



Following the events of 2022, the pensions industry will be hoping for a quieter year in 2023.

However, the issues affecting the industry towards the end of the last year look likely to rumble on, with the fallout from the liability-driven investment (LDI) crisis ongoing. This year will also see several other key themes, including the next stages of pensions dashboards, the DB Funding Code, the need for improved DC pension adequacy, and TPR's Single Code of Practice. We look at these key issues in more detail.

The year ahead: Pensions in 2023

✓ **After a year in which the word eventful feels like an understatement, it doesn't seem like the pensions industry is going to get much respite in 2023. Jack Gray investigates the key themes for the coming year**

LDI

"A big area of focus for DB schemes will be the lessons learned from 2022's gilt market volatility," says State Street Global Advisors head of retirement strategy, Alistair Byrne. "Schemes using LDI will consider their investment strategy, including leverage levels, collateral requirements, and stress testing."

Schemes will likely be busy this year assessing the risks of LDI investment and what role it will play in their strategies. Society of Pension Professionals president, Steve Hitchiner, notes that 2023 will see reviews of liquidity and governance requirements, but stresses a measured and consultative approach will be important to help avoid unintended

consequences.

"Liquidity in the Fed hike/inflation-defined era ahead will be important," adds Man Solutions head of multi-asset solutions, Peter van Dooijeweert, "and use of leverage must be modelled sufficiently to ensure there are no unexpected collateral or margin issues. Private assets could come under more scrutiny."

Aon partner, Lynda Whitney, concurs that the LDI crisis is likely to lead to investment strategy reviews this year: "We see DB schemes in a range of investment scenarios needing to reconsider their risk and return structure when overlaid by new liquidity constraints. On risk settlement, we

see schemes whose funding level has improved and are closer to buyout, but also schemes who need to reassess liquidity and may be further away from a buy-in."

Squire Patton Boggs head of pensions, Matthew Giles, states that some schemes may have to sacrifice some return-seeking assets to recalibrate their LDI to accommodate the trend towards lower leverage.

"All of this will extend their time to buyout and may mean re-opening long term funding discussions with the employer," he continues. "It could also mean that greater attention will need to be paid to compliance obligations, whilst the scheme runs on longer."

Portfolio allocations/ illiquids

The volatility following the mini-Budget and its impact on LDI, alongside the push for DC schemes to invest in more illiquids, will likely influence schemes' portfolios in the coming year, as Candriam head of UK distribution, David Morley, explains: "Scheme asset allocations have been left unbalanced as the most liquid assets were sold to meet collateral calls on LDI programmes, leaving overweights to illiquid asset

classes.

"Capacity in the pension insurance market remains a constraint on the endgame ambitions of many, so it will be interesting to observe whether there will be a rebuilding of positions in more liquid risk assets. It is hard to predict strong demand for private assets from corporate DB schemes in this environment."

Morley expects this lack of demand from DB schemes to be picked up by LGPS funds and DC schemes, where there is interest in building more sophisticated default portfolios.

Franklin Templeton head of UK retirement, Lee Hollingworth, agrees: "We believe that 2023 will be the year when private markets investment within workplace DC will come of age. Having reached sufficient scale, allocations to private markets will become a priority for most asset owners and large employer DC schemes.

"In addition, the regulatory focus shifting from an emphasis on cost to value should help support a more balanced approach to strategic asset allocation."

Octopus Group co-founder, Chris Hulatt, says he hopes this year will see the transition from a regulatory push factor to pull demands from DC

schemes: "Doing this would surely change the pensions landscape, by providing DC schemes with a huge opportunity to invest in the asset classes that can fundamentally shape the future of our economy, such as venture capital, while driving positive financial outcomes for members."

Despite the growing calls for illiquids to play a greater role in DC schemes' asset allocations, Natixis IM head of UK DC sales and strategy, Nick Groom, notes the competitive landscape of low fees in the DC market needs to change to drive greater illiquid investment. "There are a number of initiatives to try and make this happen, for example, the ELTAF will enable private assets to find their way more easily into DC schemes," he explains. "Also removing the performance fee element from the fee cap will help open up more funds from managers that work this way, but none of this will happen unless we have a change of approach from low fee to overall value to members."

Van Dooijeweert adds that "much has been made" of the poor returns in the traditional 60/40 asset allocation, but investors may not have been expecting the severe impact on portfolio volatility of rising bond/equity correlation couples with rising bond and equity volatility.

"Correlations have been very unstable in most asset classes and have created significant challenges in management for traditional investors," he continues. "Future correlations are unknowable across bonds, equities, currencies, and commodities. Adding active management around correlation, or via trend strategies, could play a role in improving portfolio returns."

DC adequacy

The issue of DC adequacy and auto-enrolment reform looks set to take centre stage this year as people grapple with the cost-of-living crisis. More people are reaching retirement with purely DC savings, and Bryne stresses

the need for the industry to provide solutions and support to help people have sustainable income in retirement.

BlackRock head of UK institutional client business, Gavin Lewis, adds that DC schemes will likely increase innovation this year, giving savers the ability to access more opportunities.

"The investment landscape in 2023 will continue to be shaped by the macro-economic forces that have led to the end of the great moderation – with savers, who depend solely on investment returns to realise their retirement goals, having to contend with increased inflation, higher interest rates and continued market volatility," he says. "This will see the structure of schemes evolve, as affordability and achieving value for money become more important. In 2023, pension adequacy – be it by gender, ethnicity, or regional distribution – will come into much sharper focus."

People's Partnership, provider of The People's Pension, director of policy, Phil Brown, adds: "The DWP has already signalled its intention to publish new value for money metrics that, if used correctly, may change how DC schemes and products are judged.

"The next 12 months will also tell us just how resilient auto-enrolment is and whether the anticipated increased financial pressures on millions of people will lead to a significant increase in the number of people who stop paying into their pension.

"The much-anticipated response from the DWP on its consultation about decumulation in DC pensions should lay out a clearer path for how savers can be supported on how to best use their pension pot."

Dashboards

One development that may help the industry in supporting greater DC pension adequacy is pensions dashboards. This year will see the mandatory onboarding of schemes

in April as dashboards get prepared for launch. “The deadlines for schemes to connect to pensions dashboards will be landmark events in 2023,” says TPT Retirement Solutions DC director, Philip Smith. “As many people have several DC pensions from different providers, the launch of dashboards will be fundamental to consumers fully understanding and engaging with their pensions. While consumers aren’t expected to be able to fully access the dashboards until the second half of 2024, the next 12 months will be significant, especially for large schemes and master trusts.”

DLA Piper partner, Matthew Swynnerton, adds that dashboards should revolutionise the way members access pension information, “hopefully ushering in an era of increased engagement and understanding”.

Hitchiner stresses that for dashboards to be a trusted and transformative engagement tool, 2023 needs to see an increased focus on their successful delivery, and the industry needs clarity on deliverables and deadlines.

DB Funding Code

TPR’s DB Funding Code, which is expected to be operational from September 2023, is set to be one of the biggest shake-ups to DB pensions in recent years. Whitney notes that the new code will require trustees to agree a Statement of Strategy with their employer and focus on the long term, and that investment strategy changes may need to be reviewed.

“The core principles and objectives underlying the new regime are sound, but there are concerns that the detailed requirements are too inflexible,”

warns Hitchiner. “This could lead to unnecessary costs for employers, reduce innovation and increase systemic risks. The industry, policymakers and TPR need to work together to ensure that the overall framework continues to provide the flexibility needed to adapt to changing economic circumstances.”

Single Code of Practice/notifiable events

Alongside its DB Funding Code, schemes will need to be aware of TPR’s Single Code of Practice and new notifiable events regulations this year. “A key focus of the single code is consolidation of a number of existing codes of practice, much of the content should already be familiar to trustees, however the key difference is the increased focus and scrutiny on scheme governance, which governing bodies have to ensure that they address,” explains 20-20 Trustees trustee director, Angela Winchester.

“We recognise that governance arrangements should be proportionate to the size and complexity of the scheme,

and we have been working to develop a pragmatic, straightforward and cost-effective solution for schemes to ensure that their governance is fit for purpose, focusing specifically on the new Effective System of Governance and Own Risk Assessment requirements.”

Giles adds that compliance projects will begin or accelerate, noting there is room for proportionality and a short path to buyout may justify a “light-touch approach”.

Finally, on the new notifiable events regulations, Swynnerton comments: “Depending on how the regulations are drafted, the implications for corporate activity could be significant, giving trustees a seat at the table in transactions, and bringing forward the trigger to notify, so that this occurs at the point at which ‘a decision in principle’ is made to proceed with the event, that is, before the event has actually occurred. The final regulations and, hopefully, the clarity they will bring are eagerly anticipated by trustees and employers alike.”

➤ **Written by Jack Gray**

