Pensions Aspects

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Edition 41 | February 2022

Change is on the horizon!

Pensions set to be a powerful catalyst

Effective investment governance

Riding the wave of illiquid investing

2021 ESG Manager Survey

Pensions Management Institute

Moving pensions forward

Knowledge & Integrity

Pensions Management Institute

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We've launched a new accreditation to help lay trustees formally recognise their expertise and competency in trusteeship.

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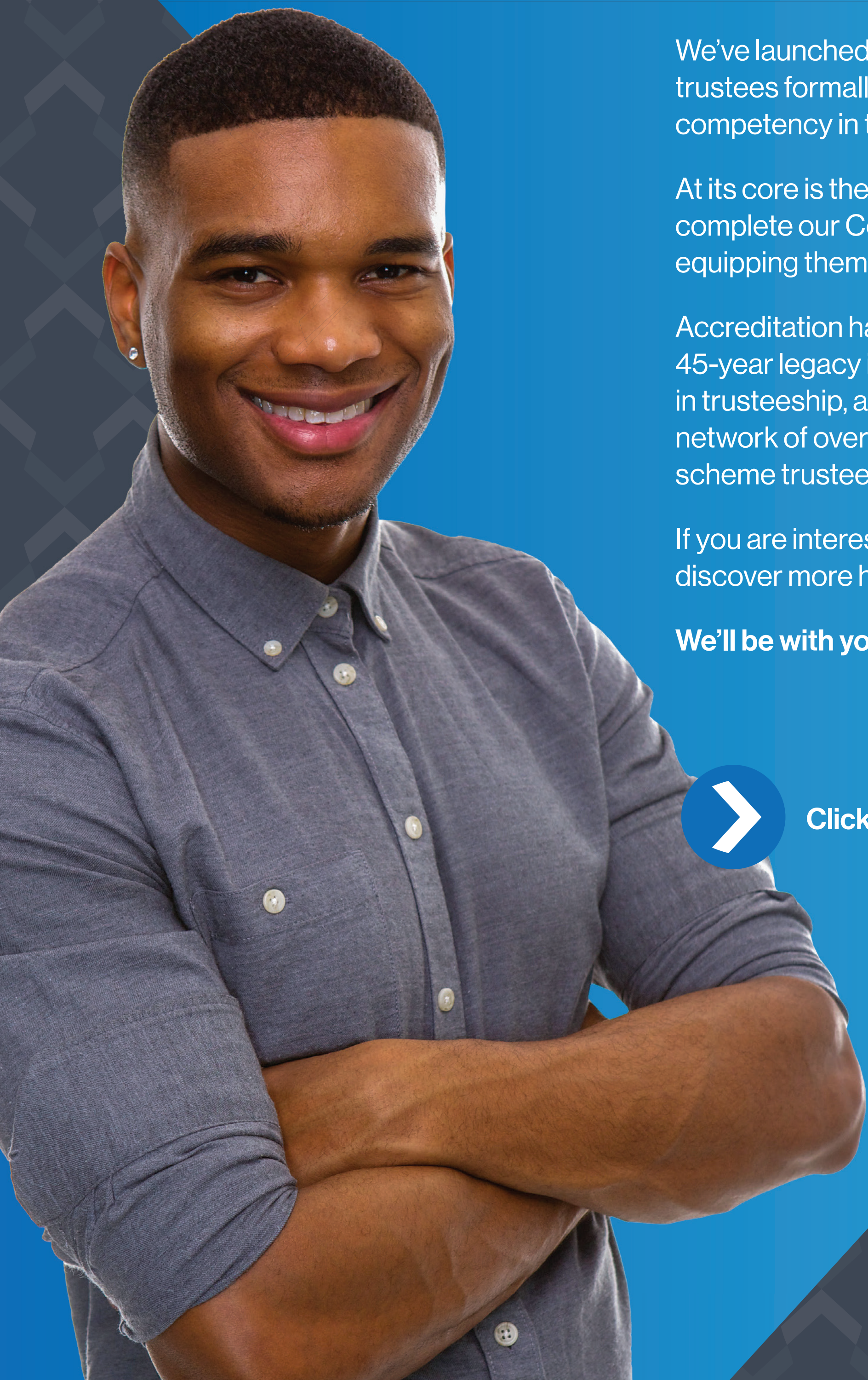

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ACCREDITED TRAINING

Editorial

Heritage

By Tim Middleton
Director of Policy and Affairs, PMI

Since its establishment in 1976, PMI has sought to promote the highest professional standards for its members. Our focus has been on the provision of professional qualifications designed to meet the changing needs of those working within the industry, and to provide a forum for the discussion of topical issues faced by our members. As we complete our first 45 years, it is worth re-stating our core values, and to consider the extent to which we continue to meet them.

PMI is structured in a way that is designed to provide the highest governance standards. Our Board and Council work closely with the permanent PMI staff to ensure that PMI is managed to the highest standards. Our range of committees ensure that those who make key decisions about PMI activities are held to account, and receive appropriate advice from those working within the industry. PMI is regulated by OfQual, and our Lifelong Learning department is particularly diligent in ensuring full regulatory compliance. This is essential if PMI's qualifications are to maintain their professional credibility.

It is important to remember that in keeping with its status as a professional institute, PMI is not a lobbying body. Our role is to guide members on how best to comply with rules, rather than to influence Government on what those rules should be. PMI engages in regular discussion with Government departments and regulatory bodies, but it is not our business to attempt to shape policy.

We will respond to consultations, because Government frequently seeks the views of those working within the industry on proposed changes. You may recall examples where we have issued surveys to help the Policy and Public Affairs Committee respond to a consultation: our membership represents a cross-section of the pensions industry as a whole, and this can provide a unique weight to our responses.

As members, you will be aware of PMI's Code of Conduct, and of the standards expected of all PMI members. Unfortunately, it is occasionally necessary for us to take action against those members whose conduct falls short of these standards: a painful but essential duty.

Our seminar and conference programme addresses the full range of issues facing pensions professionals. We are not afraid to deal with controversial topics, but will always do so in a way that does not compromise our commitment to neutrality.

For all our achievements over our first 45 years, it is important to remember that none of this would be possible were we unable to observe the very highest professional standards. That we have been able to do so is a credit to our membership as a whole. We look forward to reviewing our achievements as we commemorate our 50th anniversary!

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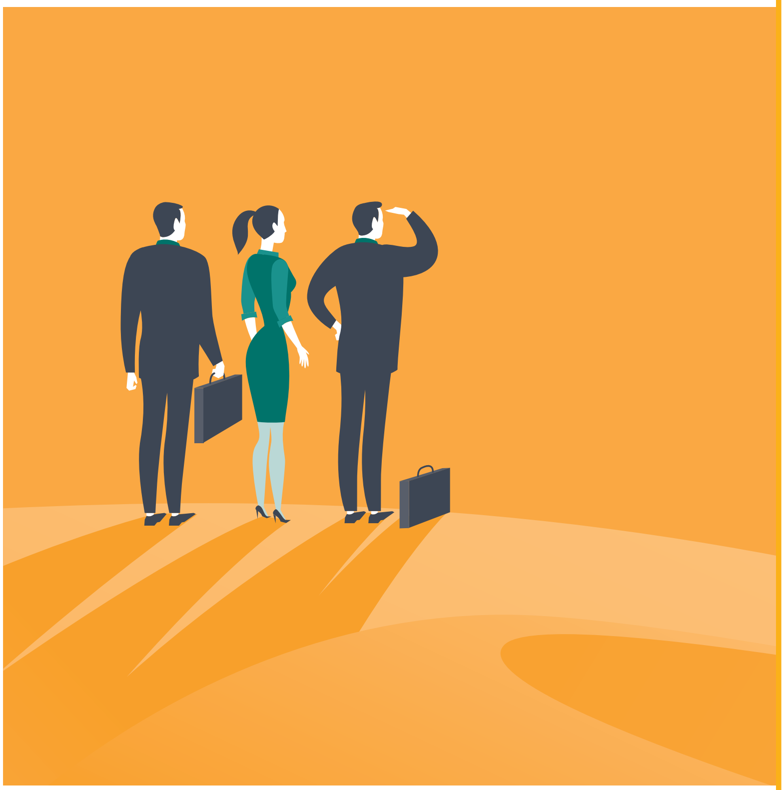

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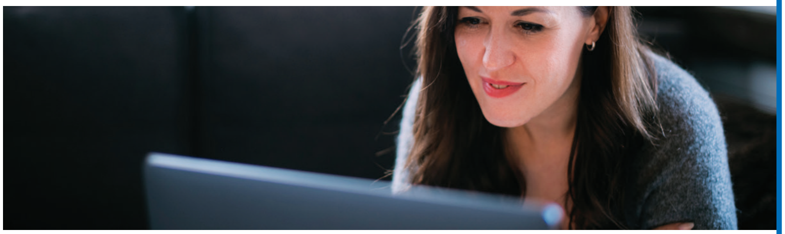

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Qualifications

PMI Academy update

The Spring 2022 exams will commence with all learners taking their exams online, via remote invigilation. Good luck to all of our students!

Exam results will be issued via email. If you do not receive your results, please contact the qualifications department: PMIQualifications@pensions-pmi.org.uk

Certificate in Pension Trusteeship (CPT)

The Certificate in Pension Trusteeship will give those wishing to become Accredited Trustees the necessary qualification to prove their knowledge, and their application of this knowledge in their role as an Accredited Trustee.

CPT unit 2 exam dates:
Register for our Certificate in Pension Trusteeship unit 2 exam; please see exam dates below:

- Friday 18 March 2022
- Friday 22 April 2022
- Friday 13 May 2022

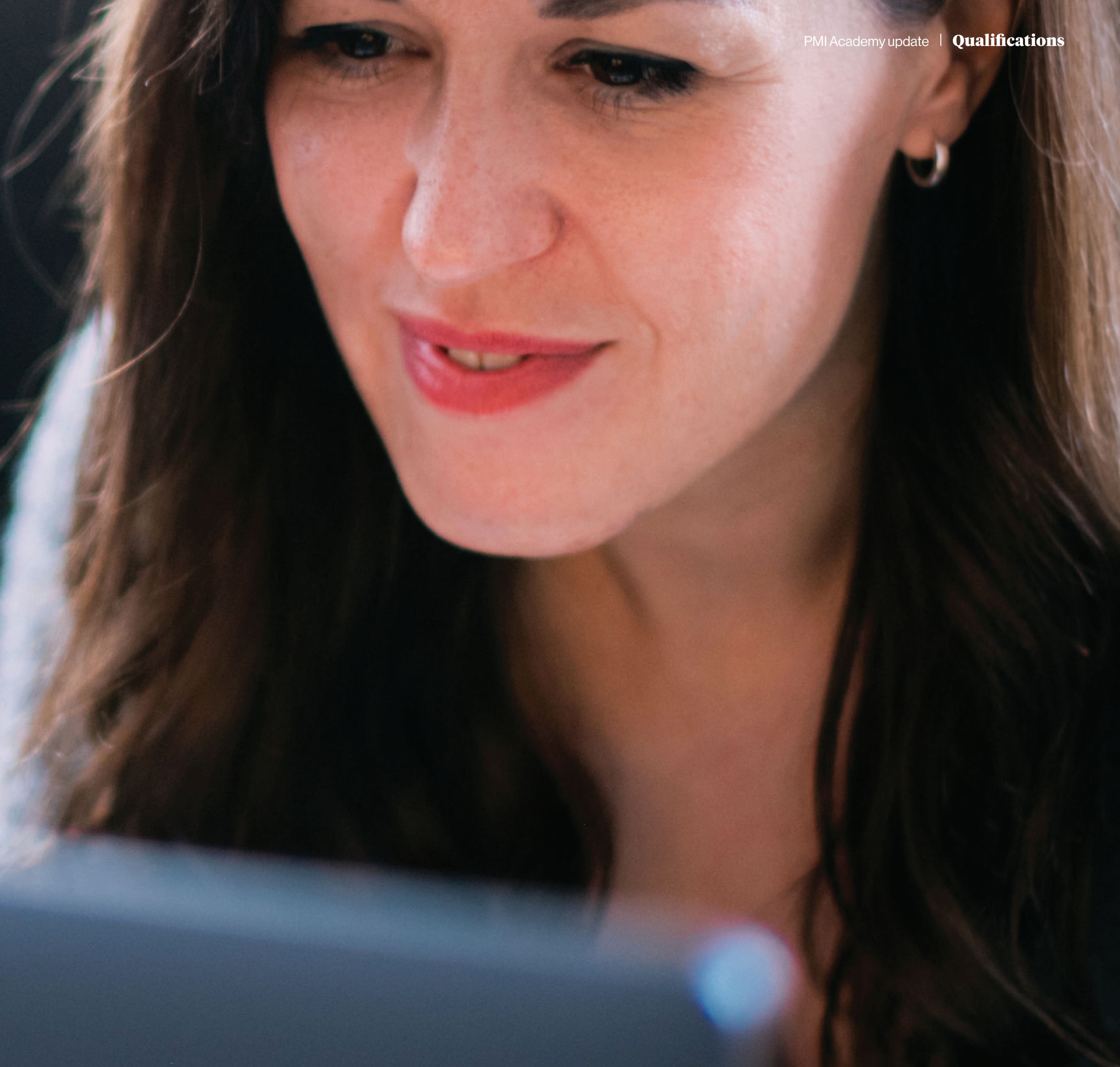
Register here:
www.pensions-pmi.org.uk/pmi-academy/qualifications/certificate-in-pension-trusteeship/

Diploma in Pension Trusteeship (DPT)

The Diploma in Pension Trusteeship is a new, standalone award, designed to show judgement when dealing with complex pensions issues, above and beyond technical knowledge.

The aim of this qualification is to increase professionalism further, and highlight the distinction between Lay/Member-nominated trustees and Professional trustees qualified at the same level. The Diploma is the PMI's first qualification to integrate ESG into its course material, making it a markedly more advanced qualification.

To find out more please go here:
www.pensions-pmi.org.uk/dpt



Revision Courses

Book our revision sessions for our upcoming spring exams here:
www.pensions-pmi.org.uk/events/pmi-academy-revision-courses-spring-2022

Course Name	Date
Retirement Provision Certificate	21 February 2022
Core Unit 1A	28 February 2022
Core Unit 2	1 March 2022
Core Unit 4	3 March 2022
Reward and Retirement Provision	4 March 2022
DB Arrangements	7 March 2022
DC Arrangements	8 March 2022
Professionalism and Governance	9 March 2022
Core Unit 1B – International 1	28 March 2022
Managing International Employee Benefits – International 2	29 March 2022

Membership

Membership update

People

We are saddened to hear that Phillipa Smith FPMI has recently passed away. Our thoughts and prayers are with Phillipa's family and close friends at this time.

Membership Renewals

The PMI would like to thank all of our members who have supported us in 2021. With over 7,000 members, we are delighted to see our membership family grow. We look forward to providing a distinctive selection of benefits, including exclusive offers and incredible professional development opportunities, throughout 2022.

Trustee Group Membership Subscription for 2022: Trustee memberships were due for renewal on **1 January 2022;** subscription renewal notices have been sent out to all Trustee Group individual members. If you have not received your renewal notice, a copy of this can be found in the 'My Transaction area' of your membership portal. Alternatively, please contact the Membership Department at **membership@pensions-pmi.org.uk** or on **0207 392 7410.**

If you are an existing Trustee Group Board Scheme member, please contact the Secretary to the Trustees or the Responsible Person to ensure that your subscription is paid to renew your membership.

Trustee Board schemes can join the PMI Trustee Group (at a reduced rate of £105 per trustee). All trustees from the board must join to receive this discount. PMI Trustee Boards can receive additional benefits, including the ability to sign up for collective training to be independently recognised by the PMI. For details of the full range of benefits as an individual or entire Trustee Board, see our website here: **www.pensions-pmi.org.uk/membership/new-members/member-benefits** for further details.

Continuing Professional Development (CPD)

Fellows and Associates are reminded that meeting the PMI CPD requirement is compulsory (except where retired/non-working). Under our CPD Scheme, PMI members are required to record at least **25 hours** during the year for 2021. Please log on to the website and update your CPD record if you have not yet done so. A digital copy of your CPD certificate is available upon request. For a copy, please contact the Membership Department at **membership@pensions-pmi.org.uk**

Fellows and Associates who do not complete their 2021 CPD by the end of January 2022 for the year 2021 will be required to make up any shortfall in 2022.

Membership Record

Please ensure that your personal details are correctly up to date on the My PMI member portal, to ensure that there is no interruption to your membership service, at **https://my.pensions-pmi.org.uk/**

If you require a reminder of your username to log in and check your details, please contact the membership team.

Certificate Membership

Certificate membership is open to those who have completed one of our qualifications at the Certificate Level – for more information please see the PMI's website. We are pleased to announce that the following person has been elected to Certificate Membership, and can now use the designatory initials **"CertPMI": Ben Tinkler**

Mentoring and Development Programme 2022-23

We are now taking applications for our third PMI Mentoring and Development programme, sponsored by The People's Pension, and delivered in conjunction with The Institute of Leadership & Management (TILM).

About the programme

- The programme will last for 12 months, during which period mentors and mentees will meet at least once every two months
- Mentees will be required to complete theTILM Leadership programme alongside their meetings with mentors
- Mentees will become a member of TILM, and will have access to its full suite of online resources for the duration of the programme, and for 12 months after completion
- Mentees will receive a Certificate of Completion at the end of the programme

Eligibility and how to apply

- Mentees and Mentors must be a member of the PMI throughout the duration of the programme
- Mentees will be allocated a mentor by the PMI, who will select an appropriate mentor based on their profile

For further information on how to apply, please contact the membership team at **membership@pensions-pmi.org.uk**

All applications will be reviewed **w/c Monday 7 February,** and we will notify all applicants who have been successful.

Full details, including the benefits of joining for both mentors and mentees on the programme, can be found on the PMI Website/Membership – Latest Member Activities.

Diploma Membership

Diploma membership is open to those who have completed one of our qualifications at the Diploma Level – for more information please see the PMI's website. We are pleased to announce that the following person has been elected to Certificate Membership, and can now use the designatory initials **"DipPMI": Briony Lapper**

Associate Membership

Associate membership is open to those who have completed the Advanced Diploma in Retirement Provision qualification – for more information please see the PMI's website. We are pleased to announce that the following member has been elected to Associate Membership, and can now use the designatory initials **"APMI": Reena Sangha**

Fellowship upgrades

Fellowship is open to Associates with five years' membership and five years' logged CPD.

We are pleased to announce that the following Associate has been elected to Fellowship, and is now entitled to use the designatory initials **"FPMI": Christopher Shortt**

To find out if you are eligible for PMI Fellowship, please contact the membership department at **membership@pensions-pmi.org.uk**

Events

PMI Events

The PMI would like to thank our sponsors and insight partners for their support and contribution throughout 2021. We are excited to see what the future holds for PMI Events.

Month	Event(s)
May 2022	**DC and Master Trust Symposium [Hybrid] –** 11 May
June 2022	**Pensions Aspects Live [Hybrid] –** 29 June
September 2022	**Trustee Workbench [Hybrid] –** September TBC
October 2022	**Annual Lecture –** 19 October
November 2022	**PensTech & Admin Summit [Online] –** 9 November **Annual Dinner –** 24 November
December 2022	**ESG and Investment Seminar –** 7 December

The PMI's 2022 Media Pack

Showcase your brand and expertise to the wider pensions industry

Find out more:

www.pensions-pmi.org.uk/about/partnership-opportunities/media-pack

Pensions Management Institute

Moving pensions forward

Feature

Change is on the horizon, and pensions are set to be a powerful catalyst

By Alexander Stafford MP
Chairman of the APPG on Environmental, Social and Governance

ESG principles were relatively little known about or discussed by parliamentarians and policymakers when I was elected to Parliament in 2019. Since then, the forward motion of ESG as an investment and corporate criterion has been expedited by the pandemic, and more recently COP26, pushing what have traditionally been non-fiduciary considerations to the top of the agenda in many boardrooms.

In a recent meeting of the All Party Parliamentary Group on ESG, which I chair, a stakeholder described the 2020s as the "climate decade". I would go further. This is the decade of change. Just as businesses have a responsibility to improve their environmental footprint, they also have a duty to inspect their supply chains and combat social issues, like modern slavery. As do investors, which is why, among a great many other things, the UK must address whether an expansion of fiduciary duties is needed.

The loud call for change amplified by COP has ushered in a dizzying number of new green projects, all of them thirsty for capital. Yes, there is a role for Government here, but as a Conservative, I'm not inclined to push big government expenditure or raise taxes. I'm far more interested in cultivating an investment climate that favours ESG-friendly ventures. My previous career, working at the WWF, and later Shell, did not disabuse me of this principle, although, as I said at the PMI's climate seminar in November, the Government does have a role to play in stimulating investment.

When it comes down to it though, it is the private sector that stumps up the cash, which is why pension funds are a critical player in the ESG landscape. The national pension pot is colossal, approaching three trillion pounds. Secondly, the time horizons of investment cycles are long and thus a vital counterbalance to the election-induced short-term attention spans of government. But perhaps most importantly, ordinary people with pensions have significant power to raise concerns and push where their savings go, so pension funds really are potential drivers of substantive change.

I am very proud to be involved in this revolution in corporate governance and investment practice. The APPG on ESG was only established this year, and its creation was closely tied to the pensions industry. Guy Opperman, Parliamentary Under Secretary of State for Pensions and Financial Inclusion, spoke at our inaugural event and backed my plan to establish the group.

Click here to watch video

Another stakeholder of the APPG noted at a recent session that change comes from the top. While I pay tribute to pension holders trying to steer funds in a responsible direction, ultimately I believe the onus is on the PMI and other top-level actors to take the initiative.

Strategies to educate and work with smaller- and medium-sized schemes is a necessary first step. I would also welcome stronger engagement with the APPG. The group can communicate ESG priorities to individual Ministers, host debates in Parliament, engage with select committees, and work with different government departments. We need coordinated and joined-up thinking, and the PMI is well positioned to make important contributions.

We are pushing for regulation which promotes clear and definitive parameters to enable businesses to practice strong ESG, not only showcasing how they are improving their environmental, social and governance footprints, but also delivering positive impact and value creation. It is no exaggeration to say that in a fast-evolving field, with a wealth of corporate knowledge and experience, we are emerging as an agenda-setter in Westminster.

The momentum is there. The landmark International Sustainability Standards Board was only created last month. At COP26, the UK became the first country to enshrine into law mandatory requirements for Britain's largest businesses to disclose climate-related risk. In October, the Pensions Schemes Act came into force, in part informed by the TCFD. Granted, the PSA does far more than simply boosting the level of financial disclosure, it empowers consumers and investors to understand what is being done with their money, with an eye held firmly on combating climate change, but the reporting requirements do not venture further than large businesses.

The next step is for ESG to become truly embedded in our corporate and investment practices, to work for both smaller private and large listed companies, and for reporting requirements to go beyond climate to other environmental concerns, together with social and governance priorities.

But to ensure more expansive regulations deliver and do not result in extra bureaucracy – box-ticking exercises with little consideration towards delivering change – regulators and the government must actively seek industry alignment and the attainment of agreed and achievable environmental, social and governance objectives.

I am in no doubt the APPG on ESG will be an important vehicle for driving this collaboration, and I strongly welcome future participation with the PMI and its members.

Feature

Effective investment governance: Preparing for the New Code of Practice

By Amanda Latham
Associate and Policy & Strategy Lead, Barnett Waddingham

The Pensions Regulator (TPR) has a new Code of Practice under development, which will combine 10 of the previous 15 Codes, as well as clarify expectations on new regulatory requirements. As TPR looks to harmonise and modernise its suite of Codes to better meet the needs of trustees now and in the future, we take a closer look at what this means for your investment governance.

Given there was limited mention of investment in the previous 15 Codes, many of the new areas TPR has included are investment-related. The requirements, which are now reflected in the draft new Code, have been coming thick and fast in recent years for schemes with more than 100 members. Here's a quick reminder of these new investment duties:

2019 brought requirements for policies in Statements of Investment Principles (SIPs) covering:

- How you consider financially material environmental, social and governance (ESG) issues including climate change
- Your stewardship policies on engagement and voting, looking to improve value for your scheme's investments
- Policies on aligning manager incentives to all of your SIP policies
- How you go about considering member views (if you do this)

2019 also brought the requirement for setting clear objectives for your investment adviser, to monitor their activities and assess performance on an annual basis to make sure they continue to meet your expectations.

2020 was the first year trustees needed to produce implementation statement reports, covering how you acted over the previous 12 months on all of your SIP policies for DC and hybrid schemes, and focussed on the stewardship policies if you run a DB scheme.

2021 brought mandatory climate governance and reporting requirements for the largest schemes, defined as those with at least £5bn of assets, with these requirements coming in for schemes £1bn and above in 2022, and for other schemes following a review in 2023. Aligned with the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations, you need to embed a framework covering Governance, Strategy, Risk Management, and Metrics and Targets, and then report annually.

2022 will bring the requirement to have an effective system of governance in place across your scheme's entire operations. This includes setting out to what extent, and how, you incorporate ESG and climate change into your investment governance. You will also need to report periodically on how your policies are effective, through a regular own-risk assessment.

What should you be doing?

For many years TPR has been clear that schemes need to view ESG considerations in the context of an investment strategy as financially material: that is, something which if ignored will harm the long-term sustainability of a scheme's investments and, by association, the retirement outcomes of members.

While we await TPR's publication of the final Code, and clarity on some of the expectations, that doesn't prevent you from starting to take action to consider how you are meeting the requirements for your scheme.

If you are looking after a larger scheme, or one that is already acting on the TCFD recommendations, and considering the risks and opportunities from climate change, this is going to help you demonstrate that you have effective governance around climate change. But what about everyone else?

If you are looking for actions to take now, your first step should be to consider your existing policies and procedures: do you expect your scheme to be able to meet the requirements? What gaps can you identify? What is your current focus and what else needs developing? Are your scheme's current managers' ESG beliefs and objectives aligned to your own? And how are you monitoring your managers' ESG and stewardship activities?

These answers will help you understand how much work there is to do, and where to start. But with the intention to legislate for mandatory climate governance and disclosure already announced for all UK market participants (including pension schemes under £1bn), considering your beliefs on climate risks and opportunities, then measuring, understanding and acting on your climate exposures, is going to be the way forward.

Achieving net zero by 2050 is already law in the UK, and the resulting decarbonisation of the economy is already impacting on pension schemes. Right now is an opportunity to get a head start, managing the risks stemming from climate change, and taking advantage of the opportunities coming from the transition to a low-carbon economy.

Investment is only part of the new Code, what about other areas?

We believe the approach of considering your existing policies and procedures is the best way to prepare now for the new Code. We are helping our clients do this using our Effective System of Governance (ESOG) gap analysis framework. It categorises policies and procedures in line with our understanding of the current draft of the new Code, and allows trustees to assess what they do and don't have to do. They can then prioritise which areas need urgent consideration.

Your ESOG should be proportionate to the size, nature, scale and complexity of the activities of your pension scheme. You may feel that certain areas are not applicable to your scheme, or that your policy can be very "light touch", so you should clearly document this to maintain a full record of the way the scheme is run.

In summary, start preparing now, rather than waiting until the final details, because we already know the direction of travel.

Feature

Riding the wave of illiquid investing

By Callum Stewart
Head of DC Investment, Hymans Robertson LLP

The DC Industry doesn't need to be like a 'fish out of water' when it comes to investing in illiquid assets. With government support, and reform of pensions regulation likely, some of the barriers to investment will be broken down over time. The latest research from Hymans Robertson suggests there is scope to significantly improve retirement outcomes for individual members using illiquid investments. Education will be key to ensure those responsible for making decisions can embrace the opportunity to do so.

First off, let's start with potential regulatory developments in this area.

The Productive Finance Working Group published its report "A Roadmap for Increasing Productive Finance Investment" in September 2021, and made several recommendations. Fundamentally, the Group identified scope to significantly enhance outcomes for DC savers, but that the pensions industry needs to take action to make this happen. We welcome the report from the Productive Finance Working Group, which in our view helps to restore the positive view on illiquid investing after the widely rebuffed attempt by The Pensions Regulator to limit exposure to 20% of pension assets. Illiquid investing is not uncommon for DC pension schemes globally, and we already have real-life examples in the UK of DC schemes investing around 20% of their assets in illiquid investments.

The recent announcement from the DWP signalled support to increase investing by DC schemes in illiquid assets, such as infrastructure and private equity. However, we do not believe that allowing performance-related fees for illiquid assets within the charge cap will be the "game-changer" the government hopes.

Performance-related fees are difficult to administer in DC schemes, as well as raising questions of fairness from one member to the next. We are already seeing innovative approaches to including illiquid assets within the present charge cap which, with competition between fund managers growing, provide significant scope to innovate towards even more cost-effective solutions for members.

So, regulations are likely to be supportive, but will these remove all of the barriers? In our view, no. Developments in regulation and guidance also need to be accompanied by efforts to change behaviours in the DC industry, which continues to focus all too often on low cost rather than delivering improved net outcomes for members. For example, a low-cost global equity index tracking fund might be expected to deliver returns of between 5 and 6% each year over the long term, net of costs and charges. A diversified illiquid investments portfolio will be more expensive, but we think this has the potential to deliver vastly superior outcomes over the long term. For example, a portfolio consisting of a blend of private equity and private debt could deliver additional returns of more than 2% each year, net of higher costs and charges. Our analysis suggests the highest-conviction investors could improve retirement outcomes by up to 40% for the youngest members. Trustees and governance committees have a fiduciary duty to explore this wider opportunity set, and scope to improve outcomes for members.

Complexity is naturally a barrier. Education is therefore going to be key to increasing comfort levels for decision-makers to consider investment in illiquid assets. The wider UK pensions industry is very experienced in this area, with Local Government and private sector defined benefit schemes investing heavily in illiquid assets as a means to improve funding outcomes. We should draw on the valuable expertise and case studies to improve education.

Daily pricing and liquidity requirements for DC schemes may be viewed as a significant barrier, but we think this is a myth. There are already a number of implementation approaches in force in the UK. Perhaps the simplest is daily dealt funds with significant exposure to illiquid investments. In these cases it's the fund manager's responsibility to balance cashflow requirements in the fund, and facilitate liquidity to investors. Although underlying illiquid assets are not priced daily, there are already frameworks in force today for property investment using stale pricing. Crucially, these approaches use the liquid portions of the fund to facilitate liquidity to investors. With greater governance bandwidth, more complex implementation approaches can be considered.

"Education is going to be key to increasing comfort levels for decision-makers to consider investment in illiquid assets"

We think Master Trusts will come under increasing pressure to invest in illiquid assets as improved competition drives a focus on delivering better net outcomes for members. By the end of this decade, we think allocations of around 20% in illiquid investments, potentially higher, will be the norm. Indeed, we are already seeing Master Trusts such as NEST, Smart and Cushon driving the industry in this area. One of the key concerns amongst Master Trust trustees will be dealing with bulk transfers, which could compromise even the most robust liquidity and cashflow management plans. This is why we are calling on policymakers to make it a requirement for Master Trusts to accept incoming transfers of illiquid assets. These allocations could be run off over time if they don't fit with the existing strategy, but crucially this will remove risk and cost for members.

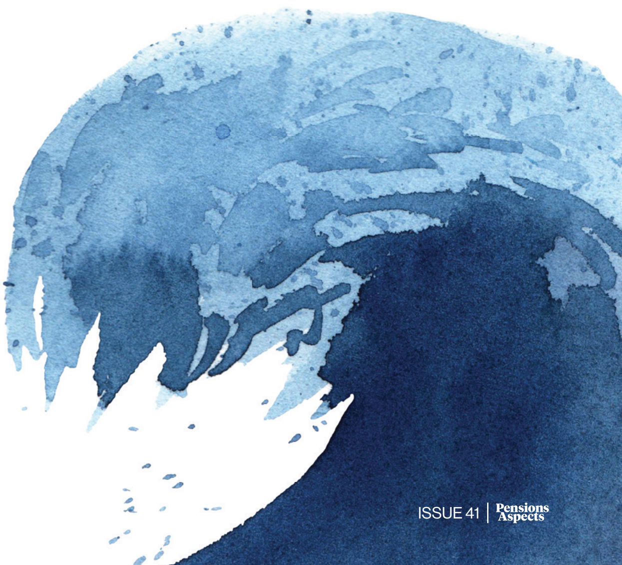
So, what are the main takeaways?

Investing in illiquid assets is going to become mainstream. As an industry we have a duty to educate, and learn from those with greater experience to build comfort, so we can embrace opportunities to improve retirement outcomes for members. We also need to accelerate a change in behaviours focusing on 'low cost' to 'better outcomes'. We don't need to be like fishes out of water when it comes to illiquid assets – the opportunity is there, let's work together to embrace it!

"...we are calling on policymakers to make it a requirement for Master Trusts to accept incoming transfers of illiquid assets"

Disclaimer:

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.



Feature

Tackling residual investment risks

By Jos Vermeulen
Head of Solution Design, Insight Investment

Most UK defined benefit pension schemes, we believe, have established liability-driven investment (LDI) strategies, hedging interest rate and inflation risks to reduce their impact on funding levels and increase the probability that long-term objectives can be achieved. We are finding that pension schemes' focus is now shifting to the residual risks they will face in the years ahead.

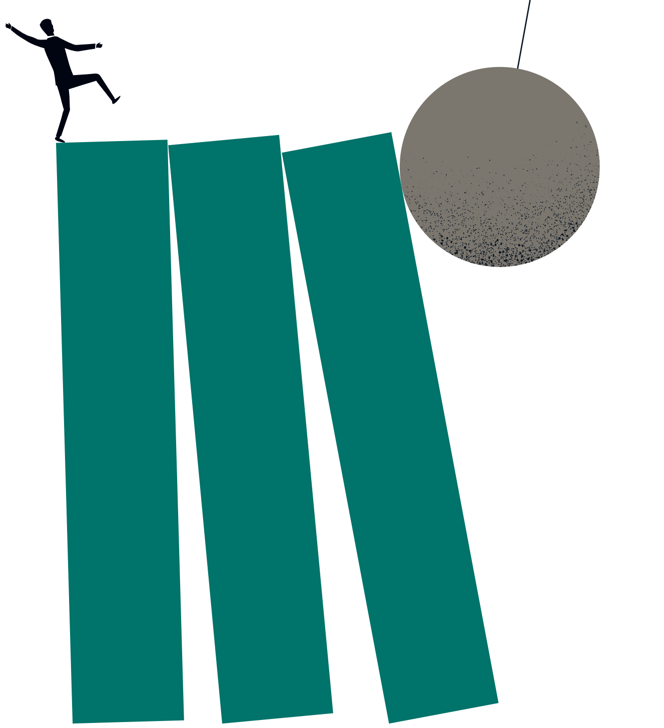
Tackling these residual risks could decide whether a scheme can achieve its target endgame on time. We offer an overview of some of the key remaining risks and how to mitigate them.

Longevity risk: hedging longevity risk effectively can keep a pension scheme on track for its endgame

As exposures to interest rate and inflation risk have been mostly hedged, and pension schemes have migrated out of equities, longevity risk has become the largest unhedged risk that many schemes now face. We believe there are three approaches to mitigating longevity risk:

1. Build a reserve: A scheme could target a funded status higher than 100% to build a buffer for future changes in longevity, but it is difficult to know what size of buffer may be needed.

2. An insurance buy-in: A scheme pays a premium to an insurer who takes on the liability and investment risks for a portion of the scheme's liabilities. The buy-in is held as an illiquid asset alongside other investments, and does not reduce reliance on the sponsor. However, unless a scheme is very well funded on a prudent basis, a buy-in could hinder its journey to its target endgame, due to the risks associated with the liabilities not covered by the buy-in, and the implications for the remaining scheme assets.



3. Hedging via a longevity swap: A scheme agrees to pay a regular premium to hedge longevity risk associated with the liabilities covered. In the past, longevity swaps were only available to very large pension schemes, but today schemes with liabilities in excess of £500m can implement longevity swaps.

Collateral risk: a dynamic approach aims to efficiently manage the collateral pool

Most schemes use derivatives as part of their LDI strategies, and so need to hold a pool of eligible assets (typically gilts and cash) to fund collateral calls. If this is too small, schemes could be forced to sell other assets to meet collateral calls. However, given that collateral pools typically consist of low-returning liquid assets, if this is too large a scheme's long-term investment returns could be impaired.

Both of these risks – that of forced selling or performance drag – can be mitigated by an LDI manager implementing a dynamic collateral risk management framework. For example, as interest rates fall and the collateral pool increases, the manager can deploy the excess collateral into liquid, high quality assets that are expected to generate a return above cash. However, if interest rates then rise and the collateral pool reduces, the manager can easily sell these liquid, high quality assets to top up collateral. By managing this dynamically the manager can help ensure a scheme doesn't have too much, or too little, collateral.

Credit risk: default risk and 'shape risk' require different approaches

As pension schemes have de-risked, they have reduced their exposure to growth assets (e.g. equities) and increased their exposure to corporate bonds. This means there are different risks to be managed.

- **Default risk – the risk that the money you have lent to a company is not repaid.** This can be mitigated through extensive credit analysis, where a manager seeks to only invest in companies that are financially sound. Additionally, limits can be specified to restrict how much is invested in any single corporate issuer. A scheme may also build a buffer to absorb defaults based on historical experience, to help cope with adverse scenarios.
- **Shape risk – the risk that the 'shape' of the future cashflows generated by your corporate bond portfolio does not match the liability payments.** This can result in reinvestment risk and forced-selling risk.
- **Reinvestment risk:** If the cashflows from your corporate bond portfolio are too heavily weighted to the early years, then those cashflows will need to be reinvested before you achieve your endgame. There is a risk that market pricing will have changed when you need to reinvest, and that you cannot achieve the returns you previously expected.
- **Forced-selling risk:** If the cashflows coming from your corporate bond portfolio are not sufficient to meet your liability payments as they fall due, the cash may need to be raised by selling corporate bonds. You may be forced to sell your bonds at an inopportune time.

To manage these risks, we believe it is essential to design credit portfolios to take into account both the liquidity needs and endgame objectives of your pension scheme.

Currency risk: an integrated approach reduces forced-selling risk

As UK pension schemes have increased their exposure to corporate bonds, many have turned to the much larger euro and US dollar corporate bond markets as they seek to build an efficient and well diversified portfolio. This introduces currency risk for pension schemes with sterling liabilities, which many schemes then hedge.

However, if currency hedging is undertaken within a corporate bond mandate, there is a risk that the corporate bond manager will be forced to sell bonds at distressed levels to cover currency hedging losses during periods of crisis – as seen during the early stages of the pandemic. If corporate bond spreads then tighten as the crisis dissipates, there is no opportunity for the scheme to benefit from this recovery.

In our view, a better approach is to integrate currency risk management with the LDI mandate, allowing liquidity for currency hedges to be sourced from the same collateral pool as the liability hedge. This allows for the efficient implementation of a currency-hedging strategy without introducing forced-selling risk.

An integrated approach to risk management could hold the key

Some pension schemes are tackling these risks using a more integrated approach as they approach their target endgame. By refocusing on their specific endgame objectives, and the cashflows required to achieve them, it is possible to manage these risks more effectively and efficiently, according to how they specifically impact the journey to a scheme's ultimate goal.

Insight Article

2021 ESG Manager Survey: The red flag is raised on climate risk

By Jihan Diolosa
Head of Responsible Investing, Russell Investments

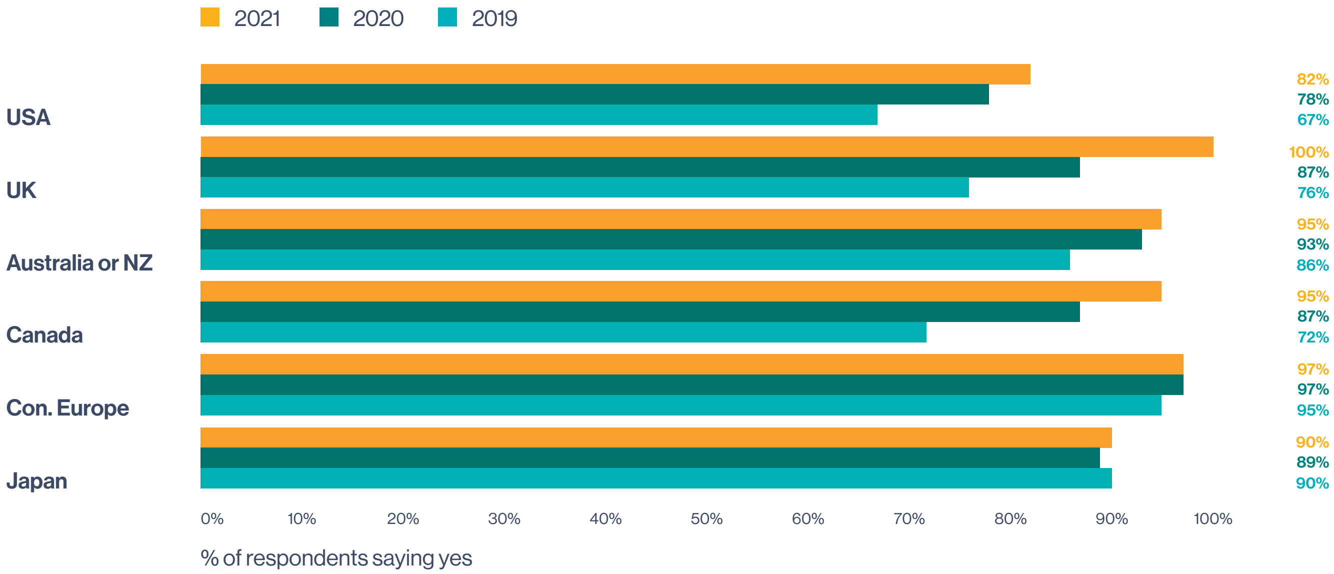
Our annual ESG manager survey of active managers assesses the integration of ESG considerations in investment processes among equity, fixed income and private market managers, and spotlights firmwide policies, use of data, engagement and integration.

A total of 369 asset managers from around the world participated in our 2021 ESG Manager Survey, representing **$79.6 trillion assets under management.** The research revealed an increased prioritisation of ESG considerations from the previous year.

ESG-specific consideration by asset managers: UK managers lead the way

The below exhibit illustrates the year-over-year changes by region, highlighting that the highest percentage increase came from firms based in the U.K., with the most improvements seen among smaller firms, likely due to the local pressure from the client base and regulation.

Q. Do you have explicit ESG factor assessments in your investment process?



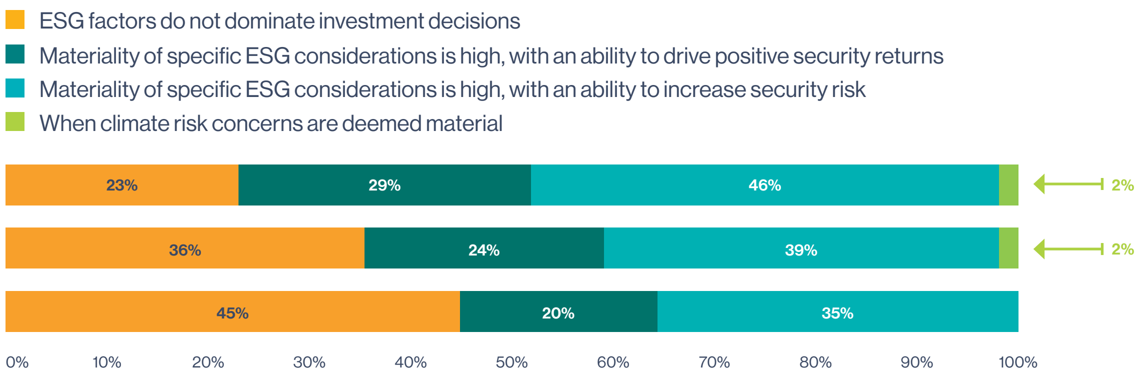
Which ESG considerations drive decision-making?

Governance is still the dominant factor for all companies, regardless of industry. There has however been a reasonable increase in environmental considerations. This is likely due to the increased awareness and desire among market participants to tackle climate risk, which could impact asset prices over time.

For those who selected environmental as the most important consideration in their investment decisions by region, we see a sizeable increase among managers who are based in Continental Europe. This is in line with the introduction of the EU's sustainability regulations, and provides further proof that regulations can drive significant industry practices.

Financial materiality is also a focal point – 75% of the respondents claim to incorporate specific ESG considerations when the materiality is high. Interestingly, climate risk concerns in isolation have little influence on most managers' overall investment decisions. We believe that this is because asset managers are mostly evaluating the materiality of ESG considerations – climate risk is a part of that – instead of climate risk being the sole driving factor.

Q. How do you determine when ESG factors should dominate the investment decisions?



Insight Article

Spotlight on active ownership

Asset managers continue to increase their engagement activities with underlying companies and governments to influence entities' potential outcomes, such as greater transparency, improved behaviours and reduced uncertainty and risk. The survey results suggest an increasing trend of engagement activities becoming more prominent.

A growth in ESG product offerings

Across the asset classes, the strategies which provide ESG integration are the largest proportion of strategies offered to date. Additionally, the results show proportionally more demand in ESG-integrated strategies, which are often mainstream strategies that are benchmarked against traditional public indices. These findings suggest that investors may be looking to substitute existing core allocations for sustainable strategies with ESG outcomes.

A growth in ESG product offerings

Our 2021 survey results identify that screening is one of the most widely used tools utilised to implement a responsible investment policy. Screening uses a set of criteria to determine which sectors, companies or countries are eligible or ineligible to be included in a specific portfolio. Negative screening with values or ethical-based criteria tends to centre on certain sectors, such as tobacco, weapons and thermal coal. Norm-based screening focuses on business conduct or operation irrespective of sectors, such as United Nations Global Compact violators. Positive screening focuses on business activities that may identify firms as leaders among peers.

The most popular screening criterion is value-based negative screening for both labelled and non-labelled sustainable strategies. 47% of the respondents who use some form of screening criteria apply the value-based negative screening for the labelled sustainable strategies. For non-labelled strategies, the use of the negative screening practices was the highest among European-based asset managers, where most of them utilise negative screening criteria (even in non-labelled strategy offerings).

Climate risk: The greatest issue flagged by asset managers' clients

It was no surprise that climate risk was flagged as the greatest issue relating to ESG that the respondents hear from their client base. Specifically, 39% of the respondents selected climate risk, followed by 21% for environmental issues in general. 15% of the respondents selected Diversity, Equity and Inclusion (DEI) as being the top ESG issue. Among the respondents who selected "Others" in this section, many cited that both climate risk and DEI are equally seen as a consistent issue.

Q. What is the single biggest ESG issue you hear the most from your client base?

- Climate Risk – **39%**
- Diversity & Inclusion – **21%**
- Not applicable – **15%**
- Environmental issues in general – **11%**
- Others – **8%**
- Social issues in general – **5%**

U.S. has highest number of Net Zero Initiative signatories

In April this year, Russell Investments joined the Net Zero Asset Managers Initiative, a group of international asset managers committed to supporting the goal of net zero greenhouse gas emissions by 2050.

We asked managers if they have signed up to the Net Zero Initiative – and if not, whether they plan on joining. We found that asset managers based in the U.S. include the highest number of signatories, with a large proportion of those not already signed up stating that they are seriously considering doing so. The UK and Europe are not far behind – which is likely due to regulatory pressures and increased demand from clients seeking to align with net zero emissions by 2050.

The bottom line

The 2021 Russell Investments ESG Manager Survey revealed a continuously high level of ESG awareness, and increasing integration of ESG data and analysis into investment processes within asset management. Many firms have moved their ESG integration practices from just making a gesture to meaningful compliance. Others have shown even greater commitment, such as identifying material ESG-related information, and incorporating such inputs into key investment decisions. Ever-growing regulatory pressure and client demand are further pushing ESG integration practices, with no end in sight. The speed of adoption creates its own issues, and many asset managers are trying to navigate through rapid adaptation and expansion of ESG integration.

Request the full report: russellinvestments.com/esg

The survey was carried out between 24 May and 17 July 2021, with the results published 10 November 2021. Unless otherwise stated, the source of all information is Russell Investments.

Insight Article

DC master trusts: Overcoming barriers to consolidation

By Tina Oversby
Director, Head of Master Trust & Consolidation Consulting, Go Pensions

The Government is pushing for consolidation of small DC Schemes (those with assets under £100m) into master trusts. In this article, we look at why some small schemes are holding back, and what can be done to address this. Findings are based on Go Pensions 2021 DC master trust survey.

Participants were invited to select their top three responses to the question: What, in your opinion, is the biggest barrier to small scheme consolidation into a master trust?

Responses revealed that the top 3 barriers are:

- Market confusion: schemes don't know how to make the move (81.25%)
- Resistance from trustees (56.25%)
- Lack of available solutions for small schemes (37.5%)

But what can be done to overcome these barriers and improve understanding of the value for members from a DC master trust?

Lack of available solutions

Despite the fact that 37.5% of master trusts believe there is a lack of available solutions for small schemes, research tells us that six master trusts will take on micro schemes (assets below £10m). In fact, none of the participants reported requiring a minimum asset value of £100m. Furthermore, half of the participants have made developments specifically to support small schemes. **MYTH BUSTED!**

Resistance from trustees

In most cases trustees have members' best interests in mind. However, Sponsors and providers tell us that there can sometimes be a resistance from trustees to discuss the move to master trust. The reasons for this are unclear. However, they seem to have concerns, so the question for the industry is how we support these key stakeholders, and allay any concerns they may have. Trustees will primarily be concerned with safeguarding members' accrued DC pots. They must ensure that the transition of past benefits will not be to a member's detriment. In practice this means understanding how the investment options of the future master trust compare to the current scheme, and how any protections will be treated on transition. Good stakeholder engagement, addressing these points up front, should manage these concerns. Using consultants without a vested interest in the scheme can also help.

Market confusion

81.25% of the DC master trust market believe that small schemes don't know how to make the move. So how do we support small schemes to address this, and help them find the best master trust for their needs? The survey participants told us that master trusts need to increase awareness of where they can offer support. We also heard that trustees need more support and guidance on transitioning to master trusts – aside from the fear of change, it's a technical challenge in places. A call for action to the industry, perhaps?

If you want to understand more about the value available from master trusts, or how to make the move, use the resources available to you. Speak to independent third-party evaluators who have access to the data from their research activities. Also speak to the master trust providers. All would be pleased to have a no-commitment conversation in the pursuit of overcoming barriers to consolidation, and improving value for members.

Insight Article

Sketching out your journey

By Felix Mantz
Associate Director, Cardano Advisory

The consultation on the new Defined Benefit (DB) funding Code of Practice has made it clear that DB schemes will require a journey plan towards a low-risk funding target. Comparing the pros and cons of different journey plans needs an understanding of how investment and other scheme risks compare relative to covenant support available.

With most DB schemes maturing, the industry's direction of travel has been largely to reduce journey plan time frames, while also paring back investment risk. Schemes are often expected to fund this reduced reliance on investment returns with greater cash contributions from their sponsor.

However, making educated decisions about a scheme's journey plan and investment risk requires an understanding of how these risks compare relative to the covenant support provided – and how this support may change over time. Covenant strength therefore plays an important role – in most cases more so than scheme maturity – in setting an appropriate and evolving investment strategy; one that allows for a level of risk that can be supported over the duration of the journey plan.

This 'sponsor risk capacity' is derived from the sponsor's current financial resources and ongoing cash generation. While similar to the concept of affordability, the focus is on the ability to increase already committed funding if needed, either in addition to current contributions or through a recovery plan extension. With these fundamentals in mind, the near-term de-risking and increased cash funding sought nearly 'by default' may not be necessary. In fact, there are situations where sponsor risk capacity is comfortably above the current level of investment risk.

Insight Article

Yet when it comes to journey planning, this is often done with a scheme-centric modelling approach – and integration with covenant modelling is now needed to allow for holistic decision-making. This enables a journey plan to be evaluated and compared by its relative risk characteristics, allowing you to answer key questions such as:

- Is the chosen end-state appropriate relative to the long-term reliability of the covenant?
- How does journey plan length compare relative to covenant visibility?
- Is the balance of contributions and investment risk appropriate relative to covenant affordability/sponsor risk capacity?

So far, we have just talked about the theory. In practice, many schemes find themselves in situations where a perfect journey plan that balances all of the above is simply not possible. As trustees weigh up the pros and cons of different journey plan options, it is important to understand to what extent contingency planning can help to better manage unsupported risks.

Let's take the example of investment risk relative to sponsor support, where helping sponsors evidence and demonstrate their risk capacity is often crucial in finding and negotiating the best balance between investment returns and sponsor contributions.

If investment risk still appears higher than readily supportable, additional comfort can be gained from contingent funding structures, with or without collateral, which provide schemes with more direct support in case of investment underperformance or sponsor failure.

Ultimately, journey plans should not be set without fully considering the employer covenant supporting the scheme, now and in the future. This is particularly true for the investment strategy, where balancing supportable investment risk with affordable contributions can be difficult, when often both or neither are available.

But if the optimal balance can be found, the win-win for scheme and sponsor is undeniable, and scheme members benefit from the double support of i) appropriate funding and investment returns to deliver benefits today, and ii) a sponsor that can invest in its sustainable growth, and offer support over the lifetime of the scheme.

Cardano has developed the innovative PensionSketch which allows trustees and sponsors to assess scheme metrics and covenant strength in an integrated manner and, ultimately, to find this optimal balance.

"The ideal pace and shape of de-risking is heavily influenced by sponsor risk capacity – and in some cases, de-risking may not be required at all."

Insight Article

Climate-related risks – "second wave"

By Liam Goulding
Senior Associate, Sacker & Partners LLP

In 2017, the Taskforce on Climate-Related Financial Disclosures ("TCFD") published 11 recommendations aimed at identifying, assessing, managing and disclosing climate-related financial risks and opportunities. The Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 (the "Regulations") now embed these recommendations into UK law.

The requirements already apply to schemes with over £5bn in assets (since 1 October 2021). Schemes with net assets over £1bn will be in scope from 1 October 2022. So what do they need to know to ensure they are ready?

The requirements

Trustees must satisfy the requirements, and then report on how they have done so. Currently, the Regulations broadly ask trustees to:

- **governance and risk management** – establish and maintain oversight of the climate-related risks and opportunities relevant to the scheme. Identify, assess and effectively manage those risks, and integrate them into the trustees' overall risk management
- satisfy themselves that persons undertaking governance activities on their behalf are taking adequate steps to identify, assess and manage any climate-related risks and opportunities, and that those who advise or assist the trustees on governance activities are also taking adequate steps to do so
- **strategy** – identify and assess the impact of climate-related risks and opportunities which they consider will have an effect (over the short, medium and long term) on the scheme's investment strategy and (if relevant) funding strategy
- **scenario analysis** – undertake scenario analysis in relation to the scheme's assets and liabilities
- **metrics** – select certain climate and emissions metrics, obtaining the relevant data on an annual basis, and reviewing the selection from time to time as appropriate to the scheme. We are currently awaiting the response (due in the new year) to a consultation on changes to the metrics requirements, and so trustees must ensure they keep a close eye on developments here
- **targets** – set a non-binding target for the scheme in relation to at least one of the metrics, and measure performance against it each scheme year
- **TKU** – to ensure that they are able to understand the outputs of activities such as scenario analysis and calculating emissions-based metrics, and to incorporate them into their new climate change risk management processes, trustees must ensure they develop the appropriate degree of knowledge in this area.

Insight Article

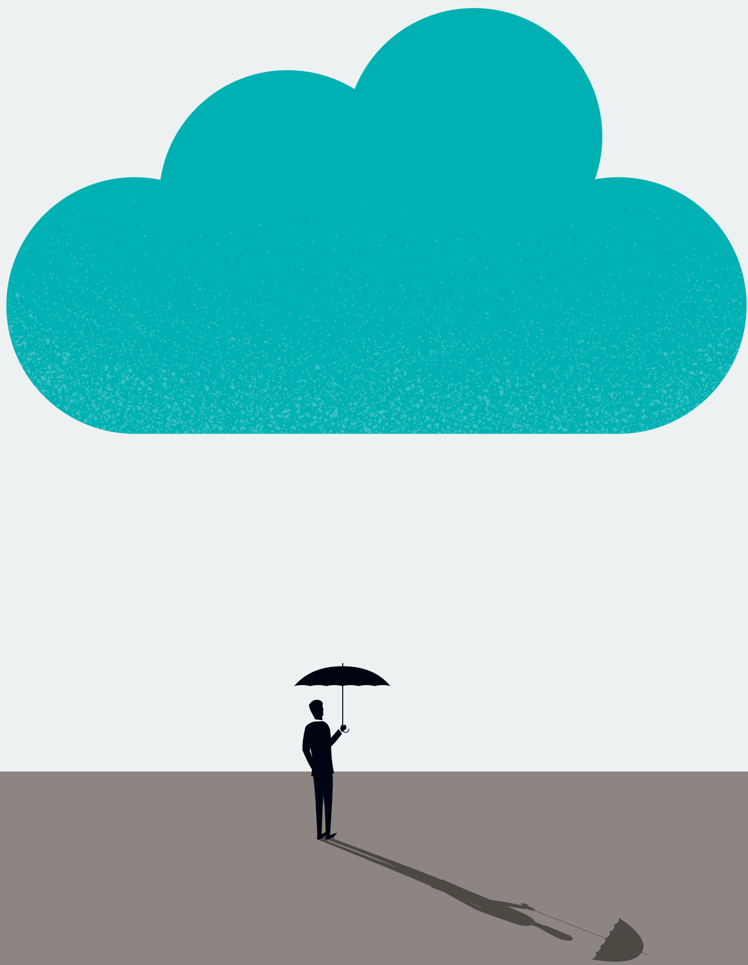
Climate-related risk and opportunity must become integral to a scheme's governance procedures. Schemes may be doing some or most of the above already, but should start to ensure that this is all within their reach.

Trustees are then required to produce and publish (on a publicly available website) a report on how they have met the requirements, and must inform members via the annual benefit statement (DC) or annual funding statement (DB) where the report can be located.

Guidance

The Regulations are accompanied by statutory guidance published by the DWP. In addition, to help trustees consider what actions would be appropriate in their own scheme's circumstances, the Pensions Climate Risk Industry Group has published voluntary, non-statutory guidance. TPR also consulted earlier this year on its own guidance, the final version of which is awaited.

Schemes needing help with the necessary preparations and any training should seek advice.



Insight Article

It's all we talk about

By Karen Heaven
Managing Director, Investment Consulting, Redington

Many larger DB pension schemes, authorised master trusts and collective DC schemes are currently occupied with the process of complying with the Taskforce on Climate-related Financial Disclosures ("TCFD")-aligned regulations. This article shares some thoughts on approaching this process, and why it is important to integrate management of climate-related risk and opportunities into a scheme's existing processes.

I was recently interviewing a candidate for an investment consulting role in our team, and he asked whether we are having many conversations on sustainable investments with pension schemes.

To paraphrase my response: "it's all we talk about". I was only half-joking.

In particular, many schemes are currently spending time on the process of complying with the Taskforce on Climate-related Financial Disclosures ("TCFD")-aligned regulations.

The objective of the TCFD regulations is to ensure that climate change – which poses both a financially material risk as well as an opportunity for pension schemes – is governed effectively.

How familiar you will be with these regulations is likely to depend on the size of your scheme.

Due to how the deadlines fall, DB pension schemes over £5bn in relevant assets (excluding insurance contracts), authorised master trusts and collective DC schemes need to already be well underway in their work to comply with these regulations. Schemes between £1bn and £5bn are next, with their relevant deadlines being 12 months later than those of the largest schemes. There is no word, at the time of writing, on TCFD-aligned regulations that may affect schemes under £1bn.

Having taken part in numerous discussions on the subject of implementing TCFD-aligned regulations for pension schemes (in my case, focussed on defined benefit schemes), I have summarised some thoughts on the process.

- **Understand your deadlines:** It sounds obvious, but there is a fair amount of work to get done in order to comply, culminating in the publication of an annual TCFD statement which sets out the details of how your scheme has implemented the requirements.
- **Don't reinvent the wheel:** the very largest schemes are treading a new path, so any scheme under £5bn should be able to learn from what these schemes have done. Broadly, the areas that need addressing, and hence where lessons can be taken from, are: governance structures; assessing climate-related risks and opportunities; climate scenario analysis; integrating climate-related risks into overall risk management; and setting and calculating climate-related metrics and targets.
- **Proportionality:** whilst it is important that the whole trustee board "owns" its scheme's approach to addressing climate-related risks, it is perfectly reasonable to have a sub-group undertake some of the detailed work to help streamline the process. Further, there are different degrees of depth to which the subject of managing climate risk can be explored: it is important that the time and resources spent is appropriate to the scheme's circumstances.
- **Keep an eye on the "so what":** if you focus just on complying with the regulations, that will amount to little more than a box-ticking exercise, and will feel like a burden. Instead, if you can identify appropriate actions arising from the process, such as putting in place a more robust process for ensuring effective stewardship of existing mandates, or changing asset allocation to meet climate emissions reduction targets, then you will add value, and see the strategic opportunity that the rules invite schemes to take up.
- **Don't let perfect be the enemy of good:** climate-related data isn't particularly robust yet, industry-wide consultations seem to appear with alarming frequency, climate-related investment opportunities are constantly evolving – there are many reasons why trustees may feel reticent about starting TCFD-related work, and indeed, about taking action now to manage the climate-related risks in their portfolios. However, it is unlikely that the pace of change will slow down any time soon. It is therefore important to bear in mind that neither your approach to addressing climate risks nor your scheme's investment strategy need to be set in stone, and as long as the actions you are taking now are consistent with your duties as trustees, there is no reason not to take action based on the information currently available to you.
- **And lastly,** focus on capturing the intended benefits of these regulations. Complying with the TCFD-aligned regulations does place a further burden on pension scheme trustees, who are already occupied with the numerous other demands of managing a pension scheme. However, aligning your scheme with these regulations should enhance your scheme's resilience to both climate transition risks (i.e. the risks in moving to a lower-carbon economy) and physical risks (e.g. the effects of climate change, such as rising sea levels or more severe weather events). Climate change-related risks are widely understood to be some of the greatest risks to the world economy, both in terms of likelihood and magnitude, hence they represent meaningful financial risk to pension schemes. Taking steps to identify, integrate and address these risk exposures should ultimately increase the likelihood of meeting a scheme's over-arching purpose: to pay members' benefits.

How much climate change will be slowed by the actions of governments, organisations and individuals globally remains to be seen.

However, whether the future outcome is catastrophic climate change or sufficient worldwide agreements and regulatory actions that limit climate change, it is the case that either scenario will present both risks and opportunities to pension schemes.

It is therefore a matter of good governance to ensure that these risks are properly integrated into every risk management and investment process that a scheme has, to give schemes the best chance of meeting their ultimate objectives.

PMI Roundtable Feature

The Master Trust Agenda

By Michael Callari
Business Development Manager, CACEIS

CACEIS, in partnership with the Pensions Management Institute (PMI), held a roundtable to discuss what's on the Master Trust agenda. Several different Master Trusts were represented, and the discussion centred around many broad themes such as governance, value for members, member outcomes and data challenges.

A key recognition at the outset of the discussion is the importance of delivering what the end-member wants, and ensuring that consolidation does not risk harming member outcomes, alongside good governance.

The biggest governance challenge is keeping an eye on the end goal, which is meeting member outcomes, and ensuring Master Trusts don't get bogged down by compliance and regulatory challenges which could create a tick-box mentality. Given the amount of regulatory change, there is a clear focus on prioritising compliance with new regulations over the next two years.

What does good value mean?

Value for members comes in many different forms and costs, and it's usually difficult to quantify value apart from performance. It's also important to note that it's not just about value from the features members actually pay for – it's also about the wider ancillary benefits a member experiences by being in a Master Trust.

However, the roundtable consensus is that value for members starts with employee engagement, which needs to be seen as a benefit of Master Trusts. And then there is the ability to provide good services at good costs, which is going to be more critical for smaller schemes.

Having independent data to help drive more realistic like-for-like comparisons between the different Master Trusts was also noted as an important future step, so that more accurate benchmarking and assessments can be achieved.

The growing need for data

It was clear that investment data is one priority, and a challenge, especially in light of increasing regulation, such as the need to report on climate risks according to the TCFD framework.

"Master Trusts are effectively first movers in the pensions industry in having to report in line with TCFD, but it's acknowledged by the DWP that there will be gaps in the data, which means trustees will have to look at plugging that data gap."

The mismatch between the regulations for pension schemes and asset managers was also noted: "With no requirement for asset managers to follow the same approach, this creates a major mismatch between what is expected of pension schemes and what is actually regulated and required by asset managers."

A call to action, however, is critical. Despite this challenge, it was commented that "change only occurs when there is consumer demand and regulatory change. The first movers, like Master Trusts, will be challenged, but we have to start somewhere because climate risk is real".

Also, it was observed that the industry experienced similar challenges with the introduction of cost transparency, where DC pension schemes had to disclose their costs, but asset managers struggled to provide the necessary data. That changed when the DC Workplace Pensions Template (DCPT) was introduced when it became a regulatory obligation, followed by the CTI templates – climate reporting requirements will probably follow the same path.

Another challenge that was highlighted is the difficulty in trustee boards digesting lots of information on climate risks for effective decision-making. Trustee boards are also questioning the area of scenario analysis, but this is posing some challenges: "Getting sufficient metrics, just basic ones, is key so trustees can determine how they might be meeting the net zero commitments of their scheme and looking at risks from their fiduciary duty".

We also need to be mindful of the different risks of climate, and why broad data is key: "We can easily get wrapped up in looking at the transitional risk of climate change and not the physical risk.....if we are investing in a company that is physically located in an area prone to flooding, that is just as challenging as transition risk.....and getting hands on data is difficult".

The other main challenge discussed was the different reporting methodologies used by asset managers, which creates difficulties in getting an aggregated and consistent view across different asset managers.

The dialogue is changing

One interesting insight from the roundtable discussion centred on the changing nature of dialogue. Currently, trustees have a stronger dialogue with their consultants – previously this was with asset managers. However, with the growing need to manage investment risks, it could revive trustee meetings with asset managers.

"The data is good but what is important is the dialogue.... and having discussions with asset managers on the transition risks and opportunities faced by companies, and how they are engaging with those companies."

As trustees get their hands on data, and can begin to understand their scheme's exposure to climate risks, this will lead to more robust dialogue with asset managers.

Moreover, activities such as managing ESG and climate risks have generally been delegated to investment committees – this is another area where the change is expected: "Trustee boards need to be upskilled so they can begin to understand and challenge around climate risks and opportunities".

Member outcomes remain key

A common thread throughout the discussion was the importance of getting the default fund right, and recognising that developing bespoke investment solutions might not necessarily lead to better member outcomes. It's here that communications back to the members need to be more personalised, perhaps utilising AI technology so that members are prompted to make decisions during the moments that matter.

"For us it's not about giving more choice, because the core default fund is central to member needs. We look at needs and not wants – recognising that there is always a trade-off between the two." Default funds remain critical to meeting member needs, and need to be structured as best as they possibly can be.

Getting members engaged on the issues of climate change was another key area for discussion.

"We are designing our member questionnaire at the moment, and asking them questions that help us understand if they require further clarification on areas such as our net-zero policy, which we'll then point them towards a specific area on our website."

Member communication around TCFD reporting also needs to be simplified, and we must not take it for granted that members will understand the nuances around climate change: "Practical examples will be good in getting members really engaged, especially younger members".

Look forward

In the next one to two years, the general focus will be on addressing the compliance requirements and getting this right, whilst staying focussed on member outcomes.

And as consolidation accelerates, and with a significant amount of DC schemes in the £100 million and below bracket, will there be a challenge in the near future for onboarding? In addition, it's also about good governance around member data. As Master Trusts grow, they will be inheriting legacy member data that may or may not have been subject to good administration in the past. This is especially relevant if there are large volumes of pension schemes consolidating into a Master Trust.

"Administration, administration, administration" – good administration quickly became a core area of focus, especially around areas such as the onboarding process. It was recognised that Master Trusts will experience strong growth, especially with more consolidation. It's here that operational processes are key, so that Master Trusts can take on new schemes, and maintain the integrity of the onboarding process.

Finally, more innovation around retirement pathways is still required, particularly around factors such as longevity risk. Moreover, there is a more structural challenge to overcome. The challenge is looking at the pension pots of low-income members and assessing how to make auto enrolment more successful for this cohort.

Insight Article

Practical thoughts on TCFD

By Alan Baker
Trustee Director, Law Debenture

Looking back just a few years, trustees were not expected to know much, if anything, about climate issues. But times change and, with us facing a global climate emergency, climate issues (both opportunities and risks) are now an essential part of Trustee Knowledge and Understanding, particularly for the larger schemes caught by the Task Force on Climate-related Financial Disclosures.

What follows is an account from an internal office discussion relating to what colleagues are seeing in relation to the Task Force on Climate-related Financial Disclosures (TCFD) implementation. Schemes are at different stages, but everyone is grappling with a meaningful choice of metrics and ways to access data! At LawDeb we believe the knowledge-sharing across our directors is part of what sets us apart, and I thought this account would be useful for others currently or shortly about to face up to the challenges of TCFD requirements for schemes.

The challenge

In line with the TCFD recommendations, large pension schemes must assess and report on the financial risks of climate change to their scheme . A framework for risk identification, management and mitigation examines the key areas of governance, strategy, risk management, metrics and targets. Master Trusts or Schemes with assets of over £5bn are already captured by the requirements, and are busy ensuring compliance. The second wave of arrangements have more time (fortunately).

In our discussions we agreed that wave 1 schemes as a minimum should by now have assessed the competence of their advisers, and drafted their policy document. The good examples of documents that we have seen set out:

- the decision-making framework, with committee and adviser responsibilities, and how trustees will maintain their TKU
- chosen metrics and their approach to compiling these
- if they have been agreed, targets in relation to the metrics, and where they haven't been agreed, the expected process and timeframe

Being caught by TCFD already, wave 1 arrangements should now have their metrics defined, and know what at least one of their targets are. But time just hasn't been on anyone's side, so advisers, and as a result schemes, currently seem quite comfortable with an end-Q1 2022 deadline for having all this in place.

An assessment of advisers is required to ensure they have the requisite skills and expertise to identify climate risks and opportunities. It was agreed that wave 1 schemes should have done this by now, and wave 2 should be getting on with it, with compliance with this task being recorded through the inclusion of a formal Board minute.

The Investment Consultants Sustainability Working Group have created a competency framework, which we have found to be a comprehensive basis for the assessment.

It's interesting (or not) that advisers all seem to be taking a similar approach.

Not all our schemes have ESG committees, but given the amount of activity required we believe it is prudent as a minimum to establish a working party.

Data

The key (and crucial) question here is do trustees know where they will get the data to complete the TCFD report? Advisers, asset managers and custodians will all be potential sources of the information. Using a single data vendor such as MSCI may be enough – trustees have an obligation to obtain the data 'as far as they are able'; no one data vendor gives good coverage of all asset classes. Use of poor data with many gaps could well result in regulatory scrutiny.

Fund managers should be a fair source of data, as they need good data for the management of the risks in their portfolios, and they should have the data licenses most appropriate for their particular holdings. That said, it was noted that some custodians are investing heavily in this area to support schemes, while there would undoubtedly be some fund managers opting for the bare minimum, while disclosure is not yet an obligation on them. It was opined that Pegasus has the capability of extrapolating the data for the purpose of the TCFD reporting.

Metrics and targets

For now, schemes must select a minimum of three metrics in year one, two of which are prescribed – total greenhouse emissions (absolute emissions metric), and emissions intensity metric. Portfolio alignment is expected to become an obligatory fourth metric next year. In terms of freedom to select a metric, we are seeing many schemes considering data quality (although these schemes have not yet agreed their approach to assessing data quality) and our trustees had a good discussion about climate Value at Risk (VAR) being an alternative. It was recognised that year one could be an opportunity to be pragmatic, and the choice of metrics may evolve.

Setting realistic targets for where schemes want to be by 2030 is important. Extending the target timeframe much beyond 2030 would be too long-term; 2050 targets likely extend beyond the buyout timeframe of most schemes.

We note that a failure to adhere to the requirements of TCFD reporting is likely to result in public naming and shaming.

TCFD compliance will undoubtedly be costly, but of course considerably less than the long-term cost of inaction!

Risk registers are being updated to include climate-related risks and impact, generally with multiple entries recognising that climate risks crop up in multiple dimensions, rather than a single risk.

Scenario testing

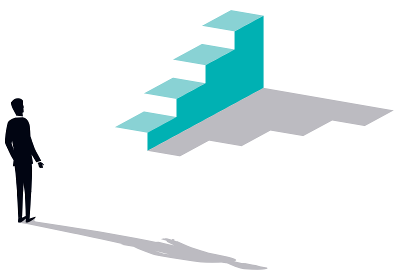
It was noted by those that had already undertaken scenario testing that it was difficult to find specific scenarios that revealed a material impact on member benefits in DB arrangements through short to medium-term adverse climate change. In this same period other risks were more prevalent. This is going to be a real challenge to embracing the decarbonisation challenge in pension funds. While we think of pension funds as long-term, in reality the timescales we consider are not long-term enough to really see the potentially catastrophic impacts of global warming. This could, of course, change – for example, carbon taxes could result in rapid repricing activity, and those that are prepared for that impact should be better placed to reduce the impact on funding levels and members.

Next steps

All in attendance agreed that, as highlighted in TPR's press release in December, one of the key areas of focus as we go forward is to ensure that those providing advice on climate have the right skills to do that

All credit to Natalie Winterfrost who chaired the meeting. These notes were prepared by me and Bill Jangra from LawDeb's pensions executive team Pegasus.

It's worth adding, of course, that many of the schemes we support are much smaller than those facing the challenges of TCFD reporting, but for all schemes it's important to consider ESG and associated investment beliefs carefully.



Insight Article

Gender Pensions Gap: Investors' role

By Ursula Henry
Head of International Decision Support, International Business, Federated Hermes

It is impossible to envisage financial equality without addressing the gender disparity in savings, investments and pensions. In order to do so, it is vital that we understand more about the causes and motivations behind financial attitudes and behaviour.

In the United Kingdom, the gender pensions gap currently stands at 40%, and resolving this should be a key priority for institutional and retail investors alike. Our recent research, conducted in conjunction with CityHive, has aimed to identify key reasons behind the existence of this gap, and provides suggestions as to what can be done to resolve this situation.

Gaps related to both gender and ethnicity in pension savings have been identified by several pieces of existing research. The 2020 FCA Financial Lives Survey, for example, found that on average across all brackets women reported having £30,000 in investible assets, compared to £47,000 for men. An astonishing 46% of women surveyed either did not know, or did not have a pension in accumulation, compared to 38% of men.

Clearly, income inequality is a significant factor behind this. Our research found that gaps in the funding available to retired women, which widen when looking at ethnic minorities, are primarily driven by the sectors and types of work that women tend to do, or gaps in their employment due to caring responsibilities. The resultant lower contributions over a lifetime of lower-paid or part-time work generally lead to a smaller pension pot. Indeed, compared with men, twice as many women surveyed – almost 30% – said that they needed to put spare money towards household expenses. Further, an alarming 15% of women said that they had no spare money to invest or put towards savings, compared with none of the male respondents.

It should also be noted that women are less likely to work in industries with the most structured pension contributions. The introduction of the government's auto-enrolment scheme, while undoubtedly beneficial, should not be regarded as a panacea in this regard. It has, for example, an earnings threshold that only applies to a single role, meaning that those in multiple part-time jobs do not qualify. The self-employed are also often not covered.

While much of the responsibility for improving existing mechanisms and resolving these issues lies with governments, the investment industry undoubtedly has a huge role to play. In fact there are, in our view, clear steps that firms can take today to reduce the pensions gap.

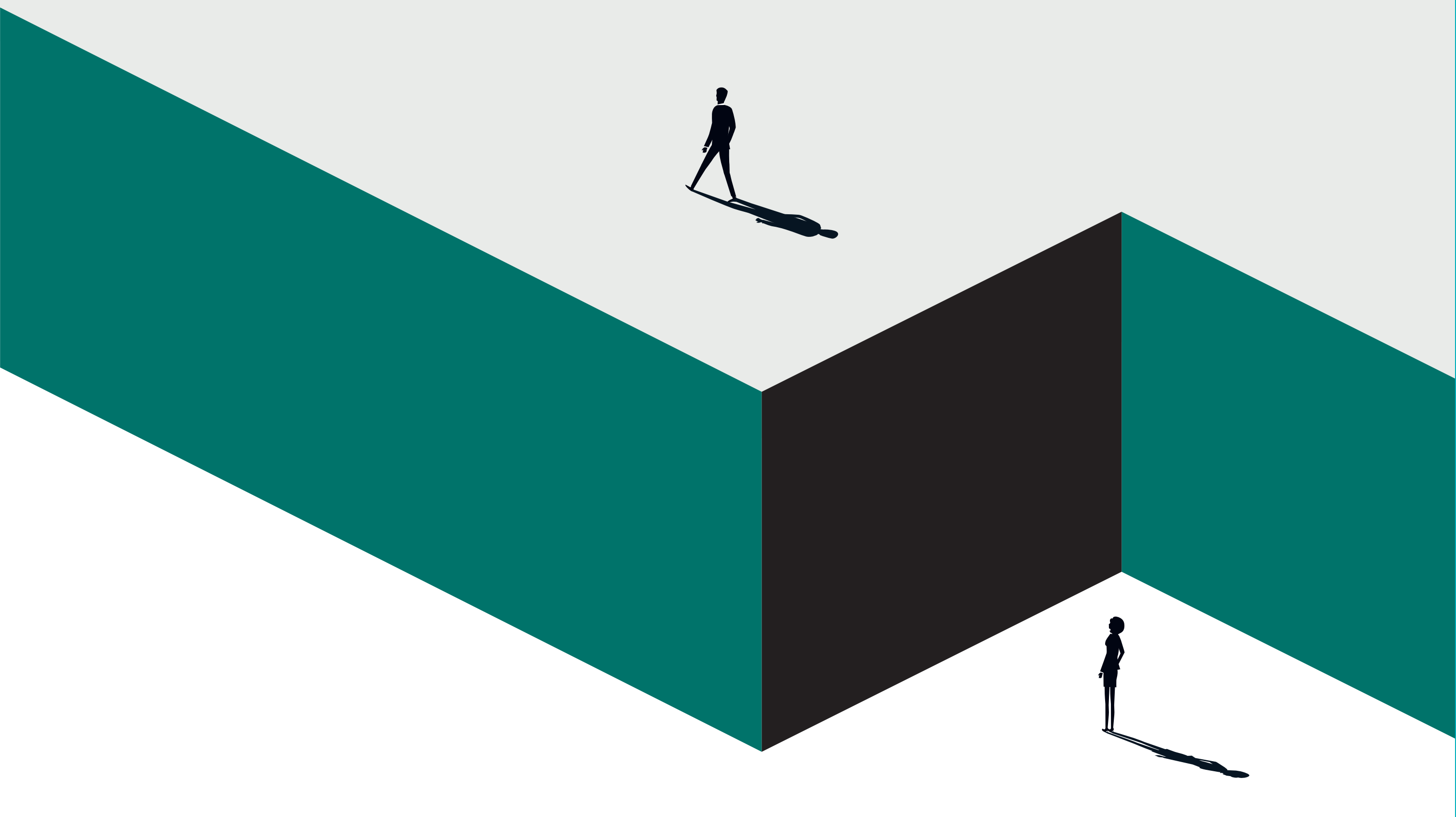
The advertising and marketing of pensions and investment products is one area in which improvements need to be made. Given the lack of representation of women and ethnic minorities in advertising campaigns, it's hardly a surprise that levels of trust and the likelihood of using pensions products and services are lower amongst these groups. Our research found that most adverts not only target and centre on men, but a particular set of men who have achieved financial security, and have disposable income to spend on leisure. When women are the target of advertising, it can be tone-deaf; examples include pink-themed materials, or savings and investment being targeted towards goals like saving for a wedding. Broadening diversity in the development and decision-making process within the pensions industry could be instrumental in resolving this issue.

Additionally, communication materials around pensions, savings and investment are still filled with jargon, and perceived to be deliberately confusing. There is no reason, for example, why pensions could not instead be presented as an integral part of achieving the meaningful goals of financial security or access to education.

Promoting financial literacy from an early age, and improving the visibility of good financial role models amongst women and ethnic minorities, could play a vital role in this regard. Almost every conversation over the course of our research highlighted the importance of good role models amongst family, friends and the community, whether it be to showcase the role of different financial instruments, or to demonstrate good financial behaviours that were relevant to people at different stages of their lives.

Such interventions, led by the investment industry, could be crucial in ensuring that women and ethnic minorities are able to make more sensible long-term investment decisions.

Access to finance and investment is central to creating a level playing field for women and minorities to participate in the economy. Without it, we risk losing innovation and diversity of thought and contribution. Further, for investors, there is now an increased need to consider their contribution to society. Addressing existing ethnicity and gender pensions gaps is therefore not only crucial in accessing untapped potential in terms of capital, but a vital social consideration for firms who are increasingly focussed on responsible investing.



Insight Article

Investment solutions for institutional investors

By Julien Halfon
Head of Pension Solutions, BNP Paribas Asset Management

Negative cash flows, pressure to diversify risk exposures, stricter investment regulations – institutional investors are facing many issues. These are also making holding listed equities harder, while low bond yields add to the challenges of sourcing adequate returns. Where can attractive alternatives be found?

One way to improve the risk/return profile of institutional portfolios is to capture the credit and/or equity illiquidity premiums by investing in diversified private debt and private equity portfolios.

Investing in private markets enables institutional investors to meet their demand for sustainable assets by directly accessing greenfield and brownfield, senior and junior, and developed and emerging market green assets. Increasingly, they are seeking not just such ESG-oriented assets, but they also want to climate-align their portfolios to the Paris Agreement.

Many institutional investors are shunning the volatility associated with listed equities, and investing in other asset classes. Private markets can be an attractive substitute for listed equities and bonds.

Indeed, private debt and equity offer a number of advantages over their listed equivalents.

- Higher returns, captured through an illiquidity premium
- Lower volatility and a lower market beta (which for insurance companies under risk-based capital regulation is crucial)
- Potentially more targeted environmental, social and governance (ESG)-oriented investments (based, for example, on line-by-line selection of well-defined projects)
- Lower immediate liquidity, as most of these assets are valued once a month or once a quarter, and are usually held to maturity to avoid liquidation costs.

Strategies for investing

In practice, asset managers have developed different types of investment strategies to meet investors' objectives when entering the private credit and private debt universe:

- **Diversified private credit** strategies generally aim to incorporate various types of real asset debt and corporate lending with some structured finance sub-asset classes, and to capture a credit illiquidity premium. They offer a blend of senior and mezzanine investments, countries, currencies, credit ratings and liquidity. They can be structured as cash-flow matching portfolios, and can be suitable for mature defined benefit pension schemes (with a large majority of retirees) as well as insurance companies operating under risk-based capital regulations (capital requirements are less punitive, because private debt assets have a lower volatility than their listed equivalents).
- **Diversified private markets** strategies add exposures to private equity, direct real estate and infrastructure equity to a diversified private credit portfolio. They aim to capture a blended illiquidity premium. They are structured as alternative growth engines, and are suitable for defined benefit pension schemes with active members, and defined contribution pension plans with long time-horizons. They typically offer higher expected returns with lower volatility levels than their listed counterparts do.

Because of their nature, these strategies are customised to individual client needs, and have varying features when it comes to:

- The investment universe can be narrow (for example, focussed on corporate lending) or wide (including semi-liquid asset classes such as leveraged loans)
- Fund design – they can be open-ended or close-ended, unitised as a Luxembourg RAIF or a UK-based LP
- The strategic asset allocation (SAA) can be directive or just indicative, with loosely set ranges allowing for active asset allocation over time
- They can be evergreen or established only for a pre-determined amount of time
- They can rely on a fund-of-funds structure or include only single investments.

For all these reasons, we believe diversified private credit or private market approaches have a strong edge over investing in single asset classes, as well as over listed asset classes.

"Investing in private markets enables institutional investors to meet their demand for sustainable assets"

Trustee Spotlight

Hotseat

By John Flynn
LTPMI (accred), Member Elected Director,
National Grid UK Pension Scheme Trustee Limited

First, let me introduce myself. I am John Flynn and I am a member elected director of the National Grid UK Pension Scheme Trustee Limited and I also sit on the employers committee of the Scottish Housing Association's Pension Scheme [SHAPS]. I consider that I am a member of the working class and originally from Jarrow in the North East of England. Having failed both my A levels and my accountancy exams, I have made a decent living as a non-qualified accountant. The first five years of my career was at Associated British Foods followed by twenty-four years at British Gas. The last nineteen years I have worked at or for National Grid Plc. Yes, as a Pension Trustee, I am one of the older ones.

I first became a Member Elected Director [MED] ten years ago, and was conscious of the private pensions mis-selling scandal of the late 80s and early 90s. I was also aware that a number of the big Defined Benefit Pension Schemes [British Airways for example] were in trouble, with ballooning deficits. So I definitely came into the pensions world with my eyes open, but the British Steel Pension debacle and the BHS pensions scandal [of more recent times] reinforced that being a Trustee is an important role to protect a pension scheme's members' interests. In addition, when broken pension scheme stories do hit the press and other media outlets, one becomes very aware of what the public and opinion-formers expect of trustees.

So, I strongly believe that the days of just leaving trustee training and further education up to individual trustees is well and truly over. Those once a year surveys of what training have you engaged in, followed by pursed lips from the leadership of individual schemes as you promise to do better next year, have to be confined to the dustbin of history.

As a lay trustee I have always enjoyed the work of my home scheme, but I have also tried to look at what other schemes [DB, DC or Hybrid] are doing in terms of best practice, and how they prioritise their competing tasks. Also, I have found the time to move around the pensions support world here in the UK, and participate in both PMI and PLSA-organised events, amongst many others.

In 2014 I was introduced to the Association of Member Nominated Trustees [AMNT] and found them an excellent organisation to support my personal development as a trustee, and to give me support to acquire recognised pensions qualifications to endorse my previous work and experience. Hence, I took the PMI award in Trusteeship in mid-2014.

In 2021, the arguments about trustees and qualifications still rumbles on BUT now there are recognised qualifications for both Lay Trustees & Professional Trustees. It would be a sad day if these qualifications just laid on the shelf. Trustees should engage with these qualifications, and do away with the argument that we are not qualified to carry out our work.

Insight Article

Trustees must be vigilant in these times of uncertainty

By Nicola Parish
Executive Director of Frontline Regulation, The Pensions Regulator

Trustees are the first line of defence. TPR's Executive Director of Frontline Regulation Nicola Parish calls on trustees to remain vigilant, alive to risk and ready to act swiftly to protect savers in these uncertain times.

Managing the retirement outcomes for savers is a role with tremendous responsibilities, and we are alive to the workload trustees are facing in these challenging times.

Some of that workload stems from a positive place, as new legislation comes into force that is designed to protect savers. While change can feel disruptive, we believe the powers created under the Pension Schemes Act 2021 go a long way to empower trustees to better protect savers, and deliver stronger outcomes.

But some of the pressure facing trustees stems from a more nebulous place; from the economic uncertainty caused by the pandemic, from the disruption to supply chains, the increased cost of raw materials and the instability of energy markets, all of which could impact employer covenant or investment performance and choice.

However, the conditions we are seeing on the ground are generally far more benign than perhaps feared. The government assistance to employers impacted by the pandemic has been very successful in ensuring that levels of corporate distress have been kept at far lower levels than might have been expected early in the pandemic.

However, for some of those employers whose sales were impacted, the effects are present in levels of debt. This can reduce capacity to absorb the impacts of the sort of challenges currently starting to be seen. For some this may translate into a threat to their ability to fund pension schemes.

Most temporary government protections have now been withdrawn, and the future remains uncertain. We cannot predict with accuracy if, or when, we may see an increase of insolvencies. More likely in the short term is a continued increase in the Mergers & Acquisitions (M&A) and restructuring activity we have already been seeing. Both can bring fundamental change to the position of the employer, which could pose a threat to the support provided to pension schemes, and to scheme funding, as other stakeholders seek to protect their interests.

In this environment, we look to trustees to be vigilant. Strong, open relationships with employers are essential, ensuring trustees keep appraised of the health of the employer, and any potential strategic changes to their position. Assessing risks to the employer and contingency planning for their response will ensure that trustees are ready to react promptly to protect members' interests, should risks materialise.

We remain clear that trustees are the first line of defence for savers. We, as the regulator of workplace pensions, will support trustees where appropriate. But we will use the full force of our enhanced powers if we feel a scheme is not being treated fairly by a sponsoring employer, or if a trustee board is not acting in the best interest of savers.

Planning for risk

We're reminding trustees what they can do to prepare for emerging risk. As part of our latest regulatory initiative, we have contacted more than 400 defined benefit (DB) pension schemes to check they have considered the risk that their sponsoring employer's ability to support the scheme has weakened.

We used external analysis, together with our own scheme information, to identify employers that may be less able to support their DB scheme due to the impact of the pandemic and ongoing economic uncertainty. We have now written to 411 schemes to check they have considered, or are going to consider, our Protecting schemes from sponsoring employer distress guidance.

Initial indications are positive. In total, more than 73% said they have read and considered our guidance with their advisers. Of the remaining schemes that did not consider the guidance, we are working with them to ensure they also consider any risk.

A small number (5%) said they do not consider their covenant has weakened. They have been asked to provide evidence to demonstrate this, and some may be investigated further. We are following up with those that did not engage with the process at all.

We also carried out more in-depth engagement with an additional 30 of the schemes most at risk from a weakening covenant, to understand in greater detail the impact of the pandemic, and what is being done to protect savers. As a result, we have so far opened nine cases (eight from the smaller group of 30 schemes and one from the main group) to investigate whether it is appropriate for further action to be taken to protect savers.

The power of the Act

Some have questioned whether the threat of our new criminal powers will scupper M&A activity amid fears that one wrong move could lead to hefty fines or even jail time.

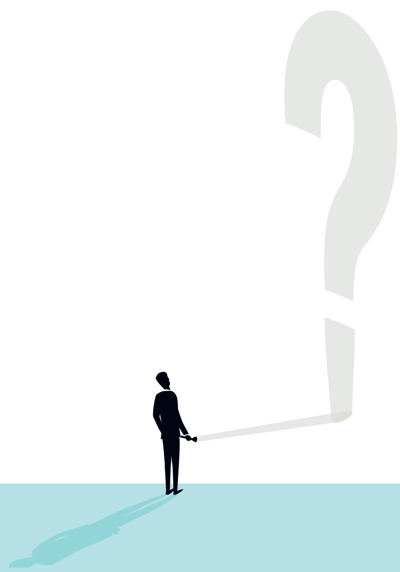
Employers who are doing the right thing should not be worried about these new powers, which give us more options to punish wrongdoers. We hope their existence will be a deterrent in themselves. We are also exploring how our new information-gathering powers may be used for our existing cases.

Will the new powers shift the balance between employers and trustees? It's too early to say for sure. But initial feedback we have received suggests the new powers are resulting in better engagement from employers and other stakeholders with the pension scheme.

We think good engagement with pension scheme trustees should have been "the norm" before, but we're glad the new powers may be helping to redress the balance of power where schemes' interests have not been appropriately respected, and put trustees firmly at the negotiating table.

Of course, it's not just criminal powers which will help improve outcomes. The Act brings in a broad package of powers relating to DB funding, notifiable events, investigation and information-gathering, as well as high fines.

Trustees have a pivotal role to play. We are there to support them through guidance and enforcement action if needed. Together we can – and must – ensure savers remain at the heart of all we do.



Pension Conundrum

Pension

conundrum

drum

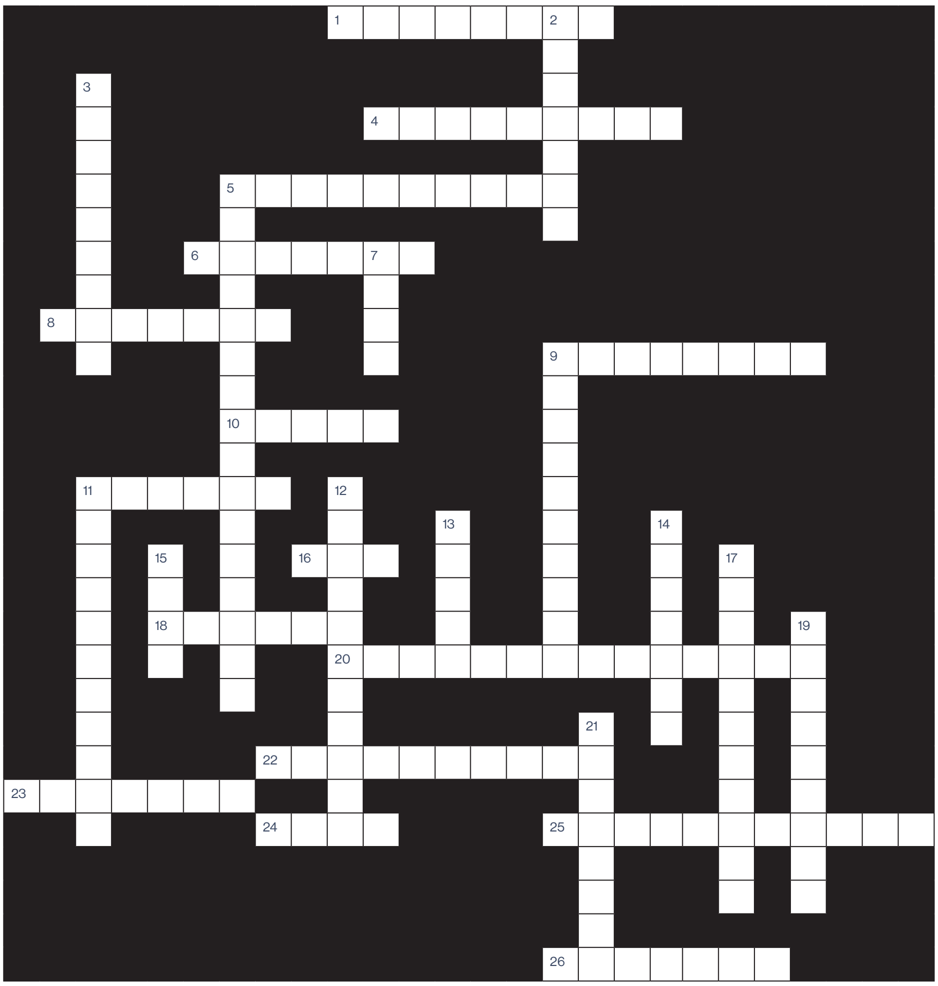
Crossword

Across

1. Agreed upon end date (8) **4.** To make varied (9) **5.** System of decision-making and oversight (10) **6.** Fixed sum, paid each year (7) **8.** To travel (7) **9.** A promise (8) **10.** Useful or valuable thing (5) **11.** A system or standard of measurement (6) **16.** More responsible investing (3) **18.** Nullify (6) **20.** To be acknowledged, considered (14) **22.** A CACEIS space for discussion (10) **23.** Negating greenhouse gas (3,4) **24.** Facts collected together (4) **25.** Able to be maintained (11) **26.** Offset losses by taking an opposite position (7)

Down

2. Person or member of a board (7) **3.** Increase in prices (9) **5.** Discrepancy in savings based on inequality (6,7,3) **7.** (Acronym)A climate taskforce (4) **9.** Conformance (10) **11.** Relevance of a sustainability factor (11) **12.** Vehicle to collectively manage pooled investments (6,5) **13.** An individual with assets in a bank or recognised scheme (5) **14.** As in warm, temperate (7) **15.** A reserve (4) **17.** (Of assets) not easily converted (11) **19.** To merge (9) **21.** To control something (8)



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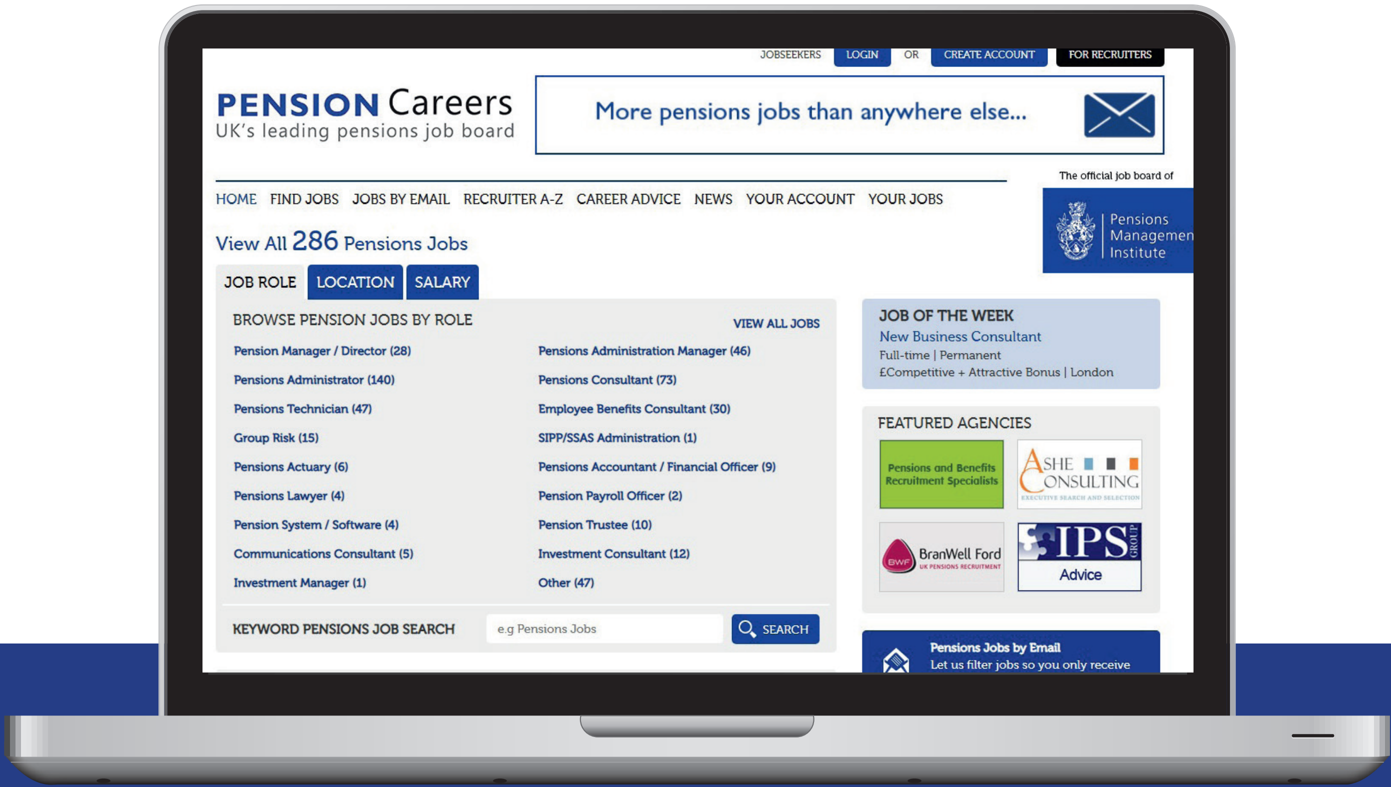

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Over a month into 2022 already, are your New Year resolutions going well? How about the one to change jobs? With so much change over the past two years, changing jobs can be like stepping into the unknown. Yet all that has happened tells you that now more than ever it is time to find the right job, the right work/life balance, be that back in the office with colleagues or hybrid working & more time at home, less time on travel, & a little bit more 'you time'. For now hybrid working seems the most popular option for the majority of our clients, so why not **get in touch & let's discuss what roles might suit your** needs & make sure there is one resolution you don't have to fail & make again next year.

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