highly correlated, including traditional credit markets. As global markets swing between 'risk-on' and 'risk-off', some of our clients have invested in ABS as a way to diversify their traditional credit exposure to less correlated assets.

5. Accessing consumer risk

The cashflows produced by ABS bonds are typically generated by the underlying consumers paying their mortgages, car loans and credit cards. These tend to follow a different cycle to sovereign and corporate markets, providing a different return profile for portfolios.

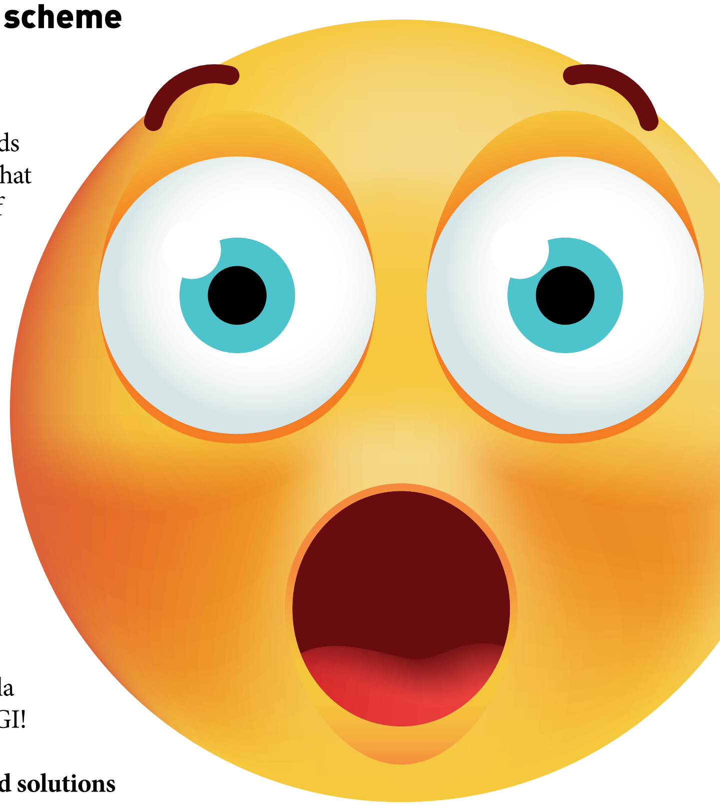
For more information about European ABS, contact the Kames Capital institutional team, which distributes Aegon Asset Management's strategies in the UK.

www.kamescapital.com/institutional

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

Unusual member interactions

Pensions Age finds out times when a pension scheme member took you by surprise



We received a pensioner payslip, returned to us. We suspended the pension and sent a letter via DWP tracing service. A couple of weeks later we received a response from DWP to say the person was deceased. We obtained a copy of the death certificate and tried to contact the spouse, as stated on the death certificate. We used a tracing company and after a couple of months we were given a possible telephone number. I telephoned, expecting to speak to the spouse, only to discover it was the member and she was still alive. She had the same name and date of birth as the dead person.

Also, we got a phone call from another pensioner. She was receiving payments via cheque, she got married, and assumed she was no longer entitled to the pension, so stopped cashing the cheques. After seven years she telephoned to check if she was still eligible for the pension. She was and we had to make back payments!

Quantum Advisory senior pensions administrator, Hywel Davies

Before they became BlackRock, Barclays Global Investors (BGI) used to have a series of funds called 'aquila'.

When I was at Aquila (the software firm) I used to get all of the contacts made through our website.

Every time BGI's funds performed badly, I knew I would get a barrage of complaints and borderline abuse from members who must have just googled 'aquila pensions' and found us.

As you'd expect, I had a pretty standard set of words that I would send back, guiding them towards their pension providers. That would work 99 per cent of the time.

The 1 per cent when it didn't work will stay with me forever.That member replied: "OK, sorry, but I don't really understand pensions. Could you speak to them for me and ask them to sort it out?" This whole BGI/aquila thing was so prevalent at one time that I even received a call querying something about the aquila series from someone at BGI!

Equiniti propositions and solutions director, Chris Connelly

If you have experience of working in member service then you'll know your job can sometimes be a mix of customer support, counsellor and agony aunt. We have members who regularly call the helplines just wanting to talk to someone. I've also heard of a particular member call up a helpline so that the team can listen to him play the piano, and a member who calls every day to get confirmation their pension will be paid as normal.

Trafalgar House client director, Daniel Taylor

We had one member who ticked all official paperwork relating to comms for 'mail only contact' – woe betide if you contacted them by accident if you were new (as I once was) – this meant all email comms to board meetings, AGMS, had to be typed out as a letter.

We also generally experienced members moving home, not informing us and then ringing up to vent why they had not received correspondence. Quietly explaining that without notification we cannot predict where they would be was very therapeutic.

In contrast, we had a member who rang up every year on a certain day/date without fail to inform us that they were alive. Then one year, they were being held in a nursing home 'against their will' but wanted to inform us of their change of address.

Anon

Written by Laura Blows

New rules

New requirements for trustees in relation to investment consultancy and fiduciary management services

On 10 June 2019, the Competition and Markets Authority (CMA) issued the *Investment Consultancy and Fiduciary Management Market Investigation Order 2019* (Order). The Order implements the bulk of the CMA's remedies following its December 2018 findings that there are features of this market which adversely affect competition.

Whilst the majority of the new requirements under the Order fall on investment consultants and fiduciary management services providers, some are also directly relevant to trustees of occupational pension schemes who use such services. In particular, **trustees who currently use investment consultancy services will need to take action ahead of 10 December 2019.**

The requirements on trustees will be replaced with equivalent obligations within the main body of pension legislation, probably in April 2020.

New requirements for trustees

• **Mandatory competitive tendering for fiduciary management services**: Trustees will be required to use "reasonable endeavours" to obtain bids from three or more unrelated providers when tendering for fiduciary management services as follows:

• **New mandates:** trustees must run a competitive tender for any new FMA(s) which would result in 20% or more of scheme assets being delegated

• **Existing mandates in place before 10 June 2019 covering 20% or more of scheme assets:** trustees must run a competitive tender within five years from the date of the commencement of an FMA not originally subject to a competitive tender process (a shorter two-year deadline applies in some cases)

• **Existing mandates covering less than 20% scheme assets:** trustees must run a competitive tender at the point the assets covered by existing FMA(s) increase to 20% or over.

The regulator has published draft guidance for trustees on tendering for fiduciary management services as part of a suite of new guidance on investment governance.

• **Objective setting for investment consultants** - from 10 December 2019, trustees will be required to set strategic objectives in respect of their investment consultancy services. The draft guidance indicates the regulator's expectations in this area.

• **Reporting** - the requirement for annual compliance statements to be submitted to the CMA is likely to be replaced with a different process and deadline (involving the regulator and via Exchange) before trustees are required to take action under the Order.

Enforcement

In due course regulatory oversight will pass from the CMA to the regulator who will have the power to impose financial penalties for non-compliance.

New requirements for investment consultants and fiduciary managers

These are summarised as follows:

• To separate advice in respect of investment consulting or fiduciary management services from marketing material, and to label such marketing material clearly.

• To provide disaggregated fee information in respect of fiduciary management services to existing trustee clients regularly.

• To disclose and itemise all costs and related charges to all potential trustee clients when involved in a tender process.

• To provide potential trustee clients with information on the past performance of fiduciary management services using a standardised methodology and template (based on a standard to be approved by the CMA).

• To provide potential trustee clients with information on past performance of recommended products or funds using a basic minimum standard.

Getting ready for the new regime

Based on the provisions of the Order and the draft guidance, trustees should consider taking the following action:

• Review contractual documentation under which any current investment consultancy and fiduciary management services are provided. This will require an assessment of the underlying nature of the services, which can be complex – trustees should not rely on how services have been 'labelled'.

• Start considering the strategic objectives that might be appropriate for any existing contracts for investment consultancy services. In due course, update processes to ensure that objective setting is incorporated into any new contract for investment consultancy.

• Update policies and procedures to ensure that necessary compliance statements are made by the required deadlines.

Written by Chantal Thompson, partner, Baker McKenzie

In association with Baker McKenzie.

Adapt and overcome

The Pensions Regulator (TPR) has upped the standards it expects of trustees when completing their chair's statements, creating new challenges. Jack Gray assesses how trustees have had to change to meet the new expectations and whether TPR's non-compliance penalties are sufficient

Since April 2015, trustees of defined contribution workplace pension schemes have been required to produce an annual governance statement, signed by their chair. TPR has said that it expects the statement to provide a "meaningful narrative of how, and the extent to which, the governance requirements have been complied with".

Three years later, in April 2018, the regulator issues new regulations that require trustees to provide additional information on investment charges and transaction costs to be made available online.

Rising challenges

Chair's statements are often lengthy and detailed, requiring trustees to obtain data and produce documents in a way members can understand. This is where challenges can arise.

"The difficulties come from the level of detail required," begins Norton Rose Fulbright pensions lawyer, Shane O'Reilly.

"In some ways the trustees are beholden to how much detail their investment fund manager will give them, because you have to do things like assessing what the charges and costs are, whether they're good value for money.

"To make that kind of assessment trustees need quite a lot of information both from the managers who operate the funds and in conjecture with their investment consultants."

It can be even more difficult for trustees that have changed fund managers to obtain the data, as the statement is retrospective on the previous year, and getting up-to-date information can be challenging.

Overcoming obstacles

To overcome this issue, O'Reilly recommends that trustees ensure they are aware that they need to engage with their fund managers and that they understand all their internal processes, training requirements and legislative updates.

Despite the challenges facing trustees, Dalriada Trustees senior trustee representative, Vassos Vassou, believes that the changes been positive for members.

He explains: "TPR's increased engagement and regulation on chair's statements has had a positive effect on badly governed DC schemes.

"It has helped highlight to those schemes what they should be doing going forwards to help improve member outcomes.

"For those schemes that are already well governed, the increased governance requirements are more of a compliance exercise, which means that trustees of those schemes sometimes view this as extra red tape with unnecessary adviser fees."

Penalties

TPR has also shown that it is not afraid to punish those who do not comply with their requirements, with trustees that do not produce a statement liable to a fine of between £500 and £2,000.

In April 2019, TPR fined two scheme trustees £2,000 each for failing to include the required information in their annual statement.

Commenting, TPR executive director, Nicola Parish, says: "As these cases clearly demonstrate, we are prepared to defend our penalties in court.

"It is the law for trustees to produce chair's statements and make sure they contain all the necessary information.

"We continue to expect high standards of trustees and will take action when chair's statements are not compliant with the law."

Vassou believes that the penalties are sufficient, especially for professional trustees. He says: "The consequences of not complying with chair's statement regulations are sufficient from a professional trustee perspective.

"Incurring a fine can affect you and your reputation, which is the last thing that any professional trustee, or for that matter, any other trustee would want."

Looking towards the future

Although TPR's changes have broadly been welcomed, O'Reilly thinks that a proportional approach would be better, as most members are in default funds, but the regulations apply equally to all funds.

He concludes: "If there's one default fund that covers 80-85 per cent of the membership, then they may have 20 extra funds that only a handful of people are in, but the same information has to be applied.

"If it were possible to make some sort of proportional approach, I think that would certainly be welcomed by trustees."

Written by Jack Gray

Strong foundations for growth

The bulk annuity market has enjoyed another record-breaking six months – and the work Aviva has put into its de-risking technology platforms should mean the next six months are impressive too

£17.6 billion. That's the staggering amount of buy-in and buyout activity in the UK market. That far exceeds the £7.8 billion that took place in H1 2018, according to research from LCP. The year's de-risking activity, from June 2018 to June 2019, was the busiest ever, with over £30 billion recorded – more than double the £14.9 billion activity the year before.

The past 12 months has also seen the largest buy-in and buyout transactions ever recorded. Amongst this record-breaking is Aviva, which conducted the highest volume of de-risking deals in the last full year, completing 69 transactions.

Aviva MD of defined benefits solutions, Tom Ground, says: "The market has seen a record-breaking volume of transactions in the first half of the year, driven by pricing affordability. From our perspective, we're continuing to build on last year's successes, where we transacted a record number of deals, serving schemes of all sizes and this ambition underpins the significant investment in the business we have made."

It's not surprising Aviva has completed the highest volume of deals in that time – after all, the company focuses on providing de-risking products to the whole of the market. DB schemes, big or small, looking to de-risk know they will get a quote from Aviva, something smaller-sized schemes can't be so sure about with other insurers.

What is surprising, however, is that Aviva delivered this outcome while also investing heavily in both its front-end and back-end technology platforms.

Behind the scenes, Aviva is significantly upgrading its administration capability, improving both flexibility and efficiency. It's also working to deliver digital service for buyout members through the integrated MyAviva portal. This makes it simple and convenient for customers to manage their annuity policies online and to see all their Aviva policies in one place.

This investment will deliver enhancements to the customer experience as the company moves into 2020.

On top of making things better for the customer, Aviva is working innovatively on its front-end pricing platform to streamline processes for schemes looking to conduct a buy-in or buyout. Through ongoing work to automate and upgrade these systems, Aviva will significantly reduce the amount of time it takes to quote for a de-risking deal.

According to Ground, schemes looking to de-risk are at the mercy of market pricing volatility. By speeding up the quoting process, Aviva is looking to help increase certainty for schemes when completing that all-important bulk annuity deal.

The final element of Aviva's transformation is its focus on refining its reinsurance and asset origination capabilities.

In 2019, Aviva created a new asset origination team at Aviva, serving both the bulk and individual annuity books – a move that is paying dividends already. At a time of record growth – when insurers need to look more widely for appropriate backing assets without breaking concentration limits – the new team has successfully diversified the spectrum of assets Aviva is using. Longer duration assets and new international asset types have played a key role in this.

It's this focus on the end-to-end process from Aviva that will help the bulk annuity market continue its soaring ride.

What does the future look like?

With a pipeline of activity already lined up, Ground expects Q3 2019 to see high volumes of de-risking activity. After that, he expects to see a quieter period at the end of the year as the dust settles on the impact of Brexit.

But with over £1.8 trillion of DB liabilities to be insured according to the PPF 7800 Index, Ground expects this to be a brief pause in an otherwise buoyant market. And, as Aviva's recent work shows, it's a market that continues to evolve to meet the needs of DB schemes.

Ground says: "The market will inevitably cool as we move through the Brexit period, but I anticipate it picking up sharply again in 2020. Affordability will continue to be the key consideration. And with the dynamic asset and reinsurance strategies insurers have in place, I think they are well placed to support this growth.

"From our perspective, we've made significant investment in the business to ensure Aviva is poised to play a key role in supporting de-risking in the UK. As a whole-of-market provider, we help both small and large schemes de-risk. Our increasing efficiency and slicker processes mean we will be well positioned to continue to be a leading provider in the de-risking market."

Aviva MD of defined benefits solutions, Tom Ground

In association with

Pensions, politics and Partick Thistle

Aviva head of savings and retirement, Alistair McQueen, chats to Jack Gray about his political aspirations, the universal love of tubas and how looking to the future is the way forward for pensions professionals

What's your employment history (including jobs outside of pensions)?
Paper boy; football crowd steward; Aviva. Simples.

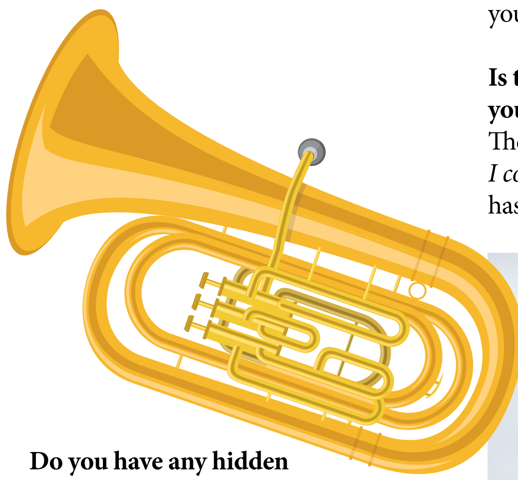
What's your favourite memory of working in the pensions sector?
I'm looking forward not backwards. As we age, pensions are going to become ever more important for ever more people. Bring on tomorrow.

Editorial credit: Chantal Heather / Shutterstock.com

If you did not work in pensions, what sector do you think you would be in instead?
Politics. Call me power hungry, but then I'd get to pull ALL the BIG pension levers.

What was your dream job as a child?
Blue Peter presenter. I continue to be amazed with what can be done with sticky-backed plastic and a toilet roll.

What do you like to do in your spare time?
I sing in my local choir. It's a great way to "shout" away the stresses of the day.



Do you have any hidden skills or talents?
I can play the tuba. I am available for weddings and parties. Everyone loves the tuba.

Is there a particular sport/team that you follow?
Coming from Glasgow, this is a divisive question. To avoid any upset, I'll say Partick Thistle FC.

If you had to choose one favourite book, which would you recommend people read?
The Road Less Travelled, by M. Scott Peck. It begins with the line: "Life is difficult". Accept that, and life gets easier.

And what film/boxset should people see?
The West Wing, if you want a good insight into the life of the US president. If you want a crazy insight, watch the news.

Is there any particular music/band that you enjoy?
The first single I ever bought was *I wish I could fly*, by Orville the Duck. Nothing has bettered it.

Editorial credit: Featureflash Photo Agency / Shutterstock.com

Who would be your dream dinner party guests?
Brian Blessed (anecdotes), Billy Connolly (humour), the Queen (perspective), Greta Thunberg (the future).

Is there an inspirational quote/saying you particularly like?
"Some men see things as they are, and ask why. I dream of things that never were, and ask why not." Robert F Kennedy.

Written by Jack Gray

The sky's the limit

Kai Hoffmann of Legal & General presents a case study of the partial buyout with the Rolls-Royce UK Pension Fund, the largest transaction in the history of the UK bulk annuity market

In June 2019, Rolls-Royce and Legal & General announced the largest transaction in the history of the UK bulk annuity market – a buyout for over £4.6 billion for the Rolls-Royce UK Pension Fund, covering 33,000 of the fund's 76,000 members.

A great take-off

We have a long-standing relationship with Rolls-Royce: LGIM has provided investment management services to the fund (or its predecessor schemes) since 1989 and more recently, has supported de-risking activity as its liability-driven investment (LDI) manager. The trustees and their advisers have worked over a long period to manage the Rolls-Royce pension schemes' risks and to get to a position where they could begin securing members' benefits.

A smooth flight

Over many months we worked with the sponsor, trustees and their advisers to restructure and transfer two legacy assets held by the fund.

First, an LDI portfolio managed by LGIM. Despite the complexity of the legacy portfolio, we were able to work collaboratively with all parties to reach a solution. We agreed an in-specie portfolio to which we locked the premium, thereby providing price certainty.

Second, a longevity swap established with a European investment bank in 2011. Restructuring the existing longevity swap was one of the main challenges of the transaction. The longevity hedge market has made great strides over the past several years. However, some of the earlier transactions, like this one, were completed using a complex derivatives structure that had not contemplated future conversion to buy-in or buyout.

The bank hedged the longevity risk with six reinsurers – each an existing Legal & General partner. The strength of these insurer-reinsurer relationships helped to ensure a clean and easy transfer of the reinsurance arrangements to us.

A safe landing

The Rolls-Royce buyout is a shining example of what collaboration between trustees, sponsor and insurer can achieve. The outcome for each of the parties has been positive, further enhancing the trusted relationships amongst the parties. A large bulk annuity transaction involves complexity, not just because of its size, but because of each pension scheme's unique history. This transaction demonstrates that jointly arriving at solutions is what will enable this market to continue to thrive and bring positive outcomes for members, trustees and sponsors – as well as the wider UK economy.

£4.6+ billion buyout	33,000 members	LDI restructure	Longevity swap restructure

Benefits to the trustees	Benefits to Rolls-Royce	Benefits to Legal & General
High level of security for the members covered by the buyout	A leaner balance sheet following buyout	Take on responsibility for the pensions of 33,000 individuals
Transfer of two legacy assets leaves a cleaner portfolio to support the remaining liabilities	Progress on its journey to simplify, de-risk and increase efficiency across its businesses	Invest premium to support long-term sustainable growth of UK economy

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

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Deloitte.

More for less: Lower costs and improved governance *– Paul Yates explains why now is the time for DB consolidation and how to make it happen* ***p56***

A question of trust *– Defined benefit master trusts have existed for a number of years and are one of the options for consolidation in the market. But, asks Andy Knaggs, how can they communicate their offerings and benefits amidst the hype of the new superfunds and the fixation with buyouts?* ***p58***

DB master trusts:

Time to shine

Deloitte director Paul Yates

Deloitte.

Sponsored by

"… Many pension schemes benefit from using a defined benefit master trust *[and]* government wants to do more to help encourage existing forms of consolidation as it recognises the benefits it can bring in reducing scheme costs per member, enabling more effective investment strategies and improving governance."

Public consultation, *Consolidation of Defined Benefit Pension Schemes*, Department for Work and Pensions, December 2018

More for less: Lower costs and improved governance

Paul Yates explains why now is the time for DB consolidation and how to make it happen

The costs of running a defined benefit (DB) pension scheme can be significantly reduced by consolidating into a larger pension scheme. DB master trusts can reduce costs by as much as a third.

However multi-employer schemes have been around in the pensions industry for a long time. So why haven't more schemes consolidated in the past, and why should they now?

Now is the time

The December 2018 consultation by the Department for Work and Pensions confirmed government support for DB master trusts and the benefits they can bring.

In other areas of the pensions industry, The Pensions Regulator wants to accelerate the consolidation of small defined contribution (DC) schemes, following research that revealed the governance in small DB and DC schemes tended to be poor.

Reduced costs and improved governance bring benefits to members, trustees and employers alike. With government backing and regulatory desire for better-run schemes that are more efficient, now is the time for employers and trustees to analyse how consolidation can benefit their DB scheme.

A solution for the majority

Much focus has recently been given to other potential forms of consolidation such as superfunds.

The idea of a superfund is to separate the employer from a pension scheme and have security provided by a capital buffer. The cost of doing this is expected to be lower than buying out benefits with an insurance company.

However, with total UK pension scheme buyout deficits estimated to be around £600 billion, few UK schemes will be in a position to buyout or transfer to a superfund over the short or medium term.

DB master trusts do not require scheme funding to be improved in order to access the benefits they bring. They are therefore a realistic and compelling solution that can be implemented for the majority of schemes in the UK.

Barriers falling away

Transferring to a multi-employer scheme would historically have meant a loss of control for the employer and existing trustees.

However, employers are now able to choose a consolidator where they can retain their existing scheme's trustees on transferring in.

By retaining control, schemes avoid the risk of a 'black box' solution for investment, funding or governance which may not be ideally suited to a scheme's individual situation – and a key barrier to consolidation falls away.

Fit for purpose

Another reason why employers have been reluctant to consolidate in the past, concerns legacy issues with some older schemes.

Multi-employer pension schemes have historically been associated with problems such as orphan liabilities. This is where the sections of a multi-employer scheme are not properly segregated, and if one employer fails their section's deficit becomes the responsibility of other sections' employers.

Older schemes will also sometimes have long and complex rules, amended many times over many years, potentially leading to uncertainty around interpretation.

Employers can now choose a consolidator scheme designed 'from the ground up' to be fit for purpose, with concise and clearly written rules. This means trustees and their legal advisers can quickly get comfortable that the scheme is properly segregated and suitable for receiving assets and liabilities from different employers.

Making it happen

The good news is that transition is straightforward for a well-designed consolidator.

The first step is a strategic decision to consolidate, and selection of which consolidator to use.

While either the employer or trustees could initiate consolidation, it is generally a more natural fit with how most schemes operate if the employer makes a proposal, and then the trustees consider whether it is appropriate to agree.

Doing a good deed

Trustees need to take legal advice before agreeing to an employer proposal to transfer to a consolidator.

The fundamental questions for trustees are: do they have the power under the scheme rules to agree to a transfer; how member benefits, trustee powers and employer covenant will be maintained; and whether the transfer is reasonable in view of trustees' legal duties and responsibilities.

When this diligence stage is complete and employer and trustees have agreed to proceed, the legal advisers can start drafting deeds. These will establish a new section in the consolidator, and effect the transfer of assets and liabilities into that section.

The legal process is much easier if the consolidator's transfer mechanism exactly replicates member benefits, the balance of powers between the trustees and employer, and the employer covenant. If this is not the case, it is more difficult to conclude the transfer is in the best interests of members and legal review will be more expensive.

Your chosen consolidator may provide template deeds and a legal guide so your lawyers have all the reference information they need to draft the deeds easily to hand.

Making an investment

Support will be needed from an investment adviser to transfer the assets and avoid unnecessary costs on transition.

Consideration of the investment transition should start early, to identify the assets the scheme has and which parties will be involved.

If your chosen consolidator offers flexibility around investments, you may wish to review the potentially wider range and lower cost investments the consolidator can offer, to make sure you get full benefit from the transition.

Transition of services

The consolidator's actuaries and administrators will need to receive details of the scheme and its membership.

Trustees will want to be sure the transition will be handled by an experienced team, and understand the key stages of the installation process.

Your consolidator may be willing to carry out the transition for free.

Keeping on track

As a number of parties are involved in the process, good project management will help keep things on track.

As soon as a decision to consolidate is made, a plan can be put into place and appropriate reporting lines agreed.

Your consolidator may be willing to project manage the transition at no cost.

Making the transfer

When preparatory work for the legal, investment and data transfer workstreams is complete, the transfer can proceed.

The mechanism is likely to be a bulk transfer without member consent. This requires actuarial certification, which should be straightforward assuming your consolidator preserves member benefits, trustee powers and the employer covenant.

There is a statutory requirement to notify members of the transfer within a specific timeframe. Communications will also need to notify of any change in administrators, and contact details for enquiries.

Transfer complete

When the transfer has happened, there are requirements to notify various regulatory bodies, including the transfer being a notifiable event that The Pensions Regulator will need to be informed of.

A good transition will have been seamless from a member perspective, with good service levels maintained throughout.

Your adviser should have a year one plan for meeting statutory requirements for the new section and moving to business as usual. Although, 'as usual' will now be at lower cost than when the scheme was standalone.

Time to get started!

The Deloitte Pensions Master Plan is a new fit for purpose consolidator of DB schemes.

It allows schemes to benefit from economies of scale while retaining control – including keeping your existing trustees, legal advisers, and full control over investments.

The Master Plan won the *Pensions Age* 2019 Innovation Award.

You can find out more at www.dpmp.co.uk.

Written by Deloitte director Paul Yates

Summary

• With the consolidation of the DB pension scheme market, master trusts are one of the options.
• DB master trusts provide benefits through economies of scale – but are the benefits attractive enough to drive significant growth?
• There are government measures in the pipeline to provide clarity to scheme sponsors about the role DB master trusts can play within DB consolidation.
• Web technology is being utilised to further improve the member experience of DB master trusts.

A question of trust

Defined benefit master trusts (DBMTs) have existed for a number of years and are one of the options for consolidation in the market. But, asks Andy Knaggs, how can they communicate their offerings and benefits amidst the hype of the new superfunds and the fixation with buyouts?

The platform for the Deloitte Pension Master Plan defined benefit master trust (DBMT) holds a billion pounds' worth of assets for a membership approaching 10,000 individuals. A major blue-chip UK company has recently selected it as its preferred option for consolidating its smaller DB pension schemes.

It's a level of market penetration that Deloitte senior manager Jeff Cunningham is bullish about, professing that the company views growth prospects with optimism.

"The industry has been a little slow to go to DBMTs because it feels new and complex, but the market is certainly talking openly about consolidation now in a way it was not three or four years ago," he says.

"Over the past year we have seen a huge increase in interest in consolidation, and our clients are approaching us because they are realising that we are the only suitable vehicle that allows them to retain the trustee board and keep control of managing their own assets. We are optimistic we will continue to see high levels of growth."

Of course, any DBMT provider is likely to accentuate the positives of both the rate of consolidation of DB pension schemes into master trusts in general, and their own success in the market specifically. Is that positivity reflected by others in the pensions sector though?

Tools of the trade

Many in the professional trustee community see it as 'another tool in the toolbox' – a potentially useful one, but one with what has seemed a narrow window of attraction thus far for those who will ultimately push the process of DB pension scheme consolidation – the employers.

BESTrustees director Zahir Fazal comments: "The direction of travel is that there will be greater consolidation and, as part of that, it's reasonable to expect that a number of schemes will move to master trusts. It's one way of consolidating. At BEST we have not seen any significant move in our schemes to go into master trusts. I expect we will though."

"Master trusts are just another tool in the toolbox towards the end objective, which is to protect members' interests," says Capital Cranfield managing director, Neil McPherson. "So, it has to be viewed through that prism, with a spectrum from buyout at one end through to self-sufficiency at the other.

"We've not had a great deal of activity with them. We act as trustees on a few DB master trusts, but there's more activity on the DC side. They are playing an important but niche role in the market, and it would generally be the smaller schemes end of the market, where schemes might be struggling to provide the governance required."

PTL managing director Richard Butcher describes the DBMT sector as "not particularly buoyant", and offers some thoughts on the reasons for this.

"In the main, the savings that can be generated are relatively small and there's a process cost in going into a consolidation, and quite often those are not trivial costs – there are quite a lot of hoops to jump through and you have to pay someone to do that – so employers might see the process risk outweighs the savings that can be made."

PLSA policy lead on DB Tiffany Tsang feels this is a valid point to make, but adds that consultation and a resulting white paper from the Department for Work and Pensions (DWP) suggested that many schemes and sponsor employers did not know enough about the different DBMT offerings available, and the possible savings they could realise for DB schemes.

"The word on the street is that DB master trusts might be helpful, but in terms of matching them to needs, that alignment has not been made smooth yet," says Tsang.

This is not for the want of trying though. A workgroup was set up, with which the PLSA is involved, to look at ways that awareness can be increased. Through this initiative, an attempt has been made to develop a template in which DBMT providers provide short narratives on their features and benefits, so that schemes and their sponsors can gain simple reference material on which of the master trusts would be best suited to their needs. It would, therefore, greatly assist providers in communicating the benefits and the relative costs of consolidating with their master trust.

The problem right now is that the development of the template, seems currently to be lost in a political landscape where Brexit overshadows all. "Everything is up in the air with Brexit," says Tsang. "The DWP said they wanted the template finished as soon as possible, but there's no news on that yet."

Members' interests

From the professional trustees' perspective, there are open minds about the use of DBMTs as a vehicle for consolidation. They stress that the members' interests are at the top of their considerations. If a sponsoring employer came to them with the idea of consolidating a DB scheme into a master trust, they say they would, as Butcher puts it, "deal with it in good faith", keeping their members' interests front and centre.

There is a recognition that there are potential economies of scale, and administration and actuarial cost savings possible by the pooling of resources that consolidating into a master trust delivers. There is also a recognition that not all DBMTs are the same – that some might be more suited to particular sectors, for instance.

Like everyone else, the trustees are looking for greater clarity on the regulatory environment that the so-called superfunds will operate in, although these have a different proposition compared to the traditional master trusts, in that the superfunds will also take on the employer covenant, which generally (though not necessarily always) remains in place with DBMTs.

There is also a consensus that there will be an ongoing move towards consolidation of DB pensions in general, even if it is only a gradual one. "A lot of people are talking about it, but that talk is not necessarily converting into action," says Butcher.

What will make DBMTs more attractive to employers? "The most obvious answer is them being clear in their offering and potential cost savings," says Tsang. "Employers will be looking for a crystal-clear understanding of what they would be getting from consolidation; a very clear understanding of the potential cost savings. The template is supposed to aid in that process."

Cunningham accepts that DBMTs have had issues in the past with sections not being properly segregated within their structure, leaving employers to pick up 'orphan liabilities'. He says that the company's Pension Master Plan had been structured specifically to avoid such problems, adding that "we think Master Plan is helping to change the perception of UK DB master trusts".

Technology investment has been another aspect that Deloitte has looked to lead on – a way to deliver a better, more modern administration and actuarial service to its members.

"Our web-enabled technology is really bringing pensions admin into the 21st century," Cunningham explains. "Members can access their own benefits and make requests for quotes. On the actuarial side, we're able to be much more fleet-footed on investment levels and daily valuations. We're aiming to drive up the member experience but drive down the cost."

Because of its technology investments, Deloitte is not constrained by systems that are 30 to 40 years old, "that we have to keep putting sticking plasters on", he adds.

"The important thing for us is that Master Plan is designed to accommodate new schemes and has had significant growth to date. We expect to see more as conversations around consolidation develop. We hope that people will view it as the optimal choice," Cunningham concludes.

Written by Andy Knaggs, a freelance journalist

In association with Deloitte.

Changing tracks

Default funds don't often get good press, whether that be for varying levels of returns across the industry, or the lack of diversification of assets within them. Natalie Tuck examines the problems with default funds and how they can be improved

Summary
• DC default funds have received some bad press for the wide gulf in returns and structure.
• Experts are split on whether there is an industry-wide problem with default funds but are clear that past returns aren't a good measure of performance.
• They are also split on whether introducing a system where the member chooses their provider, as is the case in Australia, or introducing performance league tables, would work in the UK.
• Instead, default funds should focus on the member, and look at assets such as private equity, large infrastructure projects, and ESG.

Earlier this year, The Pensions Regulator (TPR) turned its attention to default fund governance. The legislation was already in place, but a new pilot was launched to increase awareness of trustee duties and ascertain how many trustees are doing a good job.

The law states that a pension scheme's default strategy and the performance of its default arrangement must be reviewed every three years, or when there is a significant change in a scheme's investment policy or demographic of its membership. Trustees are required to check the default arrangement is performing as expected and that the default strategy ensures investments are made in savers' best interests.

TPR's focus, explains its executive director of regulatory policy, analysis and advice, David Fairs, is on good outcomes for savers in their retirement. With more than 95 per cent, according to TPR, of trust-based DC members saving in default funds, it is imperative that they're fit for purpose.

The measure of performance

Hymans Robertson's *Master trust default fund performance review*, published in September 2018, found a large difference (6 per cent, per annum) between the best and worst performer over a three-year period.

To put that into perspective, the report stated: "This can mean a difference of 10 per cent in the value of a member's DC pot in just three years (based on an individual with a salary of £24,000 a year, receiving an 8 per cent contribution (£160 per month) and with a starting value of £1,000, not taking into account any changes to salary)."

In addition, a recent report by Punter Southall Aspire, entitled *Who's performing well?*, looked at the nine leading providers in the DC market for group personal pensions (GPP) at 31 March 2019.

It found that in the growth and consolidation phases, funds varied in design and construction, investment risk and volatility, asset allocation strategy, return benchmarks, management and critically, performance. A broad range of investment strategies ultimately leads to a broad range of results. Over the past three years Zurich was the best performer (11.3 per cent), whilst Standard Life was the worst performer (5.2 per cent).

Fit for purpose?

SEI UK Institutional managing director of defined contribution, EMEA and Asia, Steve Charlton, believes that there "is an industry-wide problem" with default funds, but he does not mean the issue that has been generating the recent bad press, which has been a focus on short-term investment performance.

"The real problem with default funds is that, for the most part, they are built to be the 'least worst' option for the many members they serve. By this I mean that providers will design a single default or select a generic target date fund and squeeze every member into it, without considering the needs, objectives or means of the member," he explains.

However, the view of The People's Pension director of policy, Gregg McClymont, is that one or two poorly-performing funds have received some attention, but many other default funds are performing well.

"More widely, default funds fare well in comparison to more expensive retail

Australia since 1992.

Savers in Australia also benefit from a 9.5 per cent minimum employee contribution, and since 2005, have been able to choose their own pension provider. But would allowing members to choose their provider work in the UK?

Trainor says that the UK has approached pension saving in a different way with auto-enrolment, and the system's low opt-out rates points to its success. "Rather than seeing any further dramatic change in approach, the focus should be on building on the success to date, with increasing engagement and proxy contribution levels that go beyond the current minimums."

The policy of member choice was introduced in Australia over a decade after compulsory pension saving was introduced; SEI's Charlton believes doing that in the UK would be hard to achieve due to the levels of public apathy towards retirement saving in the UK.

Indeed, despite having the choice, many Australians don't exercise this right. Australia's Productivity Commission estimates that two-thirds of people become default members on entering the workforce or changing jobs, and half of all accounts are in the default product (MySuper).

The Association of Superannuation Funds Australia (ASFA) says that, on an ongoing basis, around 5 per cent of fund members in a year switch their fund. Some of these have switched jobs, but even in these circumstances this suggests the member is choosing to consolidate in the new fund rather than this just being a default outcome, ASFA notes.

Aside from the difficulties of implementation and potential lack of uptake, the PLSA's policy lead for investment and stewardship Caroline Escott highlights that the UK would also lose the advantages of the current workplace pension system if it were to change. "Many workplace schemes compete on having a much more generous pension than the automatic

products. The average cost of a default fund across the occupational pensions sector is c.42bps. It costs nearly 45 bps just to sit on some self-invested personal pension (Sipp) platforms, before investment costs are added. Costs matter so much in long-term investment returns."

McClymont's point raises the question of what factors make for a good default fund. Returns are of course important, but there are several other categories to consider.

As Standard Life head of investment solutions, Gareth Trainor, notes: "There are a variety of beliefs of what makes a good default, and innovations in previous years often create variations in performance, especially over the short term.

"For instance, some defaults take significant investment risk, while others do not as they would consider this would not be aligned with the risk appetite or capacity of a large proportion of the members who are asked to bear this risk."

As Nest chief investment officer Mark Fawcett notes: "There are always going to be differences across how default funds are managed, but this does not mean they are inherently unfit for purpose."

Tips from a land down under

Brits can be forgiven for envying many things about Australia, whether that be the beautiful beaches, weather, or maybe even, the pension system. Compulsory pension saving has been in place in enrolment minimum to recruit and retain staff and having an engaged employer can also help promote improved retirement outcomes by supporting employee understanding of pension saving."

Some in the industry, however, do support the idea. Smart Pension director of policy and communications, Darren Philp, notes: "It makes perfect sense for employees to choose where their employer contributions are directed. This would not only help with engagement, but it would also make it easier for people to consolidate their pensions and keep track of their pension saving. Employers would still have to choose a default scheme for those that don't want to choose, but for those that do want to choose we should facilitate choice rather than putting up arbitrary barriers."

Furthermore, Trafalgar House client director, Daniel Taylor, believes that an Australian system would "remedy the UK's burgeoning issue of members having multiple small pots".

"The biggest technical barrier to implementing the Australian model was always the creaking technology infrastructures that sat behind payroll systems. But, with auto-enrolment now introduced and many employers embracing digital engagement platforms, dramatic improvements in payroll technology has taken place that could now support providing payments to multiple self-selected pension providers."

A league of their own

Another idea to increase the competitiveness and performance of default funds in the UK is the introduction of an official performance league table. Escott says that it's important for scheme members to have access to clear, comparable information about their pension scheme to ensure they understand and engage with their retirement savings. However, the PLSA does not think that league tables would achieve this.

"We think that the usefulness to members of investment performance league tables – given the current market, low levels of saver engagement and the fact that members cannot swap from one scheme's default strategy to another scheme's default strategy – would be relatively limited."

Despite this, she does think that league tables might be a helpful additional tool for trustees and scheme decision-makers when considering and designing their investment strategies, though she stresses that trustees would need to ensure they focus on long-term performance.

Furthermore, Charlton is concerned a league table approach could "stifle innovation" and lead to a "consensus approach to default design". As McClymont notes, the main difficulty with introducing a league table would be making sure that you are comparing apples with apples. And with the wide variety of defined contribution schemes, this could be hard to achieve.

The member in mind

Experts agree, however, that creating a good default fund starts with having the members in mind. As Trainor states, rather than having a homogenised 'one-size-fits-all' approach, a solution that can be tailored to an individual's situation would likely lead to better outcomes.

"These multiple 'defaults' merging seamlessly into the next generation of pathway 'defaults' would likely be the next logical step. Gone would be the days of a 'single path' into retirement for all, instead a multi-phase choice architecture taking different variables into account which lead to a more personal approach and increased engagement," he explains.

Escott adds that schemes can help themselves by "collecting more and better data about their members so they can align the default as much as possible with the needs of their unique member demographics and objectives". She explains: "This is just as important for schemes with more members approaching retirement as it is for those with more younger entrants to the workforce."

Incorporating new assets

Provides are also looking to incorporate new assets to improve their default funds. For example, Fawcett says that Nest is looking to add private credit to the stable of asset classes it invests in on behalf of members.

"Private markets offer opportunities for higher returns than publicly-listed markets and we see long-term potential in private credit. Some of our members will be saving with us for more than 50 years. We can be patient with their capital and allow them to benefit from the illiquidity premium to be had from private loans and other illiquid asset classes," he explains.

McClymont too adds that many defaults are not yet invested in unquoted assets: "The fees these asset classes attract are higher than traditional asset classes, and the liquidity and valuations are not provided daily, so the master trust sector needs to see how these challenges can be overcome prior to investing."

Escott is also in agreement, noting that pension schemes are "uniquely well-placed to benefit the illiquidity premium offered by investments, such as private equity and debt, as well as large infrastructure assets and property.

"The PLSA is also supportive of recent regulatory developments on ESG – it is vital that schemes get to grips with financially material ESG issues, as they would with any other long-term risk or opportunity that could have an impact on risk-adjusted returns."

Charlton adds that an increasing trend in default funds is a shift towards a responsible investment approach. As well as the societal and environment benefits, he says it has a secondary benefit of helping to engage members.

Written by Natalie Tuck

A difficult balance

Many schemes with pension deficits continue to pay shareholders dividends that vastly outweigh the amount they pay into their DB schemes to try to bring them out of deficit. Jack Gray investigates whether there should be stricter regulations to narrow the ratio between dividend payments and deficit contributions

Summary

- The average gap between pension deficit reduction contributions and shareholder payments for FTSE 350 DB schemes in deficit has been steadily rising.
- High shareholder payments may be suitable for schemes with strong sponsoring employers, but problems can arise for less well-funded schemes.
- The Pensions Regulator has been stepping up engagement to help safeguard members from a minority of careless trustees and employers.

Since 2012, the ratio between dividends paid to shareholders and deficit reduction contributions (DRC) for companies with pension schemes in deficit has been gradually, but significantly, increasing. The Pensions Regulator (TPR) has found that the median level of shareholder payments compared to DRCs for FTSE 350 defined benefit schemes in deficit has risen from 9.2:1 to 14.2:1. The widening gap was primarily driven by the increase in dividends since 2012, without there being a similar increase in DRCs.

For non-FTSE 350 firms that sponsor a DB scheme, the median ratio has increased at a slightly slower rate than companies in the FTSE, from 3.7:1 to 4.9:1 during the same period.

Although there have been significant increases in the discrepancies, companies, on average, do not seem to have been performing better enough to justify the rate at which the gap is widening.

TPR has been taking a more active role in ensuring members' benefits are protected, but do not currently have any legislation in place to stop companies paying the levels of DRCs and dividends they feel appropriate.

A TPR spokesperson comments: "We have not set any specific ratio which we consider acceptable, but where dividends are disproportionate to DRCs, we would consider affordability not to be an issue.

"In such circumstances trustees and employers should work together to give greater consideration to liabilities to the scheme."

Strong vs weak

Research from the University of Bath finds that FTSE 250 companies with DB schemes are paying out nearly five times more in dividends than in DRCs. The study reveals that the cumulative amount paid in DRCs in 2015/16 was £28.2 billion, while the amount paid in dividends was £142.5 billion, despite a cumulative deficit of £26.4 billion. Furthermore, 98 of the 250 companies were still in deficit. Could this indicate that there is a problem?

"I think that it's something we should think about," begins University of Bath professor of finance and director of the centre for governance, regulation and industrial strategy, Ania Zalewska. "It's hard to say whether this is definitely wrong, but it isn't particularly good."

On paper, it seems hard to argue against this being unfair on scheme members and beneficial to company shareholders. However, schemes that have a strong employer may be able to reward shareholders with high payments without it impacting scheme members.

"High dividend payments in comparison with pension contributions may weaken the covenant," says Dalriada Trustees senior trustee representative, Vassos Vassou. "This can be a particular concern for schemes supported by a weaker employer.

"By contrast, you may have a strong covenant supported by a well-run profitable company. If this company pays a relatively high dividend there may not be a material weakening of the covenant, which means no impact on the scheme or its members."

AJ Bell senior analyst, Tom Selby, agrees that "the most important thing" for a DB scheme in deficit that has low DRCs compared to dividends is to have a financially strong employer "standing behind the pension promises made to members".

"Although a dividend payment five times larger than the money committed to plugging a firm's deficit might seem hard to justify, the reality is shareholder rewards are the lifeblood of the stock market, with investors demanding a decent, reliable income in return for their investment and firms needing outside investment to drive innovation and growth," he adds. "If a company with a DB deficit were to lower or even scrap dividends and use the cash for the pension scheme instead, investors could pull their money and potentially put the firm's long-term future in jeopardy."

Striking a balance

Although a scheme having a strong employer covenant helps justify the gap, the discrepancy can be too wide, and companies have been tasked with finding a middle ground that will balance DRCs and dividends. This year saw multiple examples of company scheme deficits increasing significantly, without the losses being reflected in the ratio between contributions and shareholder payments.

Retail group Dixons Carphone's DB scheme deficit increased by £109 million year on year, as of 27 April 2019, with the company paying £46 million in DRCs and £116 million in dividends, despite the actuarial losses.

Heathrow Airport Holding's DB scheme swung from a £28 million surplus to a £39 million deficit between December 2018 and June 2019, with the company paying its shareholders £200 million in dividends while paying £12 million in DRCs. Commenting on the discrepancy, a Heathrow spokesperson says: "Heathrow's pension scheme is 99.1 per cent funded. The deficit highlighted is due to fluctuations in interest rates and not an underlying underpayment into the scheme – the scheme was in surplus at the end of last year."

Selby adds: "Companies face a difficult balancing act between rewarding shareholders and paying off DB pension deficits. It's fair to say that, certainly historically, paying out dividends has been seen as a bigger priority by most firms.

"That's not to say the balance currently being struck between deficits and dividends is the right one, but we need to be cognisant of the fact the decisions being made here are rarely black and white."

Although striking the right balance can be difficult, especially when you have members and trustees prioritising one thing and shareholders prioritising another, TPR insists that it is doing more to ensure the right balance is struck.

"We are also being tougher with companies that should be balancing their duties to pension savers with returns to shareholders," says a TPR spokesperson. "If a scheme could be better funded then we are checking whether the balance is right."

Regulator and regulation

Although the ratio between dividends and DRCs may appear to be spiralling out of control, each company is unique and any kind of regulation or legislation trying to apply absolute rules to a complex situation could have unintended consequences. For instance, companies with strong funding could be punished for being in a situation that would not suit a scheme with a weaker employer.

"Legislation on dividend payments – contribution ratios – should not be introduced as the issue is not that black and white," explains Vassou. "By far the majority of companies look after their pension schemes well alongside the trustees.

"Having set rules about dividend and contribution ratios may have the unintended consequence of changing behaviour of those well-run schemes

with companies targeting contributions at a level of minimum compliance instead."

Zalewska continues: "As much as I like regulation, I don't think that the regulatory regime can help much.

"It won't change the reality. Saying 'we mustn't do that' may backfire and companies will be even more keen to close down their DB schemes and this is not a route we should follow, in my opinion.

"I would be reluctant to say we have to have regulation, because we can't see exactly what's happening in those companies."

Despite the lack of legally binding regulation on DRC/dividend ratios, TPR has been stepping up its activity to ensure members benefits are protected. An anonymous DB scheme agreed to improve its scheme's funding by reducing its recovery plan length from 13 to seven years, pay annual DRCs of £3.7 million and a commitment to stop dividend payments for six years, following pressure from TPR.

A TPR spokesperson comments: "We will use the full range of powers available to us to ensure members are being treated fairly. We are working with the government on its strong white paper proposals and will be clarifying further our expectations on appropriate funding strategies in a new DB funding code."

Selby adds: "With TPR taking a much keener interest in companies' approach to DB deficits – particularly in light of the disaster that engulfed BHS – it would be no surprise to see more money poured into pension schemes in the coming years."

Although steps are being made to reduce the gap, Zalewska believes that we are some way off a perfect system: "I think the regulator has woken up in the past few years and they're introducing a lot of changes, but much more needs to be done."

Written by Jack Gray

Executive pensions

Company executives have come under recent pressure to bring their pension payments more in line with their workforce's. Earlier this year, Work and Pensions Select Committee chair, Frank Field, wrote to numerous firms, questioning their executive pension payment policy. For example, Lloyds Banking chief executive António Horta-Osório receives a contribution rate of 33 per cent, while its employees are restricted to a maximum contribution rate of 13 per cent. When questioned by Field, Lloyds defended its policy, saying it has reduced Horta-Osório's rate from 46 per cent. Field also queried Standard Chartered after it proposed policy includes executive pension contributions four times higher than the rest of its staff. Meanwhile banknote printer De La Rue was issued with an 'amber top' alert, after it was revealed that its chief executive received contributions equating to 30 per cent of salary.

Firms were queried after the Investment Association (IA) issued new guidance in February 2019, which stated that shareholders wanted executive directors to be paid pension contributions in line with the majority of the workforce. Commenting at the time, IA chief executive, Chris Cummings, said: "Companies that do not take on board shareholder concerns risk facing yet more shareholder rebellions next year."

The step up in regulatory activity seems to be taking effect, with three in 10 FTSE 100 companies pledging to cut executive pensions in August 2019. Thirty companies say that they have made significant changes, with 17 stating that any new director will be given a pension contribution in line with the majority of the workforce and four reducing contributions for incumbent directors immediately.

Scammers beware

The Pension Scams Industry Group (PSIG) produced its first code of practice to combat scamming in the pension industry in 2015, and has since produced two further updated codes, receiving backing and support from across the industry. Jack Gray talks to its chair, Margaret Snowdon, about its progress, what effect the updated scams code has had and the next steps to nullify the threat posed by scammers

Pension scams and its victims have been receiving a lot of coverage in recent years, as the government and financial regulators have been stepping up their efforts to protect vulnerable savers. PSIG has recruited willing volunteers from across the pensions industry to assist in the task, and substantial progress has been made. Since PSIG's first code of practice in 2015, the number of pension scam reports has dropped by 75 per cent and the financial losses through pension fraud has fallen by 85 per cent. Through updating its code and tirelessly working to stay ahead of the scammers, PSIG has played a vital role in the progress that has been made so far.

Can you explain the key changes to the pension scam guidance – *Combating pension scams – a code of good practice*?
Version 2.1 of the scams code was published in 2019 to reflect the key developments and changes that affected the industry over the past year, including the introduction of the cold-calling ban, which PSIG had called for since 2016, The Pensions Regulator (TPR)/ Financial Conduct Authority (FCA) ScamSmart campaign, and new Pensions Ombudsman determinations and what they mean for pensions practice. It also addresses the rise of claims management firms seeking compensation for past transfers, includes the FCA letter on managing the risks of DB to DC transfers, PSIG 2018 scams research findings, updated Action Fraud reporting and new case studies.

What impact has the ScamSmart campaign had so far?
Scammers continue to evolve, and campaigns such as ScamSmart are essential to help ensure the public is alerted to the dangers of pension scams. Research released by TPR and the FCA shows that around half of people don't think they would be scammed. This is why scammers are so successful and why such campaigns are vital. Public awareness helps, but alone it will never be enough unless the message can become part of the national psyche. Given the number of people who call the helpline when the campaign launches, it's clear that the message is reaching a good number of people and leading to genuine member action, so that is success.

What impact has the scams code had on combating scammers?
The guidance in the code is the single most effective tool to help practitioners identify possible scams and help scheme members understand the risks. It does take time and effort to carry out good due diligence, but it is worth it to save people from a terrible financial fate. Through the amount of transfer money withheld as well as transfers refused or withdrawn, the work may have saved around £250 million from going to scams. This is a remarkable achievement by an unfunded voluntary group.

What can scheme trustees and managers do to help?
Follow the code, and don't be afraid to shout about it. Scammers will not waste their time on scheme members where robust due diligence is likely to reveal their tactics and cause the transfer to fail. They will move on to easier pickings. A bit like locusts; that's what they do.

What are the main issues you see while conducting due diligence procedures?
Carrying out due diligence in the stages recommended by the code shows red flags that mainly concern the transfer, for example a member receiving a cash payment or accessing funds before age 55 or having no employment link or earnings. If advisers are unregulated, in a different country from the member, or there's a disconnect between the introducer and the recommender. The origin of the request to transfer, either cold call, social media or internet advert, or the quality of the paperwork itself, for example machine signatures, sloppy copying or incorrect names.

There is a lot to look for and a lot

to find because scammers try various techniques. These techniques will continue to evolve, and new issues will emerge during the due diligence process, but regularly checking your processes alongside the latest version of the code can help your scheme stay ahead.

What impact has the cold-calling ban had on pension scams?
It has helped a bit as fewer cold calls are received, but scammers had already moved on to social media in various ways before the ban came into effect. PSIG research published in February of this year found that only 6 per cent of transfers originated from a cold call. Of course, people don't always admit to being cold called and some struggle to understand what it is.

Is the problem getting better or worse?
It is changing. We need to be cautious in underplaying the amount of pension scamming there is because we might be tempted to soften our approach. There is a rise in international self-invested personal pensions, which might be a result of nervousness over Brexit and in investment scams, that attack funds after they have gone from the pension scheme into members' hands. Threats to member outcome will likely continue to emerge, and we should be prepared for much more to come.

What is the PSIG currently working on and what is next?
PSIG's current focus is on intelligence sharing on potential scams and scammers within the practitioner community, empowering schemes with the tools to spot the bad guys and be braver in refusing a transfer. We are working on the security and technology aspects and hope to have something to say later in the year. We are also working to improve the lot of pension scams victims through a proposal to change the tax law on unauthorised payments under certain circumstances, such as when a scam has occurred.

Working towards a future with no need for PSIG will always be our ultimate goal, however.

To what extent are we heading in the right direction in minimising scams and how much more needs to be done?
There is more awareness among scheme members, although most continue to think it would only happen to someone else. There is also increasing awareness among schemes that action needs to be taken, and the issue of pension scams is moving up the industry agenda. We need more schemes to adopt and adapt the code.

However, until trustees feel safe in refusing a transfer that due diligence shows to have some red flags, the scammers will always have the upper hand.

Written by Jack Gray

Consolidation focus:

Stronger together

Gaining momentum

Sean Farrell explores the growing trend towards consolidation within the pensions sector

At a time of upheaval in the pension industry, consolidation will be one of the dominant themes of the next decade.

Whether you are an individual saver with multiple pots, a sponsoring company or a scheme trustee, you should be thinking about efficiencies and other benefits of consolidating assets.

The Pensions Regulator and the Department for Work and Pensions expect trustees of small schemes to consider consolidation, but this is not just a matter for these schemes. All schemes should make sure they understand their options when it comes to consolidation.

The new defined benefit (DB) superfunds, notably Clara-Pensions and the Pension SuperFund, have received lots of attention but they will not be the answer for all (or even the majority of) DB schemes. There are a range of options that can improve efficiency, governance, asset allocation and outcomes for members of both DB and defined contribution (DC) schemes.

Consolidation does not have to happen in a single move. There are options for schemes to test the water and put themselves on a path to their ultimate goal. Briefly, the main options are:

• Appoint a professional or sole trustee to bring more expertise to the board and improve governance
• A fiduciary management model that delegates investment to a third party, potentially enhancing governance, efficiency and investment options
• Master trusts take on trusteeship, governance and administration while maintaining the corporate sponsor's responsibility for the scheme
• Superfunds go a step further by taking on financial responsibility for supporting a DB scheme
• A buyout by an insurance company is seen by many as the 'gold standard' and the ultimate endgame objective for many DB schemes.

There has already been significant pension consolidation in the UK. Bulk annuities were a relatively niche activity just over a decade ago but have grown exponentially. Last year saw a record level of activity, with about £25 billion of liabilities secured in this way, and that is set to be surpassed in 2019 with more than £30 billion of transactions expected to take the aggregate total to around £150 billion. In another indicator of consolidation, the number of funds adopting fiduciary management has risen from about 60 in 2008 to approaching 900 in late 2018.

The experience of other countries shows once consolidation is actively encouraged it gains further momentum. A decade ago Australia had about 7,000 pension schemes; now there are about 2,000. In the Netherlands the number has dropped from about 700 to 200 in that time.

In both countries, legislation played a significant part in driving change. That active encouragement is now taking place in the UK. With about 5,500 DB schemes, the UK has a relatively large number of schemes and The Pensions Regulator wants trustees and sponsors to consider whether consolidation can provide better outcomes for members.

Mercer head of risk transfer Andrew Ward says: "This could be the most significant period of change since UK pension schemes were first set up. If the speed of contraction in the number of schemes mirrors other geographies the impact could be phenomenal. The industry has got a job to do to make sure the overriding aim of securing the best outcomes for members continues to be met."

Trustees face increased demands and complexity as rules change and DB schemes try to navigate towards the end-game. The government and the regulator want trustees to consider whether they have the right level of professionalism to make the necessary adjustments in a more complex environment.

Pension flexibility is prompting many companies to consider allowing members to draw down their retirement savings. This places an extra burden on schemes that may not have the money or expertise to run such a programme.

These demands coincide with what looks like a more difficult period for markets. After a relatively benign decade the world economy is slowing and markets may not grow at the same pace in the next 10 years. Trustees will need to be nimble and decisive – and with yield curves inverting, DB schemes may not be able to rely on bond yields to do the work for them.

There have also been improvements in the market that can make consolidation more attractive for trustees and sponsors. The Pensions Act 2017 provided assurance about standards for DC master trusts; those master trusts that have applied for authorisation will hold reserves and be monitored by the regulator.

Mercer solutions leader for DC and individual wealth, Philip Parkinson, says: "In the DC market we have an ever-increasing governance burden for single trust-based schemes. The DWP is consulting on more legislation and is likely to ask: 'If you're not consolidating, why not?' Across the industry, both demand and supply are pushing towards consolidation."

Which option to pursue, or whether to stick with the status quo, depends on a range of factors including the scheme's size and trustees' expertise and time. The long-term goal and a DB scheme's funding level, sponsor covenant and maturity are also considerations.

There are also important trade-offs in costs, member security, flexibility and other factors. A DB buyout is likely to be the most secure option but also the most costly. A superfund may offer lower costs than a buyout but is also less secure and ends the link to the employer.

These two solutions may feel to many like an 'all or nothing' answer. But there are more flexible options that can provide immediate benefits and act as a step towards greater consolidation further down the line.

DB master trusts are likely to be less costly than either the buyout or superfund options while maintaining the sponsoring employer's responsibility for funding deficits. Despite being relatively less high profile to date, they may emerge as a more mainstream solution for schemes seeking to consolidate.

Installing a professional trustee or moving to a sole trustee approach can ensure the board has the know-how to optimise governance and outcomes for members. Though not strictly a consolidation step it can be a first move towards increasing effectiveness and efficiency.

Fiduciary management services have existed for decades and are generating increased interest as an option that delivers benefits of consolidation while keeping the sponsor's link and leaving other routes open.

Mercer fiduciary management principal, Tim Banks, says: "It's a very big decision for a trustee to remove the covenant. Fiduciary management has been around for a long time, it's tested and it's no longer one-size-fits-all. For a corporate sponsor it can be a first step to get trustees over the line to a superfund or a buyout."

Consolidation has the potential to create longer-term gains for members beyond the immediate benefits from economies of scale and professional expertise. These include greater competition for fewer, bigger investment mandates, improved fee arrangements and better member engagement.

Mercer's UK chief investment officer, Jo Holden, says the pooling of local authority assets from 89 funds into eight highlights positive changes that consolidation can bring about.

"There is no doubt the local government schemes have benefited from consolidation," she says. "There has been a reduction in fees and in our view there's a governance advantage because previously the schemes spent so much time dealing with asset managers instead of concentrating on the overall risk-return funding strategy."

Changes to fees do not have to be a 'race to the bottom', she adds. "We have seen interesting discussions around models that move beyond performance-related fees to discounts for long-term relationships or fixed fees linked to inflation."

Consolidation offers economies of scale to invest in technology and services to help members make decisions in a way that most individual schemes would struggle to achieve. There are likely to be further such demands as the state transfers responsibility for pensions to individuals.

Ward says: "The potential benefits of consolidation are clear and there are more choices than before but this isn't an easy decision. You need to understand your options and objectives and consider them together.

"For many schemes the status quo will remain a valid option. But you should make sure you have considered all the alternatives and that you can demonstrate this when the question is asked."

Tim Banks, Jo Holden, Philip Parkinson and Andrew Ward, who were interviewed for this article, will be discussing consolidation on 16 October in a Specialist Session at the PLSA Annual Conference & Exhibition

Written by Sean Farrell, a freelance journalist

Summary
While not a new trend, consolidation is on the rise, particularly as regulatory bodies pressure small schemes to consider banding together.
• When done well, consolidation can reap great rewards, but if schemes are too hasty there are risks too.
• Schemes must plan properly and get their house in order before choosing a consolidator.
• If a scheme decides to consolidate, there are significant steps they need to take. These include cleaning data, coming up with a communications plan and putting good governance in place.

The promises and pitfalls of pension scheme consolidation

Consolidation can offer benefits to small schemes, but trustees must choose wisely or they risk leaving members worse off, writes Sara Benwell

Small schemes have never been under more pressure to consolidate. Regulators are breathing down the necks of trustees, encouraging them to reap the rewards that are often associated with banding together.

It's not a new trend. The Pension Protection Fund and bulk annuity insurers have been consolidating pension schemes since the Pensions Act 2004. Meanwhile, the emergence of defined contribution master trusts has seen many employers opting to outsource their pensions responsibilities, rather than taking on the expense and governance headaches of running a small scheme.

Fidelity International head of pension products James Carter says: "The variety and nature of risks facing pension schemes and their members have expanded and deepened in recent years – with threats including the uncertainty posed by investment markets and cyber threats."

Royal London director of policy Steve Webb adds: "We are some way short of the Australian 'comply or explain' approach to persevering with running small pension schemes, but The Pensions Regulator are getting increasingly vocal on the need to make sure that members of small schemes are properly protected and that if small schemes can't demonstrate they are providing good outcomes to members then they need to do something about it."

The risks of hasty consolidation

When done well, consolidation in both DC and DB can reap rewards, but there are still risks that need to be considered before making the decision to outsource.

Dalriada Trustees professional trustee Vassos Vassou explains: "One concern is that members lose the security of the sponsor covenant by being moved to a consolidator. Members will not thank trustees that move them to a consolidator, which in time proves to have diminished their outcomes.

"Other risks also exist. For example, the chosen administrator may perform badly, meaning that the service members get is poor. The Department for Work and Pensions is very keen to push consolidation. It is seen as a way of removing the governance problems around small schemes. This does have some risk associated because there is a chance the initiative fails and then members' confidence in our pension system will take another hit."

TPT Retirement Solutions CEO Mike Ramsey agrees that trustees need to consider it carefully. He says: "When scheme sponsors and trustees consider outsourcing their DB pension schemes, they are often – quite rightly – concerned whether their scheme responsibilities and members will be well looked after. Some consolidators involve sponsors relinquishing their link with members, which can be a concern for trustees."

Mercer head of fiduciary management UK, Ben Gunnee, thinks that full outsourcing, where the sponsor link is severed, will see the lowest take up among trustees. He says: "This is likely to be the least used form of consolidation over the next five years or so, as the number of schemes that have the right characteristics is lower than for the other forms of consolidation."

For defined contribution schemes, the dangers of poor governance, investment strategy, administration or communication can be even greater. If a master trust underperforms, then people's pots could be eroded or members might even be put off from pension saving altogether and opt out.

In DC, there is also a fear is that some of the smaller master trusts are themselves poorly governed and risk member outcomes. Fortunately, the Master Trust Assurance Framework has made significant strides here. The new regulations have more than halved the size of the market and should help make sure that the remaining authorised schemes better protect members by upholding high standards.

Preparing for consolidation

To get consolidation right, those responsible for small schemes need to analyse their membership's needs carefully and choose the right consolidation vehicle. This can be tricky as the options available to trustees are broad and quite varied.

Mercer leader of risk transfer, journey planning and DB consolidation, Andrew Ward, explains: "Consolidation can mean different things to different people and there is a wide range of options, from appointing a professional trustee, through asset pooling; fiduciary management; DB master trusts and superfunds all the way to bulk annuities.

"The relative merits of each of these need to be understood with reference to key criteria such as governance, investment delegation, flexibilities, cost/fees and security. Once the options are fully understood, and initial preferences are identified then more detailed feasibility work can take place to analyse whether a potential consolidation option actually has legs."

One mistake trustees can make is to leave some of the finer planning too late, choosing a provider – or even the type of vehicle – before they've done the right preparation and research. This can lead to problems further down the track.

PTL managing director Richard Butcher says: "They should have done most of the prep well before they get to this stage. You should always start a process with 'what do we want to achieve?' and then execution is at the 95th percentile of the process.

"There'll be a project plan that will include, at a high level, legal process, admin (cleanse and transfer), investments (alignment and transfer), stakeholder engagement (eg members, regulator etc)."

Ward adds: "The key here is to understand the scheme specific circumstances and objectives. A superfund solution (Clara or Pension SuperFund) will be right for schemes, say, who are relatively well funded and have sponsors that look weak in the medium to longer term but can fund a capital injection today.

"However, they might be less appropriate for poorly-funded schemes – where the contribution requirement is too great; very well-funded schemes – where buyout is deemed a safer option; or schemes with very strong sponsors – where giving up the sponsor covenant is unattractive. A structured approach to assessing each option is the most sensible approach."

He points out that consolidation choices should be periodically reconsidered to make sure that the approach taken remains fit for purpose.

This is particularly important as there is nothing to stop schemes moving from one sort of consolidation vehicle to another and for some schemes this might be the best approach to achieving their funding goals.

For instance, it is possible that a scheme could start off using fiduciary management and then over time take this further via transfer to a DB master trust before ultimately buying out with a bulk annuity provider.

Webb argues that for DB schemes, the process of consolidating can be complex and there are lots of factors to consider.

He says: "Member benefits in a DB scheme may also be structured in different ways (eg different levels of widows benefits, different pension ages etc) and there is much to be said for standardising benefits between the two schemes at point of merger."

Of course, defined contribution plans must be similarly well prepared, and lots of the same steps will apply. Choosing the right master trust is critical, as is getting governance, administration and communications right.

Smart Pension director of policy and communications Darren Philp says: "Small DC schemes should choose *[a master trust]* carefully. Focus should particularly be on governance and value for money, and the master trust's experience in managing transitions.

"They must also get their data in order. Make sure records are up to date and in good shape and reconciled. This helps massively with any transition and reduces risk to both the ceding and receiving scheme."

Mercer partner, workplace savings proposition lead, John Breedon, adds: "An important first step is to check whether the transferring scheme is fully able to move and that there are no complexities such as secured rights – for example GMP underpins. The impact on all the stakeholders including benefit administration and payroll teams also needs to be considered."

The final critical component for both DB and DC schemes alike is creating a communications plan. This is one of the most important factors to consider when it comes to making changes to members pension provision, and trustees must make sure they keep savers up to date and that messaging is reassuring, simple and uses engaging language.

Written by Sara Benwell, a freelance journalist

In association with MERCER MAKE TOMORROW, TODAY

Quality information

How to ensure the information that members receive, or are directed to, by their pension schemes is up to date, accurate and of high quality

Increasing member engagement has rightly been in the spotlight when it comes to improving member comms, but what about the quality of the information we are trying to get members to engage with? How can trustees ensure the information it provides is always accurate and up to date?

BESTrustees chairman Alan Pickering admits quality control can be a challenge with templated documents that are sent out to members every few months or so.

"The danger there is that you might not review it on each occasion that it's sent out," he explains. "Another danger if there is new stuff to add to the document, the temptation is to add to it at the end. So what began as one-pager ends up as war and peace."

Pickering gives the example of GMP equalisation: "Last year there were people who were just about to be communicated with, explaining their trivial commutation options, and then along comes GMP equalisation, which meant that trivial commutation might no longer be quite so trivial as it once was. Say you are all geared up to send a letter and overnight that letter needs to be reviewed. So do you rewrite it or just stick a paragraph on the end?"

The pension scheme handbook is another area where a similar problem may occur. DLA Piper pensions partner Matthew Swynnerton explains: "The handbook is effectively a summary of the scheme rules. But time to time scheme rules are amended to reflect changes in legislation, or to benefits etc so inevitably there is a lag between when the handbook is updated and when those changes occur. It is not cost effective for continual minor changes to be made to a booklet. Instead, the booklet will be updated at a fixed point to accommodate those changes.

"To explain this discrepancy and avoid member confusion, 'health warnings' are placed at the front of the handbook, saying something like 'at the event of any discrepancy between the booklet and scheme rules, the scheme rules will prevail'."

While information held online can be updated more quickly to changes, it is still not without its challenges.

Ferrier Pearce client relationship director Laura MacPhee warns that over time websites are regularly added to, and potentially becoming cumbersome to navigate and hard to keep track of to ensure all content is up to date.

While it may be a challenge for trustees to continually monitor their own comms for accuracy, how much responsibility do they have for the information members receive from third parties, especially when it's the trustees themselves who directed the members there?

According to AHC head of engagement Karen Bolan: "Trustees can be a little reluctant to steer employees in a particular direction, other than directing them to unbiased.co.uk for a list of IFAs or the Money and Pensions Service for general guidance."

Swynnerton notes that trustees have valid concerns about going beyond this general signposting and recommending a specific adviser, for if anything goes wrong the member may place blame on the trustees for directing them to that service.

The exception to this is when the scheme is going through a specific liability management exercise, such as a pension increase exchange.

Sackers associate director Nigel Cayless says: "If there is a liability management exercise, the employer may be paying for the financial advice, so may select a specific IFA for members to see. In this scenario, due diligence is key. Both at the beginning, at the selection process, and on a monitoring basis so that the IFA is performing as expected."

Despite the risk of signposting members to an adviser and things potentially going wrong, LawDeb Pension Trustees director Robert Thomas warns that the risk of not doing anything may be greater, as members looking themselves may fall prey to 'bad' advisers.

Cayless agrees, noting that along with a liability management exercise, a scheme expecting a lot of transfers may want to proactively select IFAs to avoid a "British Steel-type situation".

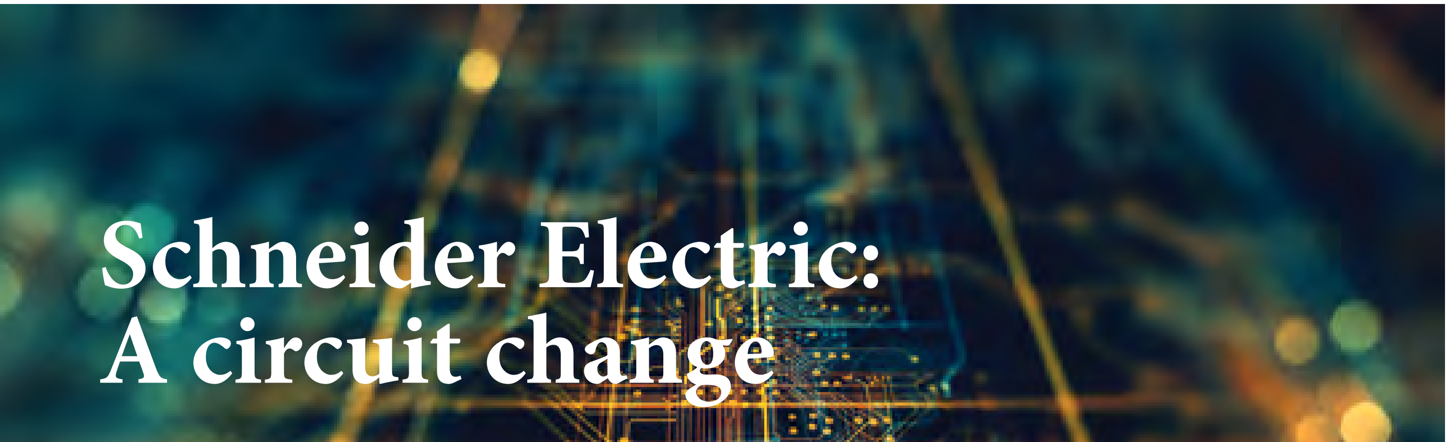
Quality control is easier during these specific events, Pickering notes, as "you may be choosing a company or person for a purpose at a point in time. To then extend that blessing on a timeless basis is quite dangerous as you don't know what will happen with that firm; its quality might degrade over time."

To ensure that the information given by schemes themselves does not degrade over time, most – other than the largest schemes – would turn to their providers/advisers, particularly their administrators.

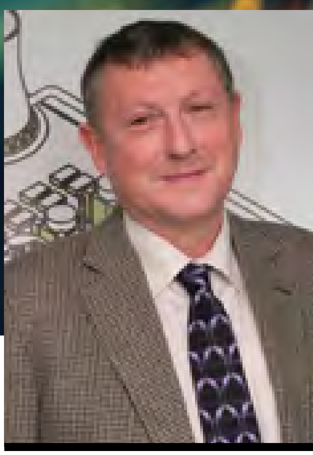
Dalriada Trustees senior trustee representative Sean Browes recommends schemes having a checklist for their administrator, which includes knowing their information review processes. "Trustees will not be able to review every piece of comms, so they need to have confidence in the people they are tasking that too," he explains.

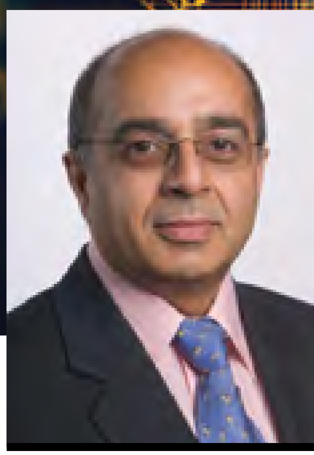
As Pickering says: "Vigilance needs to be the watch word."

Written by Laura Blows



Schneider Electric: A circuit change





Schneider Pension Plan's trustee board chair, Rodney Turtle, and pensions manager, Jerry Gandhi, speak to Natalie Tuck about the journey of switching from a traditional manager mix to a single fiduciary manager

Fiduciary management (FM). The competitiveness of such providers was at the centre of the Competition and Markets Authority's (CMA) recent investigation. Its outcome has seen a number of proposals, such as the requirement for trustees to run a competitive tendering process and set strategic objectives for schemes.

Hiring a fiduciary manager is a big step for a scheme; it involves delegating all, or part, of a scheme's investment processes to an external manager. Such a decision must not be taken lightly. When the Schneider Pension Plan (SPP) began its switch to FM in December 2018 it was one step ahead of the CMA. The plan has now switched from a traditional manager mix to a single fiduciary manager – Aon – after implementing a thorough strategic plan and running a very diligent tendering process.

The scheme

Schneider Electric is a French multi-national corporation operating in the energy management and industrial automation sectors. Its defined benefit (DB) pension scheme has a total membership of 3,532, of which 2,049 are deferred members and 1,483 are pensioners. It closed to future accrual in 2010, but retained the salary link for members until March 2019. As of March 2019, it had assets of £392 million and liabilities of £486 million, giving it a deficit of £94 million.

Rodney Turtle, who has been the chair of the trustees since March 2016, says the SPP is the main vehicle for delivering DB pensions to employees in the UK.

Looking back over recent years, he notes that the plan was very traditional, with assets consisting largely of gilts and equities. The plan has always had a good relationship with the company, but in recent years, "every triennial valuation was fairly challenging", he states.

The beginning

It was this that flicked a switch. The trustee board knew that the industry was evolving, and there were lots of opportunities. "We needed to break out. And as we've always had a very good relationship with the company, we wished to do that together," says Turtle.

This didn't mean an initial switch to FM; instead, they looked at various options. The first challenge was convincing the wider group that moving away from a traditional manager mix was the right move, as that was where globally Schneider Electric had been, pensions manager Jerry Gandhi explains.

Initially, Turtle says there were many conversations about liability-driven investments (LDI), but this broadened into looking at options that would include everything. The plan considered several options, such as LDI plus existing investments, LDI with partial FM, and full FM.

The first thing the trustees decided, with the help of their consultant, XPS, was

the need for LDI, which was completed in March 2018. The tendering for that was robust and open, says Turtle, with trustees given the opportunity to attend the beauty parade and briefings.

As Gandhi notes, the easiest option would have been to go with the existing managers or consultants, but "in order to get the best opportunity you need to go wider". As a result, an LDI structure using broadly half the scheme's assets was put in place. This allowed for some leverage to control certain downside risks.

The path to FM

In parallel to that, the trustees began looking at the other half of their assets. "We had a time horizon of 2024/25, to get to full funding. The current recovery plan, which committed cashflows from the employer, hedging from the LDI and outperformance from the return-seeking assets had to deliver that," Gandhi says.

Turtle notes that it was encouraging, when reviewing the triennial valuation, that the goal was feasible, and feasible using relatively prudent assets. With a plan the size of £400 million, they knew that gilts would be easily obtainable, however other illiquid assets, more diversified illiquids suited the scheme's time horizon, would have been very difficult to obtain, Turtle says.

"As a trustee board of the size that we were, we had to get ourselves educated on them, we had to have governance around them. Our pot size wasn't going to be terribly big, so it made it difficult to find the right things. So, for all those reasons, it seemed that the FM route suited us and our objectives," he notes.

Gandhi adds that the move made "logical sense". Initially, they considered just using FM for the return-seeking assets, but this developed into full FM after some consideration.

"We considered the return-seeking assets and the opportunities there, but concluded that going down the FM route, and wrapping in the LDI, would give an opportunity to work across a broader asset base, which could give the scheme slightly lower risk. Value at risk (VaR) was the important number. The shallower the glidepath, the lower the VaR, the smoother the journey to our outcome would be," Gandhi explains.

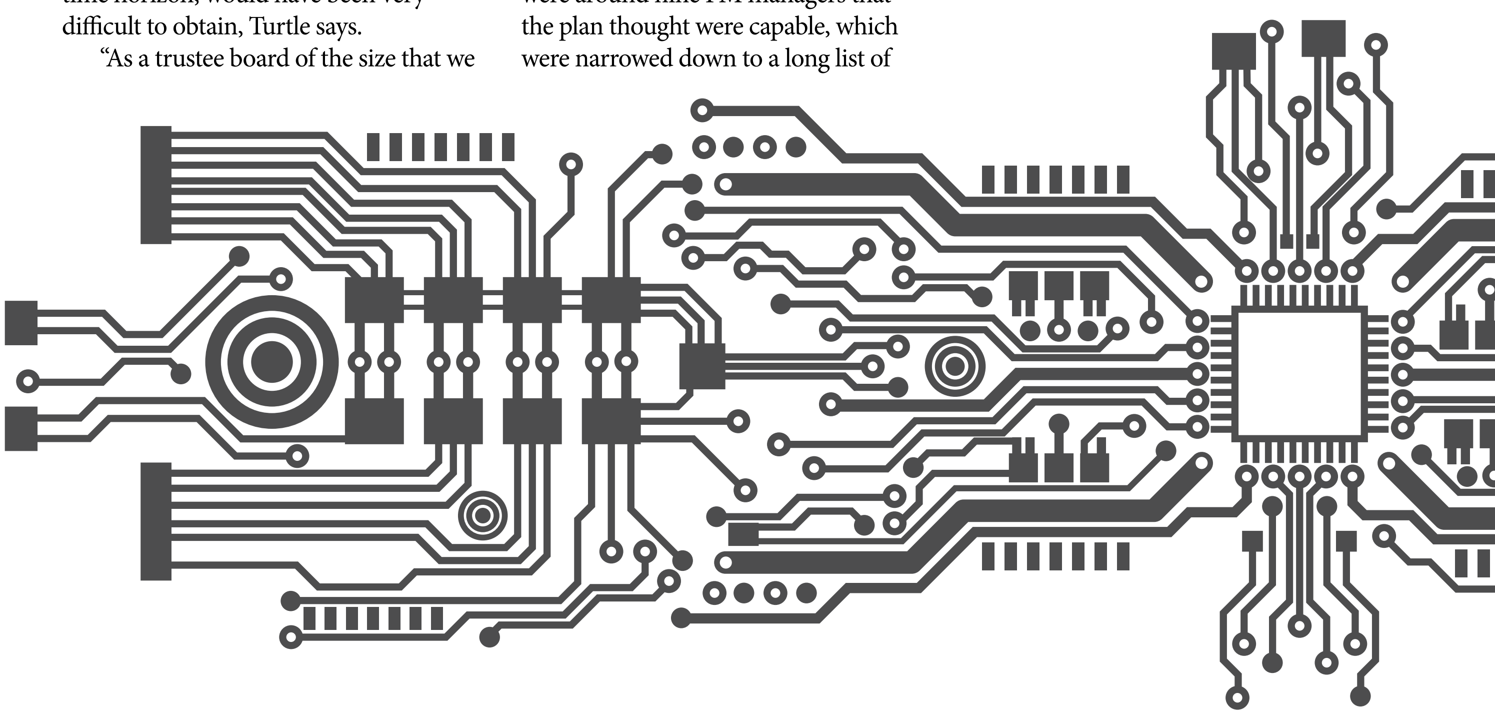
Before going to market, the trustees educated themselves on FM, hearing talks from two FM managers on what it meant. After that, the trustee board knew that it was the route they wanted to take, and asked their consultant to help them find the right FM manager.

After going to the market, there were around nine FM managers that the plan thought were capable, which were narrowed down to a long list of six, who received a request to put in a formal proposal. Turtle says this is where consultants are valuable, as they helped the scheme work out what they were asking for. Following that, the plan trustees met with four of them, visiting their offices, which was very important to get a feel for their culture.

"Going to the offices allows you to assess the culture of the place a bit better, even if it's only how they meet you, how they greet you, how they take you upstairs, what room they show you into. How they've decided to engage with you. What team they wish to bring along," Gandhi explains.

Criteria for choosing the FM involved a mix of things, such as culture, but the trustees also had evaluation reports. After the meetings, the trustees would record discussions of their initial impressions. After some time away, the trustees met again and went through a formal scoring matrix; there were about six dimensions, and one of them was gut feel, Turtle says.

"The idea wasn't to add it all up and then pick the one with the highest score, although that was important. The idea was to discuss all the dimensions of the scoring matrix, and properly talk about each of the shortlisted managers against



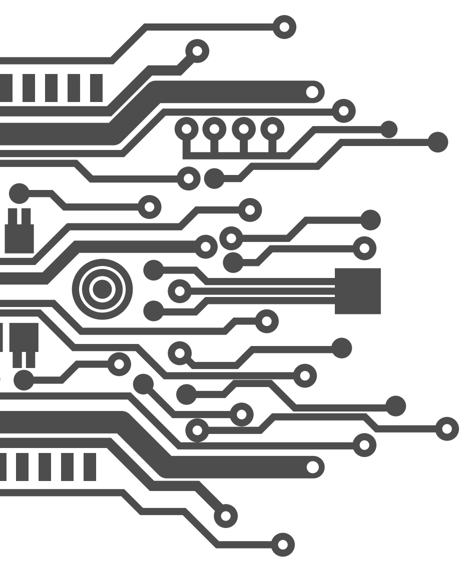
each of those criteria. Of the four, three of them could have done a good job. Of the three, there were two that stood out. It was then very hard to split the two, and it required a lot of discussion before we chose Aon," Turtle explains.

Gandhi adds that a key part of the tendering process involved discussion on fees. "We didn't rely on our consultant to do the fee negotiations. We pushed for the best fees from each manager, ourselves. The fee discussion formed part of the first phase when contacting those on our shortlist, and we actively negotiated both the quantum and structure of the fees with the final two. I believe we managed to negotiate fees that surprised the consultant."

Completing the process

The plan had found a FM, but the process was by no means complete. Work then began to sell their existing assets so they could be reinvested. Turtle notes that it's important to have a strategy, highlighting that liquid can be divested first, but some assets may have trading limits, or longer lead times.

"The implementation of the strategy was actually quite difficult in terms of bits of paper. I remember with some amazement that some of the fund managers required their documents to be faxed back to them. Also some of



them allow you to sign in counterpart and when you've got trustees in various different locations – if you all have to sign on exactly the same sheet of paper that can be quite tricky."

The LDI was transferred over into the pool in June 2019, along with the remaining assets, completing the process. So far the plan has been "positively impressed" by the reporting and results. It is now in the process of putting in place FM oversight.

How important was the consultant's role within the process? "I believe that there's probably certain stages in the process that require statutory advice. So it's important that you have a consultant along for that," Turtle states. "Remember we're not experts and the SPP will only do what we've just done – we hope – once."

The Schneider Pension Plan took a very diligent approach to hiring an FM, but did this have anything to do with the CMA's investigation? Gandhi says that the CMA has been useful but Schneider Electric has a policy of being very open in its tendering process.

Turtle adds: "Because we're a multinational, operating globally, we aim to ensure we operate with full transparency in every contract negotiation wherever/whatever that might be fore. As a company we firmly believe it is unacceptable, even dangerous not to do so. Therefore, even though the CMA guidance on process was still evolving, our selection/appointment process fully complies with the now accepted best practice.

The benefits of FM

Gandhi says the company is hoping for no surprises, or continual ever-widening deficit as a result of the switch. It is working closely to support the trustee with an asset strategy designed to deliver a smooth flightpath to achieve the plan's target of being self sufficient by the mid-2020s.

Turtle also believes that having an FM will take any stress away from the

relationship with the company. Both believe that having an FM makes the investment process less burdensome and saves time and effort. Strong results are also key.

"In the FM reports we can see the LDI is delivering the required risk control. With the FM's appointment we also have access to a wider range of funds. This is providing us with the ability to achieve the target investment objectives but at lower risk and volatility. That would have been pretty much impossible on a DIY basis," Turtle adds.

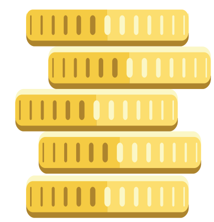
Advice for other schemes

"The key thing is really be clear on what your objectives are," Gandhi says. "Where do you want to get to by when? If you go to the FM marketplace with a clarity of what that looks like they can come back to you with clear proposals of how they can support you."

He also advises schemes not to underestimate the paper trail and processes involved in appointment and transition. Schemes should work to manage the process tightly all the way through. "Have a project plan. It doesn't have to be the most sophisticated, but one with key milestones, and measure against them."

Written by Natalie Tuck

How robust is your CDI plan?



Key players in the cashflow-driven investment space have much advice for defined benefit schemes about to undertake this journey. All agree that such plans should be robust, but not all agree on the best path of travel. David Rowley finds out more

Summary
• The most desirable cashflow-driven investment strategy is one that is robust that can cover expected pension payments under a range of scenarios.
• There is a high margin of error in timing the start of a CDI plan.
• The hardest calculation of a CDI portfolio is choosing the target return above gilts.
• One recommended approach to CDI is the use of an LDI manager who applies an LDI plus credit approach.
• One of the most appealing aspects of CDI is that fees may be lower, because it can create a passive portfolio akin to credit instruments.

While you might have a 'smart, well-diversified' or perhaps a 'cautious' accumulation strategy, the most desirable cashflow-driven (CDI) strategy is one that is 'robust'. A word favoured by those who advise and implement these strategies, 'robust' refers to the likelihood of a schedule of cashflows from investments covering expected pension payments under a range of scenarios. These scenarios include asset price change, interest rate movements, mortality experience, cash transfer activity, sponsor risk and potential collateral calls on derivatives.

Robustness also refers to governance. All stakeholders should agree on what their beliefs and objectives are and the path the scheme should take.

Before the journey begins

While it may be a natural desire to seek a high level of precision in matching cashflows to pension payments, according to many in the industry, trustees should resist this, as no plan can ever be 100 per cent accurate. Hymans Robertson partner Emma Cameron says: "Trying to be unnecessarily precise in designing a CDI solution or spurious accuracy in a complex fully cashflow-driven solution (when the cashflows on which the solution is based are not certain), could be more costly and is likely to be at the expense of flexibility to capture the best market opportunities."

Cameron is also emphatic on the need to hedge the "vast majority" of interest rate positions. "That has been a very successful strategy for clients," she says. "The uncertainty [*of Brexit*] has increased so we continue to recommend very high hedges for clients."

Legal and General Investment Management head of portfolio solutions Graham Moles warns of the high margin of error in timing the start of a CDI plan. A key risk is the scheme's portfolio of credit assets incurring a high level of default without the growth assets to put such losses right. "Trustees can be lulled into thinking that cashflow matching is all, but some schemes can de-risk too soon, then you are guaranteeing failure," he says.

What assets to take on a CDI journey

Probably the hardest calculation to get right is in choosing the target return above gilts for a CDI portfolio. M&G head of fixed income John Atkin says this requires an analysis on the health of credit markets by trustees and then an agreement on the target return to be sought. "A key belief a scheme has to make is around its projections around the default risk of the assets it uses to pay pensions and the margin of safety that is there," he says.

One part of this risk-reward calculation will be the split of overseas fixed assets to domestic assets. Overseas assets can boost yield and spread risk, but will introduce currency hedging costs and increased complexity for those governing the plan.

There are differing opinions on this split.

Atkin says: "A swap on the currency is not cheap and it cuts what you can buy on a value basis. If you want to break that swap it is going to be expensive again."

He recommends a diverse portfolio of sterling assets with around 10 per cent in non-sterling assets. A counter view on UK credit is given by Aon Hewitt investment consultant Louis-Paul Hill, who thinks a greater emphasis should be given to overseas assets for diversification risk purposes. He points out that around only 5 per cent of global listed credit originates from the UK and that this segment of the global market is already in high demand. And he emphasises how concentrated the UK credit market is; a disproportionately large section is issued by financial services companies. There is also the issue of declining credit ratings. "What is worrying is the increasing amount of triple B available," says Hill. "In 2008 triple B made up 15 per cent of the Merrill Lynch sterling investment grade index and now it is over 40 per cent of the index."

Three ways to travel

One recommended approach to CDI is the use of an LDI manager who employs an LDI plus credit.

Moles describes the role of a traditional LDI manager in running a CDI portfolio as one of a 'completion manager'. This is regardless of whether they are managing all the assets or only a portion. In this role their job is to look at the entire portfolio to ensure an even and optimal spread of risk and to best judge how much inflation and interest rate hedging is needed.

"Increasingly you are going to see more information shared with the completion manager to allow them to get to the overall goal," he says. This would mean the manager creating bespoke portfolios of assets to best complement existing mandates with other external managers to achieve good cashflow matching. It may also mean restricting external managers from buying certain types of assets or names to ensure the best spread of risk.

An alternate model is a team-based approach of investment consultants, actuaries, fund managers and trustees governing the process. In this model, a fixed income manager (or managers) is employed at the sharp end of the plan to create a portfolio that is solely designed to generate income to pay pensions. This is likely to entail a target rate of return over gilts.

There are a number of ways this could work. For funds that are not yet cashflow negative, the fixed income manager could help them transition their asset allocation to a cashflow-driven investment plan over a five-year horizon.

Or where a buyout is the chosen solution, the fixed income manager's job may be to create a liquid range of assets suitable for an insurer. On the flip side, the fixed income manager maybe helping a plan transition from an LDI approach run by an insurer.

Atkin describes how when his team has bought a target tranche of assets to match a cashflow payment profile, then the corresponding swaps positions are turned off. He adds that M&G have also been asked to strip the capital risk from a range of credit instruments and simply provide the known cashflows. For the future M&G is also working towards creating a pooled solution for smaller funds to access.

A third route is the use of an implemented consulting model. Here smaller schemes can benefit from access to pooled funds of assets shared with other smaller funds.

Hill says one of the advantages is gaining a better diversification of income producing assets across, investment grade, high yield and private credit. This has the potential to offer higher yields at a time of near historic lows in fixed income. The appeal of such a plan is that the governance aspect of it is shared too.

Fees

One of the most appealing aspects of CDI is that it can create something akin to a passive portfolio of credit instruments, so fund management fees should be lower.

M&G calculates that a buy and maintain portfolio can turn over 10-15 per cent per annum, whereas a fully active might have a security turnover of 40-50 per cent. Partly this is due to CDI portfolios not being measured to a benchmark, hence it does not need to rebalance as the benchmark changes.

Aon Hewitt is not convinced that such approach is optimal. Hill says: "Buy and hold is certainly cheaper than active grade, but you are missing out on potential performance."

Written by David Rowley, a freelance journalist

Summary
- The bulk annuity markets have seen record volumes in recent years as schemes seek to de-risk.
- Some question, however, whether this will continue.
- Funds looking to be bought out should look for, and minimise, the gaps in their data.

Coming along nicely

Bulk annuity transactions have hit record levels in recent years. Peter Carvill asks whether the trend will continue and what schemes can do to look more attractive to insurers

The bulk annuities market has seen tremendous growth in recent years. Last year, according to figures from Barnett Waddingham, the market for buy-in and buyout transactions exceeded £24 billion. That comes after annual volumes over previous years that had hovered between £10 billion and £13 billion.

The outlook for this year appears equally rosy. In December 2018, Willis Towers Watson predicted that the number of deals involving bulk annuities would be up to £30 billion in 2019, with longevity swaps set to double to over £10 billion. And as JLT's *Buyout Market Watch* stated in March: "We expect 2019 to be at least as busy."

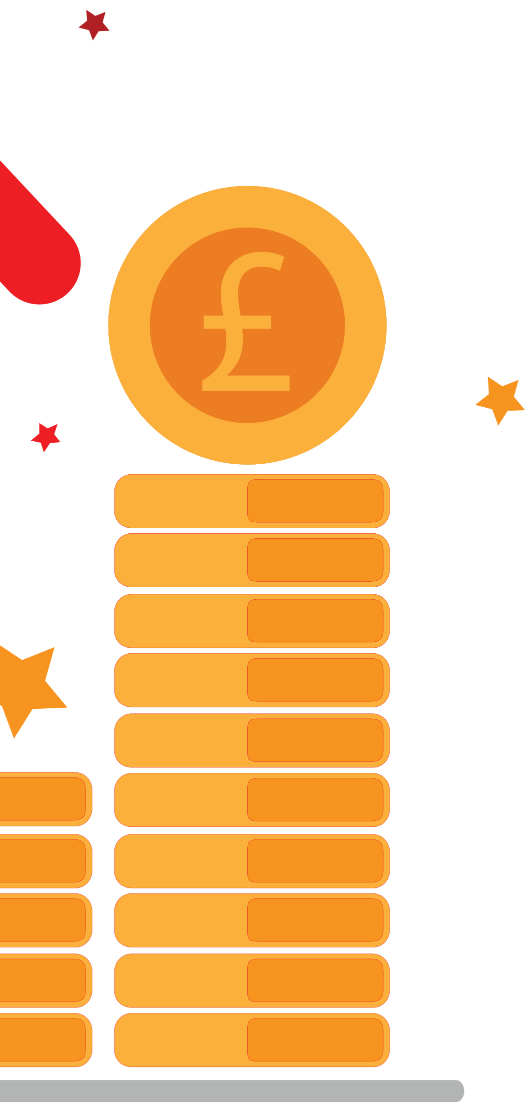
Buyout Market Watch outlines three reasons for this. The first is the competition between eight insurers, alongside the 'most-attractive' pricing seen in 10 years, aligned with a strong trend from trustees and sponsors for de-risking, improved funding levels, and the rapidly ageing demographics of scheme members.

The market appears to be remaining strong. According to figures from JLT, there have been 80 buy-in, buyout, or longevity swap transactions over 2018 and 2019 (50 buy-in, 22 buyout, eight longevity swap). And as this article was being written in mid-August, we were seeing buy-in transactions involving Cadbury Mondelez Pension Fund and British American Tobacco for sums involving £520 million and £3.4 billion, a buyout of PGL Pension Scheme by Phoenix for £1.1 billion, and a longevity swap for HSBC Bank (UK) Pension Scheme by Prudential Insurance Company of America for £7 billion.

Mercer's partner for risk transfer Suthan Rajagopalan says that the company is "definitely confident that the market will reach £30 billion in 2019". He adds: "I don't think it'll be double or treble, but we're looking at £20-30 billion on a bulk annuity basis. In terms of longevity swaps, it will be a multiple of last year, say £5-10 billion."

Others believe it could surpass the £30 billion figure. Aon's senior partner and head of risk settlement Martin Bird says there had been internal debates of whether the market would go beyond £40 billion this year due to the number of large schemes and projects that are in play. He refers specifically to the Rolls-Royce deal, valued at £4.6 billion, that was announced in June. "It only takes one or two deals like that. I don't like to speculate, but we think the right number is over £35 billion. But £40 billion wouldn't surprise me."

However, others are more sanguine and feel that what we are seeing is merely a blip in the market. In this camp are Willis Towers Watson's senior director Shelly Beard. She doubts that the current pattern is one that will be sustained. "Firstly, there's a lot of large transactions at the moment. The ability to do that is due to a fall in life expectancy and a positive equities market. This means funds have better funding positions than they expected. They're taking the opportunity to complete transactions. I think it's a one-off bulge, for want of a better term."



Market trends

With such movements, the industry is seeing, in some respects, its limitations. Anecdotal evidence suggests that there is a limit to the capacity of insurers to handle the amount of new transactions. In fact, says Bird, this is the biggest trend in the market.

He explains: "It's not that the insurers have limited bandwidth in terms of the balance sheet. It's the human bandwidth needed to process that work. The whole market is struggling a little bit there, and it's been a limiting factor this year."

Another trend in the market has been a predicted increase in longevity swaps. In December, Willis Towers Watson predicted that the £5 billion in this product in 2018 would double the next year.

This surge may be driven by a stagnation in UK life expectancy improvements. Office for National Statistics figures show that male life expectancy rose from 78.91 years between 2011-2013 to 79.07 between 2012-2014, and continued to rise very gradually in the following periods from 79.09 years to 79.17 years to 79.18. For the female population, these numbers began at 82.71, rising then to 82.81, 82.82, 82.86, and then remaining at that value for 2015-17.

Rajagopalan says: "Some schemes have an inherent level of longevity risk because they have higher pensions and more affluent people who are going to live longer. We saw improvement rates in longevity tail off between 2016 and 2018. There's been no improvement on a national level, which led to a deprioritising in thinking about longevity swaps. This year, we've seen a turnaround – a 4 per cent improvement. This may just be a blip or a turn in the market, and it may lead to a resurgence."

Rajagopalan says that the driving factors in 2019 have been improved data governance and simplified transactions. This is backed up by Mercer's *Pension Risk Transfer Market Watch*, published in July. There, the company's head of UK bulk annuities David Ellis wrote: "Getting your house in order (data, assets, and governance are good examples) before you go to market has always been good advice, especially where your potential counterparties are busier than ever."

As Bird notes, it takes only one or two big deals to boost the numbers and it is not uncommon now for the industry to see large deals valued in the billions. In previous years, these types of deals had been much smaller. But since last year, we have seen deals (the aforementioned British American Tobacco and Rolls Royce, plus the Airways Pension Scheme, a transaction of £4.4 billion with L&G; the Dresdner Kleinwort Pension Plan, £1.2 billion with PIC; and Rentokil Initial, £1.5 billion with PIC) that would have been the exception a few years ago.

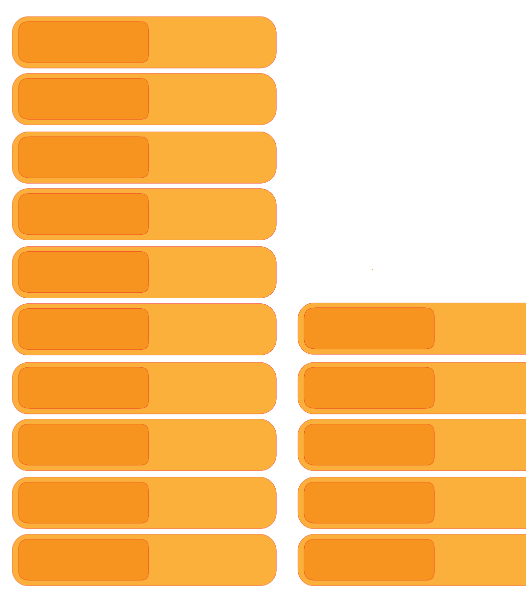
As Beard puts it: "People thought once that some deals were too big, but insurers are now more comfortable with them." She adds: "In the context of what's going on, £500 million is now considered small."

Preparation

While the market seems in good shape, schemes should not be resting on their laurels. Bird says that there are many things that they can do in order to prepare for a buyout. He says that while they are not exciting, they are crucial.

He explains: "Schemes can get properly prepared by working through their data and understanding the gaps. They're not a problem, but schemes may not have everything there in order to get a buyout price. Pension schemes often don't ask about spouses and their ages. You need to know which benefits you're going to insure. That's usually a lengthy process."

Written by Peter Carvill, a freelance journalist



With great freedom comes great responsibility

Summary

- The pension freedoms has allowed for people to customise and change how they would like to access their pensions, but there is a lack of support.
- Pensioners risk being victims of scams or running out of money if they make the wrong choices.
- Data analysis and platforms can support advisers and their clients in providing the right options, but a decent default option must be in place.

Sunniva Kolostyak reports on the darker side of pension freedoms and how professionals must take action to save people from making the wrong choices

The Pension Freedoms Act, introduced in 2015, has brought with it several benefits for savers. People can make their own choices on how to best use their pot, and with the obligations to buy annuities removed, there could be several better-suited options. But could this instead be a trap, where savers actually need to be saved from themselves?

Pension freedoms allows people to decide for themselves how to best use the pension pot, which can be accessed from the age of 55. It recognises that it is the saver's money and that it is up to the member to decide how to spend it.

There is no doubt that the act has been hugely popular and that many are enjoying and benefitting from the greater flexibility they have been given, Age UK charity director Caroline Abrahams says.

"However, we are worried that a lot of older people with small and medium-sized pension pots, who do not pretend to be particularly financially savvy, are making risky decisions that could leave them in a mess in a few years' time, especially if there's a downturn in the market as is bound to happen at some point."

The second quarter of 2019 saw £2.75 billion withdrawn from pension pots under the pension freedoms rules, a 21 per cent increase on the same period in 2018, figures from HM Revenue and Customs revealed in July.

Without decisive action, Age UK expects the growing number of consumers reaching retirement to only increase the level of detriment. So how is a situation where financially illiterate savers are left worse off under the new pension freedom system, due to the extra choice, avoided?

Information is key

One solution is engaging and empowering consumers by providing them with information. However, encouraging savers to seek out advice and guidance is an important measure but not enough on its own, Abrahams notes.

State Street Global Advisors (SSGA) senior investment strategist, Maiyuresh Rajah, says the need for flexibility is not new – the popularity of traditional annuity products is now perceived as holding no value by consumers. Their popularity is waning as people have a reluctance to give up their whole pension pot for a fixed income stream.

"Flexibility is becoming the key driver for many retirees when choosing how to access their pension pots, instead of a need for guaranteed secure income through retirement," Rajah says.

Freedom and flexibility bring with them a set of risks, such as eschewing the benefits of a guaranteed income for life, through a final salary pension or an annuity, and instead becoming DIY investors and investing in riskier pension products, according to Barnett Waddingham senior consultant Malcolm McLean.

He reports that pension freedoms are proving a challenge, even four and a half years after their introduction. "Although right in principle, and certainly popular with the public, there is no doubt that there is a need to make changes to provide better consumer protection than has existed to date.

"It is increasingly apparent that many savers are struggling to make good decisions in a complicated market fraught with tax tripwires, opaque fee structures and a few unscrupulous and self-motivated advisers. There is also the big increase in pension scams that has occurred on the back of the freedoms and has yet to be fully countered."

Other risks, McLean says, include running out of money in later life – "as a consequence of under-estimating your longevity and/or spending your available money at too high a rate in the early years of your retirement"; becoming a victim of too-high charges or a pensions scam; and unwittingly paying more tax than necessary as a result of making a large capital withdrawal in a single tax year.

A responsibility

"With freedom comes more responsibility, especially around the particularly delicate balancing act of moving investable assets from the accumulation to decumulation phase," Standard Life head of wrap platform proposition, Alastair Black, says.

"Thankfully, the confidence that this increased control has also encouraged more and more to make saving for retirement a bigger priority."

As the comfort of the retirement years are dependent on the investment decisions made now, increased pressure is added to making the right decisions. In the event of a market downturn or a sustained period of poor returns, clients could panic and disinvest at potentially the worst time for purely emotional reasons, Black adds.

Another added difficulty is how most people tend to underestimate how long they will live in retirement and end up with insufficient savings in very old age. The longer a person lives the more difficult it can become to make financial decisions due to the decline of cognitive ability in later life.

Rajah explains that a potential way of solving the longevity problem is to provide members with a guaranteed secure income in later life. However, to overcome the risk of cognitive decline, the decision to receive this secure income will need to be made earlier in a member's life.

"An investment strategy that includes the purchase of a deferred annuity type product earlier in life will help protect against cognitive decline risk and provide a secure income in later life without the associated decision-making challenges. As the secure income will only start in later life, members will also have the flexibility they want in the early part of their retirement."

Digital changes

Platforms are now the primary facilitators for many retirees and advisers in managing funds before and after retirement.

Black explains that the automation of data capture allows for regulated financial advice to become far more streamlined. "This frees up time for work that can't be systemised such as managing client emotions."

Abrahams adds that as a minimum, more people need to use the Pension Wise service. The service is used by too few, she says, but has proven popular among those who do use it.

"The government and the Financial Conduct Authority (FCA) need to take a far more proactive approach to ensuring that these consumers get a good deal so that if and when a market storm hits, it does not destroy public trust in pensions and the reasonable aspirations of thousands of consumers for a comfortable retirement.

"The onus is on the government to make it easier for people with modest amounts of pension wealth to take smart decisions that really will benefit them into the longer term, not just today, through increased use of default options," Abrahams argues.

Measures have however been taken to protect consumers, McLean says, for example by the FCA, which has outlined a package of potential actions. These include requiring providers to offer one or more investment solutions, or so-called investment pathways, reducing charge complexity and increasing transparency.

"The industry must play its part by helping to explain these important changes to consumers and strive to improve the clarity and overall standard of its communications, an area which it has so often been found lacking in the past," McLean says.

Rajah agrees that there is a lot of work to be done, as an industry, to rebuild trust in pensions: "Making pensions easier for people to understand will help with this – for example, less jargon, simple annual statements, targeted communications will all help – so that we can get to the point where people are no longer suspicious of pensions."

But the need for financial advice is greater than ever before, to ensure the delicate balance of managing performance and risk in retirement, according to Black, "and as an industry, we need to help advisers deliver an effective service to their growing bank of clients entering the decumulation phase".

Written by Sunniva Kolostyak

In the shadows

Zombies. Zombies everywhere. In all corners of the pensions industry. We find out where they're lurking within DB, DC and even within drawdown

DB

There are a number of underfunded DB schemes supported by 'zombie firms' unable to afford the contributions required for these schemes to ultimately pay full benefits to their members. But, lacking any clear mechanism to accelerate a resolution, they 'limp on' without any realistic prospect of recovery.

According to Quantum Advisory principal consultant Julian Fox, in this scenario, the management's long-term strategy is hope for the best, but "definitely don't think about or plan for the worst". This 'head in the sand' syndrome can lead to inappropriate investment strategies and over-optimistic discount rates, he warns.

Estimates as to the extent of the problem vary significantly, Lincoln Pensions managing director Alex Hutton-Mills warns. "For instance," he says, "The Pensions Regulator has classified c.10 per cent of DB pension liabilities as relating to schemes in its weakest covenant category, but expects that only c.5 per cent will ultimately fail. By contrast, recent analysis performed by the PLSA concluded that potentially c.20 per cent of DB obligations may not be paid. Either way, given the size of the DB landscape, the size of unpaid pensions will be significant."

According to recent research by KPMG, of the circa 21,000 UK private companies that it analysed, up to one in 12 (8 per cent) currently display three of more zombie-like symptoms of the companies being under sustained financial strain.

Out of this population KPMG estimates that a fifth (or around 350 companies) will have DB pension schemes. In many of these cases,adequately funding the pension scheme and turning round the business would be a significant challenge.

'Zombie' firms may struggle to attract other companies to take it over, due its DB pension liabilities, and these zombies also pose a risk for the PPF and its levy payers, KPMG explains.

Where buyout is not possible, DB consolidation may prise the schemes away from its zombie. However, this option may still be too expensive.

Instead, Hutton-Mills recommends more flexibility within DB schemes to reduce benefits to help get the company's pension debt to the 'right' size'

"Alternatively, a clear and widely-accepted resolution process is required, which includes swifter identification of 'zombie' schemes and accelerated transfer to the PPF. Coupled with fresh investment, this may give sponsors weighed down by their schemes the best chance of being able to avoid insolvency, whilst providing greater certainty for members and protecting PPF levy payers," he adds.

However, there is the question of whether monsters exist at all.

"We do not find the term 'zombie scheme' helpful, Mercer UK Wealth partner Deborah Cooper says. "Our understanding is that it is intended to indicate that a scheme is failing. In a DB context it seems to be used for many schemes that have a reasonable chance of continuing to operate and pay out benefits to members, without necessarily needing regulatory intervention."

As the pensions environment is more heavily regulated than it was when many employers first established their occupational pension schemes, it's understandable that employers may resent the distraction this can create, she adds.

"However, in most cases their schemes are still warm bodies that, given access to strong governance, controls and oversight, can produce good outcomes for their members."

DC

Within DC, there is a risk that closed 'zombie' funds are being eaten away by fees, PensionBee CEO Romi Savova warns.

A zombie pension fund is a closed or dormant fund that stops issuing new policies but typically holds on to the money invested until the existing policies mature. The structure of zombie pension funds is typically designed to generate as much cashflow from the existing policies as possible, and therefore may not generate a good return for savers.

According to Savova, in the world of DC pensions, zombies can come about when any pension provider decides that they no longer wish to keep attracting new customers. The 'book' of customers and their future expected cashflow is then sold to another company, and there are many companies whose primary focus is to acquire these 'books' of customers.

One of the main problems with zombie pension funds is that savers are often not explicitly told they are invested in one, nor told of the impact that this can have on their pension savings over time, Savova warns.

"With zombie pensions, savers are often unaware how much they're paying in fees and can be tied into costly and poor performing plans, so one of the easiest ways to avoid this is for members to regularly consolidate pension pots," she recommends.

Drawdown

In January, Zurich estimated that more than 115,000 savers risk a savings shortfall in later life due to neglecting their remaining pension pot after taking a tax-free cash lump sum.

After turning 55, savers can withdraw their pension savings, the first 25 per cent of which would be tax-free. They would typically put any remaining cash into drawdown or buy an annuity, even if they continue to work.

Zurich and YouGov's research found that 44 per cent of people who had gone into drawdown to access tax-free cash but had not retired, would leave their remaining balance 'untouched and unchanged' until they start taking a pension income, which could be many years later.

Experts have warned that after moving their savings into drawdown, people need to actively manage their pot, or it could veer off track.

Zurich head of retail platform strategy, Alistair Wilson, comments: "After triggering drawdown, consumers need to monitor and adjust their portfolio to ensure market movements don't leave them exposed to too little, or too much investment risk – yet many are planning to leave their pot dormant until they retire.

"Drawdown gives people much greater freedom and flexibility in retirement, but it doesn't run on autopilot. With no one at the controls, there is a danger tens of thousands of people could see their pensions veer off course."

Written by Laura Blows

In association with

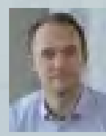
Factor investing roundtable

CHAIR

Chair for the day: Andy Cheseldine, Client Director, Capital Cranfield

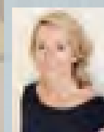
Andy joined Capital Cranfield in 2017. Before joining Capital Cranfield, Andy acted as an adviser to trustees and employers at Watson Wyatt, Hewitt Bacon & Woodrow and latterly as a partner at LCP. Using his experience of over 30 years in consulting on both DC and DB pension arrangements and liaising 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



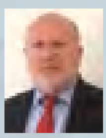
Tom Baird, Vice President, Manager Research, Redington

Tom is a vice president within the manager research team at Redington, where he focuses on equity strategies across the globe, ranging from long-term fundamental approaches to purely quantitative styles. He has worked at Redington since December 2017, before which he spent a number of years in the manager research team at Willis Towers Watson, specialising in public and private equity. Tom is a CFA charterholder.



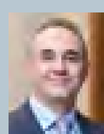
Marlies van Boven, Managing Director Research & Analytics, FTSE Russell

Dr. Marlies van Boven is a managing director in the research analytics team at FTSE Russell. She is also lead lecturer in alternative investments at Warwick Business School and has taught at Cass Business School. Previously, Marlies was a senior investment consultant with Cambridge Associates' Middle East & Africa team, working with clients throughout the GCC and wider MENA region, with a focus on hedge funds. Prior to that, Marlies was head of quantitative analysis and portfolio management at Baring Asset Management.



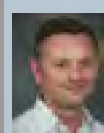
Andrew Cole, Trustee Executive, BESTrustees

Andrew has more than 15 years' pension experience of both defined benefit and defined contribution schemes, managing one scheme through five valuation cycles. For the past seven years he has also chaired the Investment Sub-Committee of a £650 million portfolio. Andrew joined BESTrustees in April 2019. Prior to joining BESTrustees, Andrew spent over 35 years working in global financial markets working for both American and European investment banks where he held a number of senior roles in capital markets.



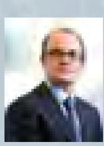
Ian Mills, Principal and Senior Investment Consultant, Barnett Waddingham

Ian advises pension trustees and sponsors on investment and risk management strategies. He helps to develop Barnett Waddingham's investment consulting services to DB pension schemes. He provides clear and actionable advice that helps pension schemes take control of their situation and focusses on the issues that will have the biggest impact. Ian has advised the trustees of one of the UK's largest DB schemes; and has advised on some of the UK's largest and most complex insurance buy-in transactions.



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

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



Jonathan White, Head of Client Portfolio Management, Rosenberg Equities, AXA Investment Managers

Jonathan is AXA IM's lead client portfolio manager, responsible for factor-driven investing, having contributed to the development of Rosenberg Equities' sustainable equity and advanced multi-factor strategies. Now head of Rosenberg Equities' client portfolio management team, Jonathan joined the firm in 2007 as a client portfolio manager with responsibility for managing clients investing in Rosenberg Equities' low-volatility equity strategies.

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Factor investing roundtable

The evolution of factor investing

We look at how factor investing is evolving and whether its place in pension fund portfolios has been truly defined

Chair: What is factor investing and where does it come from?

Vial: For us, factor investing is ultimately an investment framework whereby, rather than defining your asset classes, you define your strategies. Factor investing was talked about in academic literature – I refer to the Fama-French papers from the 1980s, which highlighted the fact that you can isolate persistent plausible strategies that would be reasonably uncorrelated and decide to allocate, as an investor, into these components in any given amount.

For example, in the equity world the size effect would be one of them. The momentum effect, as defined by up minus down, would be another. Value is one of the oldest – whereby you can buy stocks relative to a value metric which relates to the price of the stock with certain fundamental quantities that you can isolate, and this has been in the marketplace for ages.

White: I agree that the factors you've mentioned are some of the primary factors, but we think of factor investing a little differently. We simply see factor investing as fundamental investing. These ideas – of value, quality and so on – are simply empirical ways to access ideas around earnings and earnings growth. That's a really fundamental concept, and ultimately that's why factors work and why they've got a proven long-term track record of delivering better returns than standard indices. For example, quality is a way to access stability of earnings and long-term earnings growth. Momentum or sentiment is a good way to access one-year-ahead earnings growth. These are fundamental concepts, kind of like a forecast about the future.

So, while there are technical definitions, and mathematical definitions, all that factor investing boils down to, in our view, is fundamental investing.

Chair: How confident are we that where we are today is close to the endgame? Will we continue to develop philosophy around factor investing, expanding into different factors, perhaps?

Baird: The main factors that have been in place for a very long time tend to be pretty static in terms of the behavioural biases that are driving them – value, momentum, quality, and so on. What is constantly developing is how you define them, how you harvest those factors. Those factors are based on behavioural biases that are ingrained in humans, and some economic reasons and, even though there are constantly new factors coming out, they can normally be placed into one of these key buckets.

The definitions have evolved, and

Factor investing roundtable

how you harvest them has become more complex as the world evolves. There's also more innovation, as people get more comfortable with factor investing. But the broad actual buckets are pretty stable, and even though you can invent new factors all the time, where they actually sit tends to be driven by the behavioural biases that existed 10, 15 years ago; just how you harvest it now has changed.

Mills: I agree. I think the most significant substantial factors have probably been discovered. There are most likely things out there that haven't yet been discovered, but they are possibly less significant, because otherwise they would have been spotted. But we shouldn't stop researching this area; we shouldn't stop thinking about it, because we're all in the business to try and get more efficient returns for our clients.

Van Boven: The reality is that, while there maybe are 200 or 300 factors out there that some people quote, whenever the academics redo the statistics, they find that they're not significant. Most of them are totally irrelevant and a result of data mining. We have to be very careful that we first define the economic rationale for a factor testing, because otherwise you will find spurious factors, which will not add any alpha to your portfolio.

White: Exactly, and economic rationale is key. It is what you should anchor on. Does the factor have an economic intuition underpinning it? Does it have a link to corporate earnings in some way? A few years ago, when people were talking about hundreds of factors, it was unhelpful and confusing for many investors and clients. It is healthier that we seem to have moved past that now, and the industry is more aligned around a handful of key factors.

Cole: That is an interesting point because, from a trustee's perspective, it is confusing. There are lots of different things out there and we do need to start simplifying things.

Keeping things simple

Chair: When you talk about factor investing to trustees, do they get it?

Cole: I don't want to generalise, but it is quite challenging for most trustee boards to understand. They clearly understand the fundamental investment principles and the asset classes, but when one looks at factor investing, it's a step beyond; so we need to ensure that they are educated appropriately and there is also a degree of simplification that needs to happen alongside this.

Mills: Factor investing is one of the most complicated topics that pension trustees face within their investment strategies. It isn't for everyone. There are some trustees who will want a simpler approach, and will take the view that the additional complexity that this way of investing brings is not for them. I would encourage trustees to spend the time to think about it, because I believe that by introducing some form of factor investing into a portfolio introduces more diversification, more sources of both risk and return, which overall results in a more efficient portfolio.

Chair: How can the adviser help?

Mills: Our job as advisers is to try and make things as simple as possible. I like using analogies wherever I can to try and explain how factor investing works. I also like discussing the psychological aspects – one thing I've done in the past with clients looking at this is to demonstrate to the trustees through some games that actually they have these psychological biases built into them just as other investors do, and that's why some of these things work.

Not all these factors have psychological roots of course. Some of them are rooted in risks, i.e. you're actually buying something that is a little bit riskier, and that obviously has pros and cons.

Baird: The key thing for us when explaining this is to not to get too much into the weeds. What is factor investing? It is fundamental investing in a way, just a different way of defining it. When you start off on a high level with the behavioural biases and economic reasons behind their existence, you can actually explain it simply and it makes sense. Sometimes, if you bring in a portfolio manager, they can very quickly get into the detail of the optimisation, the factor construction and how everything works, and it can get very convoluted and confusing for the trustee.

If you step away, keep things at a high level, explain that this is just another way of choosing stocks using a quantitative framework, a factor framework, it can be effective. The danger is when you get too technical too soon.

White: As a portfolio manager,

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when I am going out explaining this to people, I find it very helpful to focus on the outcomes. There is a mathematical element to factor investing, of course, but the key question to ask is: what does it give you in terms of an outcome? It's much more helpful to talk about, say, the quality factor in terms of buying stable earnings, buying into companies such as consumer staples, companies that are likely to go on to deliver good earnings growth into the future. That's highly intuitive to an investor – that if I invest in these types of companies, I'm more likely to perform well in an earnings recession, for example. When earnings are under pressure, when earnings are falling, I'm buying companies with good earnings, solid earnings, and predictable earnings.

Vial: The reality is that anyone who buys equities has exposures to factors. So the conversation could start with: What is your equity book? What does it look like? What exposures do you have? Some people may have had a great few years because they have the growth factor embedded into their portfolio, which did very well versus other factors. But it's worthwhile analysing their equity portfolio and explaining to them how much factor exposure they have – then you can start a conversation about whether it's appropriate, whether they ought to have it balanced differently, whether they should have more exposure to certain things that might perform better in the future and so on.

Another way, perhaps, to deal with it, is to disentangle the pure equity premium versus the factors in a market-neutral framework. You can tell people, for example, you've got equity risk, and that's purely equity risk. Now let me give you, in a market-neutral framework, exposures to value, to momentum, and so on, that are not correlated to the market.

So, they will be getting an investment with risk-adjusted objectives that are similar to the stock market, but the outcome will be different. They will make or lose money in a different way than the stock market, and that's where the diversification can play a role.

Size of pension scheme

Cole: Is there a certain size of scheme that tends to buy into this? Where do you see the opportunity for factor investing, given that there are an awful lot of sub-£50 million schemes out there?

Vial: Size-wise, small pension funds tend to be intermediated, and maybe they would buy products that are tailor made to smaller schemes, perhaps comingled with other pensions. The direct conversation with smaller schemes is very different.

Van Boven: Interest in factor investing started off with the larger schemes because they're more sophisticated, and they have large in-house investment teams. We are now seeing it rippling down to the smaller schemes.

In the Netherlands and Scandinavia, they have been doing this for a long time, so they're very familiar with it. In the UK, of course, the whole pensions market is more consultant-driven, so the consultants need to be on board with the strategy first for it to gain traction with the trustees.

We run an annual smart beta survey across the asset owners and, when it comes to interest and even adoption of smart beta, the gap between the larger and the smaller schemes is much less significant than it was, say, six years ago. Today, smaller schemes are at least considering smart beta allocations.

White: That's our experience too. We have seen growing interest in the UK from both DC and DB schemes. Smaller DB schemes tend to want to come into more fund-like approaches with a multi-factor focus. This can be attractive to smaller schemes as it offers a replacement for a pure passive investment, particularly as the fees for factor funds tend to be much lower than traditional active management.

Factor investing has also moved beyond institutional – we are seeing interest from wealth managers and from wholesale advising networks.

Chair: What's the consultant's view?

Mills: It comes down to governance budget. I don't think there's a size for which these factors don't make sense from a pure investment perspective. There are off-the-shelf pooled funds that can be bought at relatively small sizes, even actually at an individual level. You can access these strategies through some of the platforms.

But what really makes the difference on the size of the scheme is the amount of time that the trustees are prepared to spend. If you're a multi-billion-pound scheme, you will spend a lot of time thinking about investments because the marginal benefit of a few more hours in your trustee meeting to think

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that they like. Whether they're conscious of it or not, you can often correlate that quite closely with some of these factors.

I genuinely think most active strategies are factor strategies of some description.

White: And all factor strategies are active strategies. We wholeheartedly reject the idea that factor-based investing is in any way passive. It's an active approach, it needs active oversight, and an active mindset.

about a new investment idea is going to be worth it if that idea is a good one; whereas if you're a £10 million scheme, spending some extra time on something which might improve your returns incrementally, marginally overall, at an overall portfolio level, is it worth it? That's a question that genuinely gets asked, and if it isn't worth it then they're not going to invest in it. They're going to have a simpler, more straightforward investment strategy that's easier for them to keep an eye on, easier for them to understand, but still going to do an okay job overall.

Passive and active

Cole: Do you see factor investing more as a replacement for passive funds, or more as a replacement for active managers?

Mills: I'm not sure I even see the distinction between factor investing and active management. You can classify many active managers as factor investors. They may or may not agree with that distinction, but if you talk to an active manager – and we're talking equities here – they will be able to articulate their strategy, and how they define the stocks

Van Boven: We see quite a few pension funds that have, as their default allocation, a market cap benchmark and, while you do need somebody to drive the discussion on the board of trustees, we do see an interest in switching that to a factor-based strategy– often opting for a balanced multi-factor approach. They are also often interested in including ESG considerations and climate risk in a factor framework to target specific outcomes.

Baird: I agree that you shouldn't think of this as active versus passive. However, what we do see as being fairly useful is, if you can get investors to get over the governance burden of what factor investing is, how it works, etc, then a one-stop multi-factor solution can be a good option if they're already in passive, but they don't want to go fully-fledged active in the traditional sense – because otherwise they'd maybe have to hire a value manager, a quality manager, a momentum manager, and so on, to get that smooth return stream.

So, if your governance is a little bit lower and you can't monitor four to five asset managers, the idea of using a one-stop solution in terms of multi-factor can be a pretty nice outcome, because it is active but it means you only have to monitor one manager, and can dial the risk up or down depending on what's appropriate.

Economic and regulatory environment

Chair: Does factor investing suit the current regulatory and economic challenges pension funds are facing?

Mills: Whatever regulatory environment pension funds are in, it is a sensible thing to do to try to invest your money in an efficient, diversified way, and factor investing is one of many tools that you have in order to achieve that.

The economic environment at any point in time usually favours one or more of these factors over others. These factors tend to come in and out of favour at different points in the cycle, and to me what's important in a factor-based strategy is having a diversified approach, so not having all your eggs in one factor, because that could significantly underperform or outperform your expectations, whatever they are, over a relatively short period of time. By having a diversified approach, it should work in pretty much all market environments when given long enough.

I'm not saying that if you diversify your factors, you're always going to get a positive return, but you should get a smoother return than putting all your eggs in one basket.

Vial: If we all agree that in reality there are only five or six truly persistent, plausible factors out there, then it makes sense to diversify and get exposure to them, and not try to time.

White: Taking a slightly different

perspective on this, one of the advantages of factor-based investing is the ability for an asset owner to take a step back, think about what it is that they want to achieve. What are they looking for? That, in some scenarios, might lend itself to a factor design that isn't multi-factor. One that is more focused, say, on quality and low volatility, because they are possibly an asset owner that really cares about downside protection – an insurance company, for example; or maybe they are a more mature scheme, which is in de-risking mode, and therefore lower volatility and downmarket protection makes more sense.

Baird: On the economic point, in certain economic environments you perhaps need to make the return part of your portfolio work a bit harder, so looking at something like factor investing could make a lot of sense.

Chair: Low volatility has become expensive. Is that a risk?

White: We are challenged a lot about the low volatility factor – this factor has performed very well this year and there has been a huge amount of asset flows into low-volatility ETFs, particularly in the US. The result is that, through our lens, some stocks have been bid up to expensive levels. This tells you that factor investing is an active approach. It comes with side effects. You've got to monitor those side effects – you've got to keep on top of them. When we build a low volatility strategy, we think about a couple of things. First, we can avoid some of the expensive names – we just don't buy them. There are plenty of other stocks to buy. Also, low volatility is not just about price. It's about earnings, and buying stable earnings, so we need to be thinking about fundamentals as well.

This is where active management has something to add, compared to index-based approaches, which can potentially have unintentional risks built in. An active manager has more leeway to control these unintended risks.

Baird: If you just have a pure low vol approach, which is purely price-based, it can lead you into pockets of the market you don't necessarily want to be in and give you unintended exposures, so we prefer managers who have a multi-factor model and a low vol overlay.

Chair: Is value broken?

Baird: It's a pretty bold statement to say that value's broken, something that's worked for over 100 years. We don't believe that. Saying that, how we define value may be changing. That's the innovation. That's what might change over time.

Looking ahead

Chair: How are things changing?

Vial: Ultimately, investors may start to allocate according to factors as opposed to allocating according to asset class. That's what a good outcome would be – a future where people understand that when they buy a lot of equities, within that portfolio they have exposures to momentum, quality, low vol and so on. Then they can figure out according to the cycle where they are, and whether they want more low vol or less etc. I think the industry's getting to a point whereby this will be more trackable, and people will be more able to make investment decisions on this basis. I'd also add that we're talking about equity factors here, but these things can be applied elsewhere, in fixed income and in other places.

Cole: The challenge the trustees have is knowing exactly where they are in the cycle because they usually meet just four times a year (more often of course if they have investment committees, so it does depend on the size of the scheme). The challenge then for the people selling to and advising the trustees is identifying where the scheme should be in 6-12 months' time and whether, on that basis, now would be good time to enter into a momentum factor or whatever it may be.

Also, as trustees, we're investing for the long term, but that long term seems to be getting shorter because The Pensions Regulator is looking for fuller funding in a shorter period of time.

As a trustee, I'm tending to look five years out rather than 10-15 years out, and therefore market timing is becoming more important. But unfortunately, as a trustee, we tend to be very slow. So, market timing is important, but our decision-making process is slow.

Education

Chair: Is it challenging to get those

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schemes that are not currently in factor investing to make that breakthrough into factor investing?

Vial: The reality is that they are already in factor investing, but they just don't know how much or of what.

So that's the first step – helping them understand that they have exposure to certain factors already and helping them see what they have and how much. Then you can move on and discuss whether what they have is appropriate, whether it's diversified enough or not and so on.

Van Boven: There's an educational process that is needed here. You have to start by presenting in a very simple way the basics of factor investing; use analytical tools to show the behaviours of different factors, when you combine them what happens and then, often they come to the conclusion that they do not want to time factors, or do not want to switch between factors, but that a diversified approach is more suitable. Then, depending on their stamina or how strong the governance is, they can take more risk or less risk.

Cole: You're 100 per cent right. To me, it's the education process that is key because it will take a long time to get people on board.

Van Boven: You can also, for example, show the difference between the behaviour of cyclical factors like value and momentum, and the defensive factors, like low vol and quality and how, if you combine them, you can improve the relative risk-adjusted performance. When you combine cyclical and defensive factors in a multi-factor index you again get a different risk-return profile. So, if you show that and talk them through, investors will probably come to their own conclusion of what is a suitable risk-return profile. Different investors will address different concerns via a factor approach and require a specific factor allocation in line with the desired investment plan outcome.

Mills: I've advised quite a few clients on these types of investments in the past, and I don't think there's ever been a decision made in the first meeting. But for the schemes that have invested, it's usually a three or four-meeting process – it can take up to a year before they're ready to invest.

Vial: We already have people asking us to analyse their portfolios and tell them what exposures they have in the various factors. I think the industry will reach a point where this will be a service provided by consultants, managers, etc. So, you can start with some real numbers and talk to your trustees and your peers, and explain what there is, and move on from there.

White: Investor education is critical – this is active management. I find it very unhealthy when you get into a scenario where factor investing is considered some form of passive approach and asset owners are told they can relax because it's replicating a benchmark.

When it comes to investor education, quant managers like us tend not to be perceived as transparent or as interesting as more traditional managers – we don't have entertaining stories about themes or companies we've visited. What we've found recently though is that we can make use of technology to help investors better understand what they're buying when they buy a factor.

We have built a suite of visualisation tools, which we can put into the hands of our clients, or into the hands of anyone who's potentially interested in investing with us, and they can interactively explore the portfolios visually, on a screen. They can touch it on their iPad!

Van Boven: I agree. When I go to a client meeting, I bring an iPad with me to visualise factor investing on our analytical tool. If a client is already invested and I have their portfolio holdings, with this analytical tool they can really see what their portfolio looks like in terms of factor exposure, performance attribution, where the return is coming from, whether it is really doing what it says on the tin. With visualisation, people suddenly perk up, and then you can give them access too. That's one way to really bring it alive.

Risk

Chair: Most trustees now get concentration risk, but do they understand the factor risk they've got?

Vial: We do regression analysis against commonly accepted factors – so we can show how they are exposed to certain factors. For example, if they are concentrated in BP, that's the growth factor, perhaps. But it would be tremendously useful for trustees to have a better understanding about the risks that are in the portfolio, because typically people forget when things go well, and when things go badly then there's a big problem.

Baird: A holdings-based analysis is another option. You get the whole portfolio in front of them – so, all the portfolio managers they have within the portfolio – and you show, for example, if they've got big tilts to quality, and where that's coming from/which companies, and why maybe they should be worried, because in a market where quality underperforms that's going to hurt. That's a nice visualisation for people. People can understand it because it's not the most complicated calculation.

Van Boven: Trustees will hear a lot of pitches – everybody telling them that they have the best approach. But if the factor story's true, and factors drive performance, two portfolios with the same factor exposure should have the same performance. If the performance is different, the factor exposures are different. So, a better way to look at the difference between alternative factor indexes is to look at the implementation efficiency of the portfolios – how diversified are portfolios to similar factor exposures? What's the turnover? How much active share do I need to execute the strategy? You're almost turning the question upside down.

You also need to make sure that the portfolio is delivering the exposures you choose to have exposure to, and it avoids off-target exposures.

Cole: One of the challenges as a trustee is that we tend to buy in to different ideas. For example, 10 years ago, a lot of trustees bought into DGFs. You then come to the problem that some of these DGFs become too big and therefore don't perform.

From a trustee's perspective, though, it's quite challenging not to follow the latest trend. Today, for example, everybody's investing in infrastructure. It's amazing to me how many investment managers, all of a sudden, have an infrastructure fund. I came from an institution that had been investing in infrastructure for 30-plus years, and you cannot tell me that people who are starting to invest in infrastructure now have the wherewithal to know what to do when things go wrong.

So, from my perspective as a trustee, where I become sensitive is, am I just following a trend?

White: My response to that would be that there's an assumption here that factor investing is a generic, singular concept. If you come back to the very simple notion that factor investing is simply a proxy, a mathematical proxy, to access fundamentals, then I think concerns about it just being a trend that's somehow going to stop working don't stack up.

There are risks to certain approaches that could get arbitraged away if you had an overly simplistic way of accessing value, such as price-to-book 20 years ago. It's probably no longer a good measure of value. It has to evolve, it has to adapt, but the underlying idea here is to buy good fundamentals, and that is something that will remain robust. It's robust today, and it will be robust into the future.

ESG

Chair: Where does ESG sit in factor investing?

White: The ideas behind ESG are actually very long term – we would see them as economic in nature, just like earnings, just like a balance sheet. Thinking about E, S, and G, and all of the granular components that go underneath them can be analysed alongside traditional fundamentals. Therefore, you've got to consider them when you build a portfolio, but perhaps the slight difference with some of them are, they're quite long horizon, and that is a good thing. To have a long horizon discipline built in alongside other ideas is a healthy way to invest.

Chair: Is ESG a factor?

Van Boven: It's too early to call it a factor because we don't have a lot of historical data to evaluate.

At the moment, we are seeing that clients are looking to engage with companies that fall below the desired ESG score. So, by having a sustainable investment overlay, you can identify companies to work with and try and influence their governance. In addition, an ESG score or overlay allows you to identify those companies that are better prepared for the transition to a low carbon economy, companies you may want to tilt towards. We are seeing less clients 'divest' as complete divestment can lead to concentration and negatively affect portfolio dynamics. That said, some clients do choose to divest as by divesting, you're out of the picture especially if judgement is more values based.

Cole: For me, if we separate out the E, S and the G, clearly both social

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responsibility and good governance are part of the UK code of conduct. All the large firms must be responsible for each one, and there are clear rules that are set up around that.

The interesting one is the environmental component, which is more challenging. As a trustee, we maybe all want things to be better with the environment and everything else, but if you are a trustee for a scheme that is, for example, the Coal Board, you will have a very different view on ESG than if you're a trustee for an underlying sponsor that is dealing in wind farms or solar panels or whatever else.

White: Is ESG a factor? My response to that is, it's certainly fundamental, and therefore it's a potential source of future return and risk mitigation. So, with my catchphrase that factor investing is fundamental, it's very well suited to a factor-based approach.

Also, we don't draw a distinction anymore between an ESG strategy and a non-ESG strategy. That's the past. We just think of ESG information as bits of fundamental data that we have to pay attention to and consider when we build portfolios. ESG information is integrated into all Rosenberg Equities' strategies.

We are also taking ESG integration a step further by upstreaming ESG information right into the heart of the models that we use to build factors. I'll give you an example. We have a quality model that, for many years, was based on the things you'd expect to go into a quality factor – balance sheet strength, cash on the balance sheet, earnings stability, all those things.

Something we introduced into that model recently was diversity of the boardroom. When you build a diversified factor-based approach you need breadth of data, and this met that criteria. Our research found that there was a strong link between diverse boardrooms from a gender perspective, and the capacity for companies to deliver and protect high profits into the future. So, it's a very fundamental idea. You can upstream that and put it alongside balance sheet and earnings data.

So, that's bringing these ideas right into the heart of these factors and is something we are embracing.

Baird: I think ESG comes under other factor umbrellas. For example, governance could be regarded as a quality factor. So, it can be another lens through which to look at quality, essentially.

The key thing with ESG that we're thinking about when it comes to factor investing is, we think it's easier done by a more traditional fundamental manager, who more qualitatively assess ESG characteristics and are more able to engage. It's more difficult for quants because the data's a bit spotty, and not everybody agrees with each other about how you define these things.

It is of course on a lot of quant research agendas. There's a lot of interesting work being done by quants and there's a huge business push by them. But we're spending a lot of time with them, and making sure that when ESG factors are incorporated they've gone through the same robust tests as a more traditional factor, because there is definitely some greenwashing going on in certain areas of the market.

Van Boven: We don't incorporate the data in the factors, because every client has different demands in terms of how they want to address ESG, or how much carbon reduction they want to achieve, for example. I like the idea of incorporating it in factors, but with the clients we've worked with so far, they really have very individual needs.

Vial: We don't see ESG as a factor. First of all, we have a statistical definition of factors so we need to have a lot of data and do regressions to see whether it's present in the past. So, number one, there's not an awful lot of data. Number two, governance is pretty much like quality – a good quality factor would encapsulate governance. Interestingly enough, it perhaps brings new data and new ways to look at quality, which is good. We published an academic paper that states that G as governance, part of quality, would be a factor in the sense that there's a little bit of data, and it has a positive outcome in terms of performance. But with the E and the S, it's very unclear as to whether there's any money to be made, at least when looking historically.

So, because we're very conservative, and because our definition of factors is persistence, but over decades, we're a little bit sceptical about calling it a factor as it is, and we think it probably is already within the existing factors.

White: Factor investing's broad by definition – it's typically a large number of securities. It's not a concentrated approach. It's a diverse approach. You need to spread your bets. You want to reduce stock-specific risk. You want to access factors. So, with respect to, say, carbon for example, one can form a view, and we have formed a view, that it's the right thing to do to reduce exposure to carbon. We think that would be a long-term benefit to investors as the planet moves on a transition to low carbon and away from high carbon-intensive industries. That is a forward-looking statement, and I think as an asset manager one should make those types of statements.

But at the same time we could also, because of the diverse nature of factors, look at our capacity to build a factor-based portfolio with and without these high-carbon companies, and actually it doesn't really impact it. You can still build a really good factor portfolio and not invest in the most high-carbon utilities out there.

Say you've got two utility companies, A and B. They've both got the same factor footprint which at face value is attractive. However, company A is a high-carbon, coal-intense company, and the other one, company B, has a low-carbon footprint and is expanding its use of renewables. We would not invest in company A but we would increase our allocation to company B. Overall the portfolio gets the same factor exposure, and we also get to embed our long-term view that lowering carbon intensity makes sense.

Concluding thoughts

Chair: Following today's discussion, what key message would you like to make about factor investing?

Cole: I think factor investing is a great idea and there's clear value in it, but the most important thing is for the advisory side and for the fund managers to continue to educate trustees, because I believe people will buy into it. There's merit in factor investing, but the knowledge base is relatively limited.

Some trustees are aware of it, some are investing in it, but the industry needs to help trustees along the journey.

In response to the suggestion that we analyse portfolios to understand the factors that we're already invested in, that absolutely needs to happen. But it's the education that is key. It's making sure that the journey is as easy as possible. Trustees are going through a change in the way that we have to look at the assets under management and what we're trying to achieve out of those assets, so we need to make sure their journey plan is clearer and more obvious, especially as many schemes are beginning to de-risk, and changing the journey that they're on. So, education is fundamentally important.

Baird: It is important also that we're not trying to be too clever with these factors and trying to time them. One thing we would suggest is, when you allocate into this space you want to have a diversified, blended approach to these. It's very difficult to accurately tilt towards value or momentum or whatever's going to work over the next five to 10 years. So, the key thing is, if you believe in these things, and you believe they work, a diversified approach is the most sensible way of implementing.

Mills: I agree that there's value in these factors and that diversification is key. There are lots of different ways to access them, but the key point is that there are sound reasons why they should work, but they won't all work all the time. So building a diversified approach is key.

White: With factor-based investing, we should always be conscious that we can learn from the past, but we've got to treat investing with great humility and recognise any sort of future volatility is not going to be an exact replication of the past. We should therefore be humble about how we invest. We also need to innovate, and continue to think about how we can build the best possible ideas that are going to be robust into the future. That means thinking about new data like ESG, thinking about analytical techniques like machine learning, how we can build that into these ideas to embrace change and to embrace innovation, because we can't rely on exactly what we've done in the past.

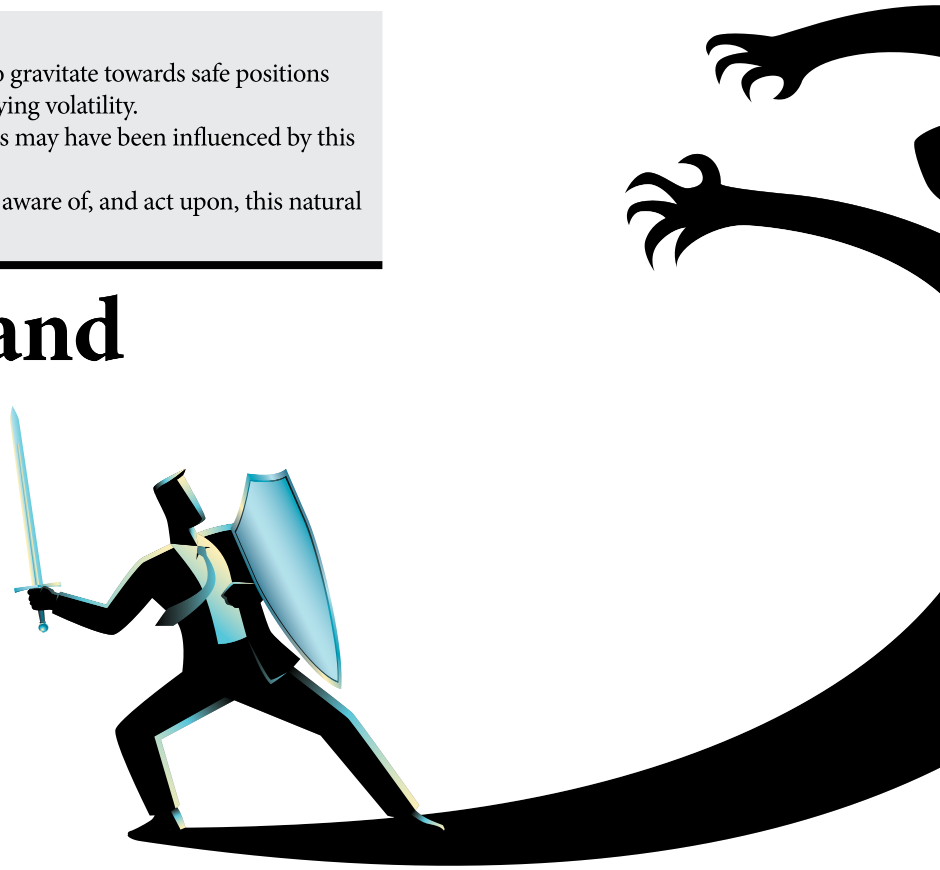
Van Boven: I agree. Where we see an interest is to go beyond equities and to look at multi-asset factor investing. There's quite a bit of demand to expand beyond equities.

Vial: Yes – these concepts are moving towards fixed income, FX, and so on. It's only an investment framework, and I also agree with the knowledge gap that needs to be filled between investors and managers. It's a long road, but we'll get there.

Summary

- Loss aversion is a human's innate tendency to gravitate towards safe positions when confronted with different options of varying volatility.
- DB trustee boards decision-making processes may have been influenced by this aversion to risky investments.
- There may be a need for trustee boards to be aware of, and act upon, this natural 'fear of loss' in order to maximise gains.

Feel the fear and do it anyway



Paul Beardwell explores the effect of the human tendency for loss aversion on trustee boards' decision-making

If somebody were to be approached by a trusted colleague or friend, right now, and offered a cheque for £100, no strings attached, they may be inclined to accept it.

However, just before it is handed over a caveat is introduced. The £100 may be taken immediately. Or it can be refused, and tomorrow morning two unmarked envelopes will be offered in its place. One containing a cheque for £1000 and one containing nothing at all. Only one of those envelopes can then be chosen and the contents must be accepted. This situation could either lead to a ten-fold increase on 'yesterday's potential gain', or a net profit of zero. What decision would you take?

This is a simple way of demonstrating the concept of loss aversion. An individual with an increased aversion to risk would most likely accept the cheque for £100 immediately. Even though the future reward may be ten times greater based on what is essentially a 50/50 gamble.

Avoiding risk

The human propensity towards risk aversion is a subject that has been the focus of a number of studies over the years. The majority view appears to be that humans have an innate tendency towards the mitigation of loss. A paper, *Who's Afraid of a Little Risk? New Evidence for General Risk Aversion*, by Princeton University professor of psychology and public affairs, Elke U. Weber, states: "While there is evidence that a small proportion actually like options that they perceive to have greater risk and are willing to pay more money for these options than for options of equal expected value but smaller perceived risk, this is not true for most people."

Asked to define risk aversion, Dalriada Trustees professional trustee, Andy Scott, proposes it is: "The desire (and actions taken) to avoid any adverse consequences of a decision or future event. It usually arises because people worry more about the downside and what can go wrong than take risks to achieve an upside."

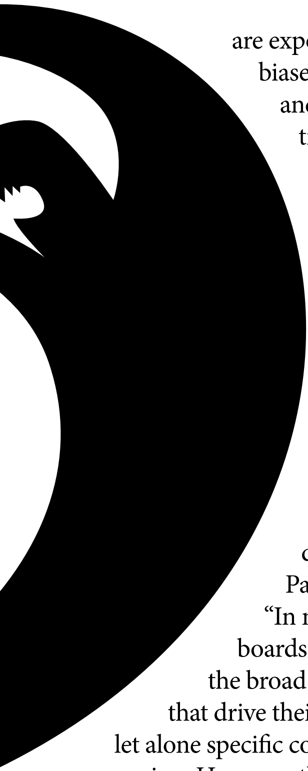
This innate human 'fear' of loss may drive trustee members to make certain, safer, decisions that could be preventing them from realising potentially greater returns.

Cowry Consulting behavioural consulting lead April Vellacott explains: "Trustee boards are no exception to this bias. When weighing up a novel approach or opportunity, they'll be tempted to focus on the potential risks and costs, known as loss aversion. This is because we feel the impact of losses twice as much as equivalent gains."

Awareness

Trustee boards may not be aware of this innate bias. After all, they are not required to be experts in human psychology.

However, Cardano director Stefan Lundbergh acknowledges that: "Trustees



are exposed to the same biases as the rest of us and I think that most trustees are aware of their own biases. But as an individual, it is extremely difficult to mitigate our own biases, especially when making decisions under pressure."

In contrast, Redington head of governance and decision research, Paul Richards, says: "In my experience, many boards are not aware of the broad behavioural issues that drive their decision making, let alone specific concepts such as loss aversion. However, this is changing, with professional trustees often being a driver."

Examples

Richards also understands the difficulties that some board members may have when making decisions. "Trustees constantly have to make high-stakes choices in complex areas outside of their professional expertise. These factors can, understandably, lead to more tentative decision making," he explains.

Scott gives an example of this tentative approach: "There is a desire for trustees to hedge most or all risks in pension scheme investments, leading to the lowest interest rates ever recorded and guaranteeing that gilts will provide negative real returns for many years into the future."

Trustees' own awareness of loss aversion tendencies may be nuanced, depending on the individual risk capacity of each member of the board and how that board works together.

Richards makes the following distinction: "A scheme that needs a high level of investment return, but which has a board of highly risk-averse individuals, is likely to struggle to make the choices that need to be made. Here, the group dynamic is likely to reinforce preferences. While a board with different levels of risk aversion has less likelihood of defaulting to a low-risk position. However, diversity of preferences does not guarantee a good outcome. In some cases it will simply lead to nothing being agreed and the status-quo being retained."

Trustee boards leaning towards 'safer' positions is a theme that seems to hold a lot of weight with industry professionals.

For example, "the slow adoption rate of integrated risk management (IRM) can be explained by a concert of human biases, of which loss aversion is one", Lundbergh states. "From a logical perspective, a scenario-based approach to IRM makes perfect sense since it helps trustees to make the funding ratio more resilient, but in some cases the 'current practice' will deliver better outcomes. Framing the latter as a risk, means that loss aversion will nudge decision making towards status quo."

Lessening impact

In order to lessen any negative implications of risk aversion, the framing of loss may need to be re-evaluated so that it can be presented and considered in a more positive way.

"Trustees can frame risky approaches in terms of the potential benefits, rather than ruminating on potential losses. Instead of leading with 'this is going to cost us £35,000', try introducing a risky approach with, 'this has the potential to bring us an extra £100,000 in revenue'. By framing risks in terms of their potential gains, this will help trustees to overcome their natural inclination to shy away from risk," Vellacott says.

Trustee boards' advisers may also be able to help trustees adjust their inclinations towards loss aversion.

"Consultants and advisers can play a key role by ensuring the thought and decision making is objective and by challenging trustees in considering an alternative view," Columbia Threadneedle Investments senior thematic analyst and behavourial economist Dr Ben Kelly says. "This is not per se designed to force trustees into changing their minds, but to ensure the decision they do make is grounded within an objective and routine process."

Scott agrees with this principle. "I think that education, good governance and chairmanship, and good consultants/advisers will go a long way to mitigating any unnecessary caution in trustee decision making," he says.

Benefits of loss aversion

So far loss aversion has been framed as a potentially negative influence. M&G director, fixed income, Annabel Gillard, brings our attention to an alternative position. "It's inherent in trustees' nature to be risk averse given they are responsible for the scheme's performance. A degree of risk aversion is also appropriate, given trustees are exercising a fiduciary duty on behalf of members," she explains.

Scott agrees, stating: "Avoiding bad risks are very much what trustees are there for, so there should not be a mad rush into taking reckless or unnecessary risks. That is for the gambling casinos and racetracks. Trustees should never totally abandon caution – it is a natural outcome of being prudent."

The human tendency towards loss aversion plays an intangible, but still important, role in trustees' decision making and risk analysis. Therefore, greater awareness of its impact may make a significant difference.

As Legal & General Investment Management head of DC client solutions, Simon Chinnery, articulates quite succinctly: "If board trustees are tutored to recognise behavioural traits and can practice in a healthy environment where it is acceptable to challenge one another, then great."

Written by Paul Beardwell, a freelance journalist

Summary
• The FCA's recent guidance paper on the fair treatment of vulnerable customers emphasises the industry's lack of consideration of the needs of these individuals.
• Schemes are encouraged to clearly outline the different types of vulnerable customers, and the behaviours that could put members in each bracket.
• Pension scheme staff need to be trained to identify vulnerable customers.
• Once identified, providers should look to assist vulnerable customers with tailored support that suits their specific needs.
• There is always room for improvement, and vulnerable pensions customers should be viewed as an ongoing challenge.

A helping hand

Talya Misiri discovers how the pensions industry assists its vulnerable customers

Amid an ageing population, and the nature and complexity of pensions, this industry will inevitably be presented with vulnerable customers.

The Financial Conduct Authority (FCA')s recent guidance paper, *Guidance for firms on the fair treatment of vulnerable customers*, published in July this year, emphasised a lack of consideration of the needs of vulnerable individuals. The regulator's reiteration of its policies suggests that pension providers, schemes, advisers and trustees are not doing enough to assist those deemed as vulnerable.

Hurley Partners pension director Martin Tilley says: "With pensions, you've got a lot of decisions that need to be made on a fairly regular basis. Vulnerability is a circumstance that changes and can occur quite quickly; people can become vulnerable quite rapidly. So, identifying and helping these members is crucial."

The FCA has said that up to 50 per cent of consumers could be potentially vulnerable and need extra support.

Nonetheless, its research found that the typical number of vulnerable customers identified by firms was around 5 per cent or less. "Clearly there is a huge gap between the regulator's expectations and the firms' experience," Just communications director Stephen Lowe comments.

Shortfalls

The FCA defines a vulnerable consumer as: "Someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care."

On the whole the pensions industry does not have the provisions in place to cater to and identify vulnerable customers.

Trafalgar House client director Daniel Taylor says: "The industry tends to be very reactive when it comes to meeting the needs of vulnerable members. Instead, processes need to be in place to enable vulnerable customers to be identified and supported at the earliest point possible."

Identification

The fact that the FCA has continued to reiterate its guidance highlights that there is a considerable level of neglect for vulnerable customers. Training staff and all those that deal with pension scheme members and consumers about how to identify vulnerable customers is a key starting point to tackle the problem.

Schemes are encouraged to clearly outline the different types of vulnerable customers, and the behaviours that could put members in each bracket.

AHC head of engagement strategy Karen Bolan points out: "It's important first to identify how we would define vulnerable members. For our industry, the focus tends to be those in or approaching retirement with insufficient provisions in place. In fact, we need to look beyond these and focus on any member who struggles to understand or plan for retirement." This could include the physically or mentally less able, or those going through bereavement or a divorce.

Discussing his recent task to rewrite Hurley Partners' vulnerable customers policy, Tilley says that staff training is essential. He explains that "key to this process must always be staff training to identify the signs of vulnerability or potential vulnerability". Once these are realised, Tilley says, the pension scheme, employer and/or adviser can begin to assist accordingly.

Nonetheless, it is important to ensure that staff who are dealing with vulnerable customers are also supported.

PensionBee founder Romi Savova highlights: "It can also be very challenging and emotional for the staff of a pension provider to help vulnerable customers, so internal support systems should be reviewed and adjusted where necessary."

Communications

Nethertheless, identification is not always completely straightforward; certain signs can be missed if members are unable to communicate with schemes directly.

Savova says: "It is difficult to identify vulnerability through cookie-cutter forms. Hard-to-reach call centres compound the problem. Therefore, providers need to ensure vulnerable customers can easily speak to real human beings when they need to.

"If a vulnerability is identified, providers need an action plan to deal with regular occurrences." Examples of this include: "Referring heavily indebted customers to the right support channels that can independently explain why accessing a pension is not desirable, helping survivors of deceased customers make arrangements for their loved ones' finances, or simply helping customers understand their options patiently and in plain English."

In the digital age, pensions information for vulnerable customers can now be presented in simpler, more accessible formats.

An example of this is pension provider Smart Pension's Amazon Alexa and Google Home integration that provides visually impaired people with the option of managing their pension through voice alone.

Smart Pension director of policy and communications Darren Philp says: "As we move into the digital age we have a unique opportunity to use technology to communicate in a more effective and accessible way."

Bolan agrees that a range of formats should be available for consumers to view information. "If we produce a website, we should make sure that it's just as informative on a screen reader as it is for someone viewing the site. If we include video or infographics, there should be alternate ways of seeing the information."

Tailored assistance

It is important to be aware, however, that not all those deemed vulnerable will have access to or be able to use these new technologies. Digital applications should operate as an aid and not a replacement for other forms of assistance for vulnerable customers.

Philp notes: "Going digital doesn't mean ditching more traditional forms of support and it is important that all providers don't just see going digital as a way of reducing costs and the prevalence of other important channels that help customers with specific needs and wants."

So, once identified, providers should look to assist vulnerable customers with tailored support and information that suits their specific needs.

Taylor explains: "Most administrators have processes in place for providing accessible format communications, but don't advertise it or provide these options as part of upfront communication preferences."

He adds: "Pockets of excellence do exist, and there are some fantastic examples of best practice for accessibility, clarity of communication and support. But these schemes are the exception."

At present, best practice can be demonstrated by schemes with sponsors related to vulnerability. For example, schemes where the employer is a disability charity or advocate for vulnerable people, have placed supporting these needs at the centre of their pension provision also.

"For most other schemes and administrators, it tends to be an afterthought rather than a strategic objective," Taylor says.

There are a number of factors to be taken into consideration when assisting vulnerable customers. Tilley says: "The time of day that correspondence takes place, i.e. if on medication, they may be tired towards the end of the day; if they have just experienced a bereavement or financial difficulty, or if someone should communicate on their behalf; etc. You have to be careful about the terminology used and make sure it's very simple. Maybe have large typeface if perhaps vulnerable because of age."

Where full support cannot be provided by administrators, providers and employers, consumers and their families can be guided to organisations that are able to help. Examples of this include: the Citizens Advice Bureau, charity websites, Office of the Public Guardian and the Money and Pensions Service, among others. Or if they are able to seek independent financial advice, this should also be encouraged.

Overall, it is evident that the industry still has a considerable way to go in improving its understanding and treatment of vulnerable customers. Identification is key to ensure members who need further assistance are identified at the earliest stage possible and changing circumstances can be supported. Then, schemes must have provisions in place to provide tailored communications and support each individuals' needs.

These processes will, in turn, place scheme members into a better position to tackle complex pensions decisions and to make informed choices.

"There is always room for improvement and providers should consider managing customer vulnerability an ongoing challenge," Savova concludes.

Written by Talya Misiri, a freelance journalist

Scams

The fact that large amounts of money can be held in pension pots means that all members can be regarded as vulnerable to scams.

While The Pensions Regulator, FCA and other industry bodies have worked to inform and warn the public about cold calling and scams, pension members are still key targets. Pension members who are also regarded as vulnerable due to personal circumstances are even more at risk.

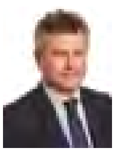
Savova says: "It is incredibly important to support vulnerable people, because they are more susceptible to financial scams and other forms of consumer detriment."

"Vulnerable clients, by their very nature, are more likely to make ill-informed decisions," Tilley adds. These could involve agreeing to transfer their pensions into scam schemes or defined benefit transfers that could leave them at risk and financially worse off.

"Policies whereby individuals are remunerated for sales: those are the types of policies that would be directly opposed to vulnerable clients," Tilley concludes.

How much is too much?

Following the recent FCA comment that retirement savers have had to take on more responsibility at a time of increasing investment market challenges, *Pensions Age* asks: How much risk and responsibility for retirement saving is feasible for individuals to understand and manage? And what efforts can the industry take to help reduce the burden for DC savers?



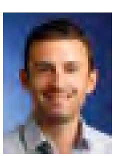
Many forward-thinking employers and trustees are now putting robust processes in place to support their employees and member's at-retirement, which can lead to better outcomes for all. This includes offering access to financial education seminars and financial guidance over the telephone, as well as regulated financial advice for those who need it. We have seen a notable increase in employers and trustees conducting formalised due diligence processes to select specialists in the retirement space who can deliver these services, to not only manage their risk but the risk to the individual as well.

Wealth at Work director, Jonathan Watts-Lay

Having relied on experts to makes decisions for them throughout the savings phase, the introduction of pension freedoms has required retirement savers to make big decisions, not just about which type of product to buy to secure an income in retirement but, in the case of drawdown, where to invest their money. Choosing the right investments is simply too complex for most investors, particularly in a volatile market where factors such as sequence risk (the danger that the timing of withdrawals from a retirement account will have a negative impact on the overall rate of return available to the investor) also come into play.

Investment pathways will go some way towards helping savers at the point of retirement but there is no substitute for taking professional advice. With the majority of people not willing or able to seek advice, employers should bear more of the burden by making advice and guidance services available to their staff alongside their company pension.

Bravura Solutions product manager, pensions, Jonathan Wileman



The industry – employers, trustees, providers, regulators – and government can all play a part in providing invaluable support in areas that drive positive retirement outcomes. Through a greater emphasis upon engagement and increasing auto-enrolment savings rates, which could hugely benefit millions of scheme members, the provision of structured investment solutions that address customers' needs – exposing them to appropriate levels of risk and return, and ensuring they have access to simple and comparable information, impactful guidance and nudges to steer action and accessible advice if they need it.

If customers are to be responsible for making decisions themselves, our responsibility as an industry is to ensure they have a clear understanding of the options available to them and the tools with which to make good financial decisions at key milestones.

Fidelity International head of pension products, James Carter

The shift from DB to DC, and thus the move away from a system of collective passivity and certain outcomes to one of greater individual responsibility and uncertain outcomes, has placed an overly onerous decision-making burden on individuals. People find it difficult to engage with pensions as they face a myriad of impediments during both the savings and retirement income phase, especially the sheer number and complexity of investment decisions that need to be taken. The answer to reducing this burden may well lie in the industry providing better fit-for-purpose multi-asset defaults, or investment pathways, to and through retirement.

Columbia Threadneedle Investments head of pensions and investment education, Chris Wagstaff

More than half of respondents to the *Aon DC and Financial Wellbeing Member Survey 2018* do not know how much money they will need to save before they can fully retire. And one in five say they cannot afford to save as much as they would like. Our experience is that this lack of understanding stops them taking action to meet any shortfalls or to cover risks.

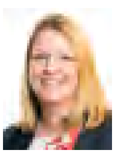
When asked what they most wanted to know about their current pension savings, the majority just want help with the basics – how much do I have and what annual income can I expect. Only three in 10 want to know about charges, risk and investments.

So we need to keep it relevant, simple and easy to act upon. And, importantly, we need to get out of our pensions bubble and present pensions as part of each individual's broader financial situation.

Aon partner and head of DC consulting, Sophia Singleton

It remains a fact that, with the advent of DC, investment risk has been firmly shifted onto the individual, who may not be equipped to appreciate the complexities of financial markets. While some strides are being made to embed financial education in the school curriculum, the cultural shift needed will take some years. Arguably the best result this can achieve is to instil basic financial principles such as the benefit of making steady, incremental pension contributions, harnessing the effects of compounding. We do not need individuals to become fully-fledged investment experts, and it is here that the industry can and should play an important role. By providing individuals with the appropriate building blocks and solutions, they should be better equipped to weather the vicissitudes of markets, with a strong focus on capital preservation in the lead up to retirement.

Newton Investment Management head of DC, UK, Catherine Doyle



The move from defined benefit to defined contribution pension schemes has seen the transfer of risk from the scheme/employer to the member, even if they haven't really appreciated it is happening to them. It is this lack of understanding of the risks associated with the investments that can lead to bad outcomes. For many, making decisions that could impact their retirement in such a monumental way is too much to deal with and can lead to no decisions being made at all. This could mean remaining in default funds or not paying in as much as they could, neither of which are likely to be the right decision for everyone. This is where advisers can really add value, guiding members through their options and helping them make decisions that will impact positively over the long term.

For those that are happy to engage, increased information to help them make the correct decisions is vital. Without information about all the available options it would be very difficult to know what is, and isn't, possible. We should actively encourage engagement with retirement planning because it tends to be something many just leave to chance.

St James's Place Group head of pensions strategy, Claire Trott

Over the past 20 years, we have moved from a system that provided certainty of income in retirement to one that transfers all risk and responsibilities to the individual. This has been coupled with an emphasis on flexibility and choice, particularly regarding the ability to opt-out, as well as the level of contributions payable. As a result, it has led to a generation that may not understand the importance of adequate retirement saving until it's too late. This places too much emphasis on the individual today.

Previous generations were typically members of defined benefit schemes and so didn't need to worry about risk and responsibility in the same way, as this sat with the employer. Meanwhile, the younger generation is grappling with issues such as high levels of student debt, saving to get on to the property ladder and relatively easy access to credit etc. Fear of missing out (Fomo) unfortunately doesn't extend itself to saving for retirement, which then falls down the list of today's priorities.

It is therefore paramount that the industry helps to reduce this burden for today's DC savers. By creating a culture of saving, this will be a key starting point to helping individuals take responsibility for their retirement. This means educating and engaging members from a younger age. Greater efforts should also be made to help members understand what income they need through retirement, and how that translates to their savings needs today to ensure expectations are effectively managed.

The current system automates saving, but to really relate with members, the industry needs to be clearer in encouraging saving by helping members understand what they are saving for, and how much they will need to achieve it.

River & Mercantile Solutions associate director, DC, Jiten Parekh

Pensions history

Pensions and Europe

Speaking at the European Institute of Social Security conference dinner held in Cambridge on 10 September 1973, George Ross Goobey expressed his delight that the conference was being held for the first time in England so soon after our entry into the European Economic Community. He went on to say there were many differing opinions as to whether this country should have sought entry into the Common Market and, indeed, as to whether we should have been allowed to enter.

"Now that we are in, it behoves us all to make a success of it. I therefore particularly welcome this opportunity of meeting those who are interested in the world of pensions from across the Channel, and it is essential that we should exchange our views on pension matters with our new colleagues," he said.

He explained his involvement in this country with occupational pensions. For the past 25 years he had been managing one of the largest privately administered pension funds in the country where there was a tradition of fully-funded pension schemes. He recognised that the attitude towards pensions by some in the continent of Europe was different and they favoured a pay-as-you-go approach called 'repetition'.

This tradition of funded schemes was given a great boost by our 1921 Finance Act when after long campaigning, the social and economic importance of pension funds to the country and the encouragement of them, was recognised by the granting of valuable tax concessions. For approved funds under this Act, the income from investments was allowed to be free of income tax. The employees' contributions were also allowed as an expense against income for assessing personal income tax and the employers could also charge their contributions as an expense against tax.

The full speech can be found in the Pensions Archive website; www.pensionsarchive.org.uk under "Our Collections" – "The George Ross Goobey Collection" reference LMA_4481_C_04_003

Written by Alan Herbert, chairman, The Pensions Archive Trust

Fun and games

Wordsearch

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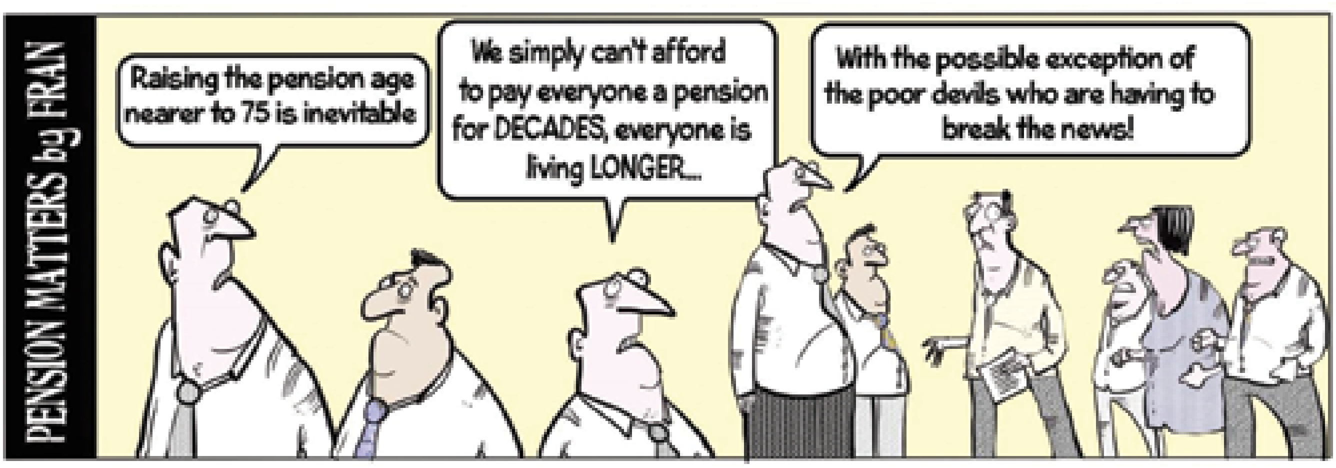
ACCOUNTABILITY
BALANCE
CONSOLIDATION
DEFAULTS
DERISKING
DIVIDENDS
QUALITY CONTROL
RISK AVERSION
VULNERABILITY
ZOMBIES

I know that face...

Answer at bottom of page



I know that face... Answer: Aviva head of savings and retirement Alistair McQueen

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LaSalle INVESTMENT MANAGEMENT

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LaSalle Investment Management is one of the world's leading real estate investment managers with over 40 years of experience. LaSalle manages $60bn (as of Q1, 2018) of assets on behalf of institutions and private investors across the world, investing in private real estate equity and debt, and public real estate through a complete range of investment vehicles. Our products include separate accounts, open and closed-end commingled funds, joint ventures, and public securities.

From the London office of 168 people we manage £12.6bn assets of which £12.3bn are located within the UK. We have extensive successful experience of managing portfolios to both MSCI relative and real return performance targets as well as assets and strategies targeting index-linked and absolute returns.

PENSIONS ADMINISTRATORS

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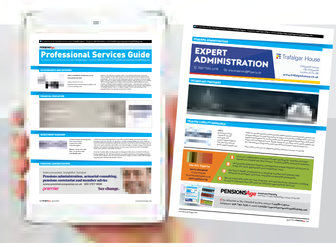

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Pensions Age is the leading media for the pensions market
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We can offer recruiters:-

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