Go west

The DB funding code, changing investment strategies, master trusts, sustainability, scams – *Pensions Age* looks at the some of the big industry topics set to dominate the industry over the coming year, as discussed at the second Pensions Age Western Conference

Back in Bristol, bigger and brighter than ever, was the Pensions Age Western Conference.

Now in its second year and hosted once again by the inimitable pension scheme trustee and Stamford Associates chair, Roger Cobley, the event kicked off with a dynamic presentation from the first keynote speaker, The Pensions Regulator (TPR) executive director, David Fairs.

He began by providing an overview of how TPR has transformed its supervision and enforcement approaches through its latest work and future plans, including the reassurance that the DB funding code will still appear independently of the stalled Pension Schemes Bill.

"We will wait and see what the new government's intentions and proposals are in relation to pensions and we will be working with them with those proposals. But that doesn't mean that our funding code will not appear. To a very large degree the funding code is independent of the contents of the Pension Schemes Bill. And we will progress that in the New Year," Fairs stated.

He described the aim of the new funding code as "to make it much clearer for employers and trustees around what we expect in terms of scheme funding".

"As pension schemes now reach maturity, with around 73 per cent cashflow negative, we think it's really important that the funding issues that exist with funding DB schemes are resolved. We will be looking to set a suitable minimum long-term target for pension schemes to reach by maturity," Fairs explained.

The principles of the funding code will be consulted on in the New Year, with a consultation on the code itself later in the year, he added.

Continuing this look ahead, Fairs moved onto master trusts, describing them as 'trailblazers' in terms of the standard and quality of governance. He also said that he would like to see master trusts 'go further' and lead the way with implementing ESG, at-retirement product innovation and trustee board diversity.

Speaking as the master trust authorisation process was in its final stages, Fairs pointed out that once completed, they will still be subject to one-to-one supervision.

"The knowledge and insight we have had from the authorisation process we take forward to that supervision. Even where schemes are authorised we've noticed areas where they could improve on. The high levels of governance we can see with master trusts does mean to some degree that master trusts are trailblazers in terms of the standard and quality of governance."

Attention then turned to investment, with Pictet head of multi asset London, Andrew Cole, providing an overview of the markets and the influence of macroeconomic forces on asset class returns. He found that the investment trends pension funds have been implementing over the past decade are "no longer working".

He pointed out that real yields with gilts over 10 years have declined from +4 per cent to -3 per cent. "It means you get poorer at the expense of the government," he added. According to Cole, schemes have therefore had to 'sweat' other assets harder than ever, resulting in schemes buying more corporate bonds. Private equity has also had a boom in the past few years, but "now that extra return is

dwindling", citing WeWork's fortunes as an example, with more such valuation reductions expected to occur.

"So what has been happening this decade I'm not convinced will still work for the next 10 years," he summarised.

"Bonds are going to make you poorer because they can't change their business model. Equities can adapt to remain profitable in different market situations. Considering the cheapness of equities today, there is some value, so should you add more risk? It is difficult to do so due to regulations, meaning there is a role for active management," Cole concluded.

Also stressing the need for investment strategies to change was AXA IM senior consultant relations manager, Matthew Murtagh. He highlighted how over 90 per cent of DB schemes may become cashflow negative over the next 10 years, so his colleague, portfolio manager, Robert Price, warned that pension schemes need to adapt their investment strategies to address these challenges.

"While investment-grade corporate bonds pay fixed, predictable cashflows, and are long dated by nature, the demand for these long-dated sterling assets is outstripping supply," Price stated. "This may push pension funds into riskier, less liquid assets and foreign markets like dollar credit. But this causes its own challenges, such as currency hedging." Therefore cashflow matching, through the use of cashflow-driven investment (CDI) was recommended as a potential solution to these issues.

For those DB schemes looking towards that all-important buyout, Murtagh also suggested the use of CDI not just to match cashflows, but as a stepping stone to achieve this.

The security of a buyout is high on the agenda for many a DB scheme, considering the several high-profile corporate failures that have occurred in recent years. Picking up Fairs' mantle, Lincoln Pensions director, Adolfo Aponte, and Capita director, Colin Parnell, delved deeper into the upcoming DB funding code requirements from the regulator, and its seemingly diminishing emphasis on the employer covenant.

According to Parnell, the objective of the funding code seems to have schemes be 100 per cent invested in by the time they reach the 'relevant date'. "To have less reliance on sponsor funding and more so on more secure investments, so likely bonds," he explained.

Ensuring compliance with the code will consist of a cheaper, light touch, 'fast track' approach and a more extensive and expensive 'bespoke' approach, he added.

Schemes can get an idea whether they would be suitable for the fast track approach by considering TPR's many grading approaches now, and where they fit in within this, Aponte suggested. "For instance, the average recovery plan is seven years, so if you are around that then you may well be suitable for the fast-track option."

Under the bespoke option, Aponte stated his expectation that the focus would be on contingency plans and non-cashflow structures.

"From a covenant perspective, the new code may be transformational. TPR is now willing to and able to recognise the limits of the covenant," he added.

Suitably refreshed after the coffee break, the conversation moved to home bias within pension funds' property portfolios. This may be the case now, but J.P. Morgan Asset Management managing director, Sorca Kelly-Scholte, noted that it is already changing, and considered it akin to equity allocations in UK pension funds, which used to be UK tilted, but now are more much global.

The UK is not the only country to have this home bias, and she attributed this to issues such as tax barriers and a lack of vehicles for a global property portfolio. While there will not be a 'big bang' change, as there was with equities, there will be a 'gradual erosion' of these barriers, through changing trends, for instance in office space and retail units moving from shopfronts to warehouses for online shopping, she predicted.

Also looking globally was Credit Suisse Asset Management senior portfolio manager, Andreas Fischer. He stated that emerging markets (EM) are still very under represented in most portfolios. As globalisation sets in, EM countries will be the main beneficiaries, he predicted, noting that credit ratings for EM and developed countries are already converging.

Another considerable change within EM, he added, is the rise of EM corporate bonds. Investment-grade EM corporate bonds are now larger than EM sovereign bonds, he said, with EM corporate bonds having grown by 15 per cent per annum over the past 10 years.

A pension conference about the latest trends would not be complete without mentioning the investment subject on everyone's minds lately – sustainability. M&G fund manager, Maria Municchi, explored how this area has transformed in recent years, from ethical investment that excluded specific sectors, to assessing the environmental, social and governance (ESG) impact of the companies in which pension schemes invest. And now 'impact investing; is taking over from 'sustainability'; realising the potential effect schemes' investments could have.

Integrating these ESG and impact principles within a multi-asset fund is achievable through flexible, dynamic and diversified multi-asset products, she explained.

Following a lively lunch featuring networking opportunities with the speakers and other attendees, the first session afterwards focused on schemes' journey plans.

Lane Clark & Peacock partner, Dan Mikulskis, asked what the difference was between those schemes getting great results and those that collapsed.

"Those that have done great followed basic principles for having a good journey," he answered.

"Understand the covenant, plan for uncertainty, measure what matters, expect things not to move in straight lines and expect regulation to change," Mikulskis said. Contingency plans are a massive part of this, he added, as well as only measuring the things that make a difference to outcomes, and that you can change.

Attention then turned to the issues facing DC schemes, with a panel discussion between Dalriada Trustees professional trustee, Judith Fish, DLA Piper partner, Matthew Swynnerton, and Capital Cranfield Pension Trustees professional trustee, Kevin Wesbroom.

Wesbroom gave the discussion a strong start by describing the lack of decumulation products with DC as a "scandal" and "failing our members".

Fish focused on the issue of small, legacy DC schemes, such as those with-profits and guaranteed annuity rates that are therefore unable to move into a master trust. "I do not think the answer is to move every scheme into a master trust," she said. "There is a case for keeping them, but only if the sponsor is engaged."

Swynnerton considered this trend towards master trusts as being due to the increased and 'onerous' governance pressure placed upon those responsible for pension schemes. He listed TKU requirements, CPD, increased assessments of schemes, the rise of trustee professionalism and monitoring the risk of scams as examples.

ACA professional affairs committee chair, Jenny Richards, as the first keynote speaker of the afternoon, stated that the industry is in a state of transition, and that "great ideas are finally starting to pick up momentum".

An example she gave is the ACA finding that 70 per cent of its members support TPR's funding code, as it "answers many questions that we have all been grappling with for a number of years", along with her expectations that the pensions dashboard will "help considerably" with improving financial education.

However, while progress is being made, there is still work to be done. For instance, she highlighted that 64 per cent of employers thought GMP equalisation will take them at least two years to complete. Also, there are five million self-employed people, for which the pensions industry needs to create suitable savings products, while the currently-stalled Pension Scheme Bill "missed a massive opportunity to raise auto-enrolment contributions".

Bringing the conference to an emotional and thought-provoking end was Pension Scams Industry Group (PSIG) deputy chair, Tommy Burns.

Highlighting the devastation of pension scams, he pointed out that some victims do not tell their families through embarrassment, some get physically ill and some even take their own life. "The total lost to scams is unknown as many are underreported", he said, stating that estimates are that only one in six are reported.

Scams have moved on following the cold-calling ban to social media, or calling from abroad, using an unregulated financial adviser and turning the member against the trustees. Developments also include fractional scamming, where many parties take a cut of the money, such as through trading activity and secondary scamming, "where someone who has been scammed is approached by a claim management company to 'help' them retrieve the money – failing to do so and leaving the member further out of pocket".

Being voluntary and unfunded, PSIG has its limitations, Burns admitted, but still goes to great efforts to make a big impact, such as lobbying the government for an amnesty for tax charges for pre-2013 pension scam victims.

By ending the event with the focus on when things go wrong for savers, it helped to give attendees a renewed dedication to ensure the developments discussed on the day bed in well, and ideally in time for next year's Western Conference.