Summary
• Globally, DB schemes' funding levels have largely followed financial markets, dipping sharply as the pandemic gathered pace in early 2020 before launching into varying levels of recovery.
• Pension schemes' interest in ESG factors appears to have only increased throughout the pandemic, rather than the crisis serving to distract from the issues.
• Interest in technology is popular right now, whether it is for the convenience of employees or customers, but professionals need to be aware of the risks that come alongside innovation.

All around the world

Duncan Ferris examines what the UK and other major pensions industries across the globe have been up to during the pandemic, whether it be struggling for stability amid tanking equities or spending time understanding ESG concerns

As I write this, England are flying high in the Euros. As you read this, it may be the case that England have crashed and burned, just as my beloved Scotland did in their inevitable (but still tragic) group stage exit from their first major football tournament in more than two decades. But, in the grand scheme of things, it will not affect people's enjoyment of the competition, which has been a joyous distraction from the unpleasant pandemic that has been dictating the course of our lives for the past 18 months. The on-pitch drama, the skill and the endless comparisons made about teams by pundits, commentators and fickle fans have really brought people together.

While there is no Euros or World Cup for pensions, potentially because television viewing figures would not be quite so high as they are for football fixtures, it is still interesting to make similar international comparisons. An exploration of how the worldwide pension trends have mirrored or differed from the UK's pension industry over the harrowing months of the pandemic could be a helpful way to examine how we can do better in the future, as well as identify what we really excel at.

Markets and funding

One of the most notable titbits of international news to come out of the past 18 months was that Japan officially overtook the UK to become the planet's third largest pension market, according to Willis Towers Watson's *Global Pension Assets* report. Behind only the United States and The Netherlands, Japanese pension assets now total $3.5 trillion, 95 per cent of which are in defined benefit (DB) form. This is far higher than across all of the top seven markets, for whom 53 per cent of their assets were in DB form, and slightly higher than the UK, where DB assets make up 81 per cent of assets.

Interestingly, and yet perhaps unsurprisingly, the aforementioned growth of the Japanese pension market can be tied to the strong year for the nation's equities, as they were the top performers worldwide in the 12 months ended February 2021, according to AJ Bell.

The OECD's *Pension Markets in Focus 2020* report, which used data from up to November 2020, noted that major nations' retirement savings plans had largely followed the same trends as the financial markets in 2020. That is to say, assets and funding levels declined sharply in the first quarter before making a steady recovery throughout the year.

Looking back at the global perspective across the pandemic, the OECD report's forecasts showed that the value of OECD retirement plan assets had declined from $49.2 trillion to $44.3 trillion in the first quarter, before rising to $50.7 trillion by the end of the third quarter.

Russell Investments head of strategic client solutions, David Rae, says: "You would have been hard pressed, 18 months ago, to find anyone who would have predicted that pension funds would have been as resilient as they have been to a global pandemic.

"In many jurisdictions, the funding position of pension schemes has held up remarkably well, and in some cases improved. The fiscal and monetary policy response has led to a surge in risk asset prices helping to improve funding positions."

These fiscal and monetary policy responses include the United States' Federal Reserve purchasing securities in an effort to drive prices higher, while similar efforts, such as the European Central Bank's asset purchase programme, were used in an attempt to regain stability elsewhere.

While funding ratios or deficits of retirement schemes around the world appeared to follow largely the same trends, the OECD report pointed out that this had been experienced to different degrees in different nations. For example, the decline in European nations' pension scheme assets varied from just 1.6 per cent in Luxembourg to 12.4 per cent in Lithuania, while the subsequent resurgence ranged from 0.5 per cent in Luxembourg to 14.4 per cent in Greece.

Looking at the UK, Mercer's *Pension Risk Survey,* which relates to about 50 per cent of all UK pension scheme liabilities, has the accounting deficit for defined benefit schemes' from FTSE 350 companies standing at £72 billion in May 2021, having been as high as £103 billion in August 2020. Speaking in January, Mercer chief actuary, Charles Cowling, still said that the impact on pension funds had not been major, but warned that "the relatively modest reduction in funding levels hides far more dramatic consequences of a really challenging year for some".

He explained that schemes had seen "big growth in pension liabilities and risk and a big growth in employer covenant risk" and encouraged trustees to "consider looking for every opportunity to take risk out of their pension schemes, whether through better hedging or cashflow-driven investment strategies and/or through liability settlement programmes".

ESG

Interest in environmental, social and governance (ESG) issues was already very much in the ascendancy before the pandemic hit. In research released in August 2020, although conducted before the full impact of Covid-19, Mercer found that 54 per cent of European pension funds were actively considering the impact of ESG risks in their investment allocations, compared to just 14 per cent in 2019. Meanwhile, 89 per cent of schemes surveyed were found to now consider wider ESG risks as part of their investment decisions, up from 55 per cent in 2019.

It appears that this uptick of interest in ESG issues has not been slowed by the pandemic. Rae explains: "Spurred by regulatory change, political emphasis and changes to personal and societal attitudes, the integration of ESG factors into portfolio construction and management has grown through the pandemic.

"As pension schemes look at the investment opportunities that will arise from post-pandemic economic growth, ESG factors play a critical role."

Zurich global head of corporate life and pensions, Wendy Liu, notes that the awareness of ESG issues was also stretching beyond investment choices, stating: "There is a trend toward duty of care of employers, looking at employee wellbeing and beyond just providing a job. Flexible working conditions, wellbeing programmes and employee benefits including training and insurance cover are all recommended."

Bfinance's *ESG Asset Owner Survey,* which was published in February 2021 and drew survey results from mainly pension investors around the world, argued that the pandemic had highlighted the importance of the 'social' and 'governance' side of ESG issues, noting that lockdowns had

disproportionately affected low-income workers. Just 3 per cent of those surveyed said the pandemic had caused their teams to focus less on ESG.

Of course, it is difficult to track ESG consideration by pension funds on a nation-by-nation basis, especially when many schemes are only just getting their heads around the concept and so might have the best intentions but are only just commencing their journey. As such, perhaps the best way to examine this issue is to look at initiative membership in the world's major nations.

Data from the Principles for Responsible Investing (PRI) published in May 2021 showed the United States and UK to be way out in front in terms of signatories, with over 700 each. Japan trailed most of the other major players with just 92 signatories, but there is still evidence from the nation's largest pension fund, and one of the nation's few PRI signatories, that ESG is becoming an ever-more important issue in the Land of the Rising Sun.

Speaking in September 2020 and illustrating this, Japan's Government Pension Investment Fund executive managing director, Ueda Eiji, said: "The highest priority for all society at present is to overcome the Covid-19 pandemic, which represents a threat to humanity.

"At the same time however, we face a multitude of medium- and long-term challenges, including climate change, and we believe that ESG will prove increasingly important both during the global pandemic and in the post-Covid-19 age to come."

Actions are louder than words of course, but the words of such a major player undoubtedly have weight.

Tech

Technology has been another key area for pensions industries around the world over the past 18 months or so, as workers across the globe found themselves toiling away in living rooms and home offices. However, this increased digitisation has brought into sharper relief the technological revolution that the world's pension industries could now undergo.

Allianz Global Investors head of retail and life/asset solutions, Kai Wallbaum, explains: "We believe that Covid-19 significantly increased the trend towards digital solutions and that people want to decide by themselves on their individual path of living. This requires also that pension solutions need to adopt accordingly.

"A modern pension solution needs to be digital and needs to provide transparency on current pension asset plus a projection of potential pension outcomes at any point time through any device possible.

"Also the underlying investment philosophy needs to offer a high level of flexibility and customisation. Through technology, pension solutions can offer nowadays digital pension ecosystems with client-individual asset allocation schemes underneath. In our eyes, Covid-19 will significantly increase the demand for such solutions."

Liu appears to agree with the increased importance of technology, highlighting "an increasing popularity of robo-advisory", which are services that automatically allocate investments based upon a consumers answers to survey questions, and explains that "the pandemic has expedited the uptake in this".

However, there are risks that come packaged with this progression, with Aon cautioning in May that businesses leaning further into conducting their dealings online had led to "an exponential rise in cyber risks". Speaking at the time, Aon Cyber Solutions cyber risk consultant, Mark Bouman, warned: "During the corona pandemic, a lot of digital innovation took place under time pressure, but the security measures are now lagging behind.

"It is crucial that a balance is found between managing cyber risks and the benefits and opportunities of digital evolution."

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