Pensions Aspects

www.pensions-pmi.org.uk

Edition 49 | June 2023

Investing for your tomorrow

Educating to invest or investing in education?

Adapting to meet a lower growth outlook

Best ways to invest in this environment

Pensions Management Institute

Moving pensions forward

Foreword

Celebrating the Pinnacle of Pensions

Jessica Taylor
Events Manager, PMI

We look forward to hosting the second PMI Pinnacle Awards. These unique awards recognise the height of pensions excellence and those who are making a real difference to the profession.

Winners will be celebrated at an exclusive awards ceremony on Thursday 23rd November at The Londoner, the world's first super boutique hotel. This is not one to miss out on!

The Pinnacle Awards celebrate the people and new ideas that contribute in making a real impact in the pensions world. Winners will be recognised in the following areas:

PEOPLE

This category recognises the remarkable people of pensions; those who are making a real difference to the industry

- Star in the making
- Team of the year
- Frontline hero of the year
- Leader of the year
- Lifetime Achievement Award

INNOVATION

Celebrating the innovators who are pushing the boundaries to help move pensions forward

- Innovation in learning
- Innovation in systems or technology
- Innovation in new product or service
- Innovation in trusteeship

IMPACT

Showcasing those who are making a significant, lasting impact on the industry

- Impact on climate
- Impact on customer experience
- Impact on the profession
- Impact on society

Why enter?

This is your chance to be given a stamp of approval by the leading body for pensions professionals. Winners will get:

- Use of a winner's logo
- A winner's trophy
- Inclusion in a promotional video
- A written case study published in our magazine and digital supplement, which you can also use in your own marketing
- Inclusion in a press release

Submit your entries before the upcoming deadline on 2nd June.

Visit pmipinnacleawards.co.uk to find out more and to book your tickets.

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Membership update

Your membership, what's happening?

Following the launch of PMI Pathways and the new member portal, we encourage all members if you have not done so already to login to your new [My PMI member portal].

If you have completed any PMI qualifications and/or units of the ADRP post 2016 but are not yet fully qualified, your journey to Associateship has now been accelerated through the PMI Pathways.

Log on to your personalised member portal now to see how far along you are on your PMI professional journey. You may find that now you are only a couple of exams away from being eligible for Associate membership.

Following the launch of the new portal, the membership team has been working hard to enhance your existing membership benefit offerings.

CV and interview support

Get in touch with the PMI Membership Team at membership@pensions-pmi.org.uk if you would like support with interview skills or your CV and we will put you in touch with a recruiter specialising within the Financial sector.

Affinity Discounts

NEDonBoard
Have you recently become a non-executive director or board member? Did you know you can receive a 15% discount for training courses with NEDonBoard.

Portfolio Institutional
We have partnered with Portfolio Institutional to offer all Associate and Fellow members a free monthly subscription of their magazine. More than 6000 copies of their print magazine are distributed each month to pension fund trustees, asset managers, investment consultants and related industry readers. To find out more and request a free subscription click here.

Totum PRO
All our members can benefit from hundreds of discounts and savings from a range of products and services with a Totum PRO card. Click here to find out more today.

HMCA
Are you paying too much for your present private medical plan? The PMI have partnered with HMCA to offer all members discounted rates for medical plans, dental plans, hospital cash plans, travel plans, income protection and vehicle breakdown products.
Click here to find out more.

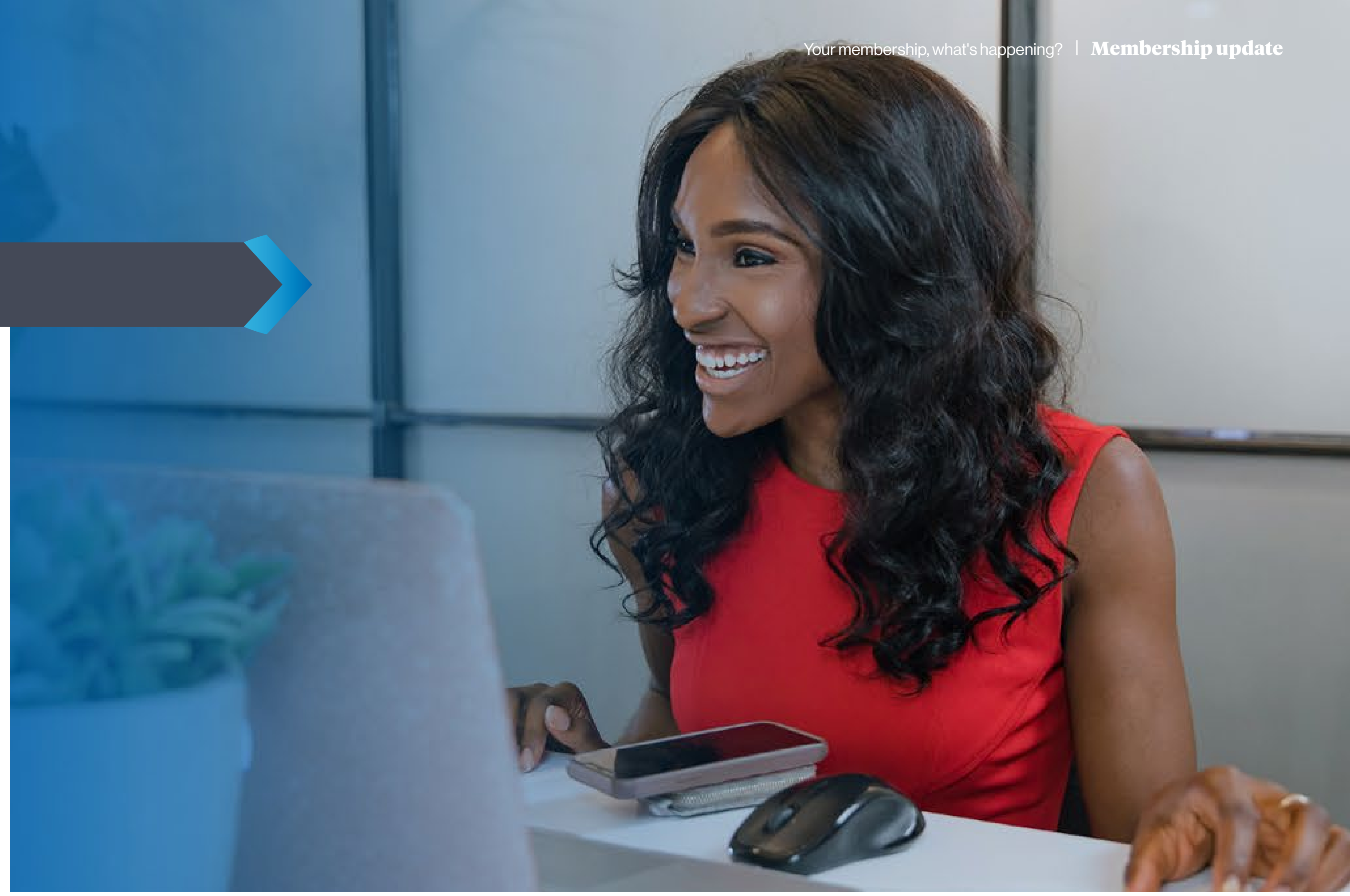
CIPP - Affiliate Membership

We are thrilled to announce we have partnered with the Chartered Institute of Payroll Professionals to deliver enhanced value to members of both organisations. The partnership will also support PMI members with payroll functions in their role and help those wishing to expand their own professional understanding of this area. All active PMI members who would like the additional CIPP benefits included can have this membership bolt-on added for an extra £50 per annum.

Benefits include:-

- Access to CIPP Advisory Service – 12 enquiries per year
- Online Professional in Payroll, Pensions and Reward magazine
- Discount on CIPP training courses
- Payroll-related collateral
- Networking opportunities on CIPP's Specialist Interest Group
- CIPP's payroll jobs board
- Free attendance at online BeKnowledgeable webinars

We will be discontinuing the existing PMI affiliate membership on the 31 October 2023. If you would like to retain your PMI affiliate member benefits and have access to exclusive benefits from the CIPP get in touch.



Membership Renewal

Your **2023-2024** membership becomes due on **1st September 2023**. Renewal notifications will be sent out to all student, professional, associate, and fellow members shortly and will include a copy of your renewal invoice.

Please ensure the contact information is up to date via your 'My PMI' member portal. If you have any problems accessing the PMI member portal, please contact us at membership@pensions-pmi.org.uk.

PMI Membership Fees 23/24

Membership Category	Fees 2023/24
Student	£178
Professional	£255
Associate	£385
Fellow	£475
Retired/Non-Working	£75

PMI Student Essay Competition update

We would like to thank all participants who have recently taken part in our 9th Student Essay Competition sponsored by ITM.

The winners will be selected in the next couple of weeks and you will be able to read the winner's essay in the August edition of Pensions Aspects magazine. The winner will also receive £1000 prize money and two runners up will each take £250. For more information on the 10th competition and final one for 2023 please check our dedicated webpage here.

Congratulations to all our recent membership upgrades

Fellowship upgrades

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

We are pleased to announce that the following Associates have been elected to Fellowship and are now entitled to use the designatory initials "**FPMI**"

Joanne Rayner

David Brown

PMI Academy Qualifications Update

Autumn 2023 exams

The PMI has opened for the Autumn 2023 exams. Don't miss out and book now, to secure your place onto an exam, as bookings are subject to maximum capacities.

Bookings close on Monday 17 July.

The PMI will be holding Autumn exams on the following dates:

- Certificate in Pensions Calculations (CPC): 18th – 22nd September 2023
- Retirement Provision Certificate (RPC): 26th September 2023
- Award in Pension Trusteeship (APT): 27th September 2023
- Advanced Diploma in Retirement Provision (ADRP): 6th – 13th October 2023

Please review the booking information carefully on each of the booking pages (before making a booking), as you need to ensure you have the correct device compatibility to sit the exam.

Please note, due to high volumes, your exam time could differ to the timetables on each booking page, to ensure a smooth onboarding experience while taking your exam.

The PMI encourages each learner to book onto a revision course to help prepare for the Autumn sittings; these have been available to book since 24th April.

We encourage all learners booked onto the ADRP to take part in assignment submissions, as this is an ideal way to practice questions from the manuals and have them marked by a tutor, to receive individualised feedback.

If you would like any guidance on our qualifications, please contact the qualifications team directly: PMIQualifications@pensions-pmi.org.uk

PMI Regional Group News

Southern Regional Group

Mark Hodson
Communications, PMI Southern Regional Group

PMI Southern Group's next meeting is on Tuesday, 20th June 2023 at 6pm

To be held at: RSM, 1 London Square, Cross Lanes, Guildford, GU1 1UN

DB Pension Consolidation

DB pension consolidation is now available and many smaller schemes are looking at the pros and cons.

Kim Toker, Chief Operating Officer at Clara Pensions will explain how the consolidation process works and how the covenant and member security can be maintained.

For more detail, please contact Mark Hodson, CPD Chair at mhodson@omniumbenefits.com

Events

The view ahead for PMI Events 2023

PMI is hosting a range of pensions-industry-leading events for 2023. With industry specialists delivering the best insights and knowledge to flagship events such as The Pinnacle Awards, excellent networking opportunities and extensive partner exhibition and sponsorship packages. For further details please select from the list below or see pensions-pmi.org.uk/events for the full programme.

20 June 2023
Pensions Certificate in ED&I

21 June 2023
Pensions Aspects Live

04 July 2023
Pensions Practitioner Training

13 July 2023
Retirement Matters Training Taster Session

18 - 19 Sept 2023
Introduction to Pensions (Basic)

20 - 21 Sept 2023
Introduction to Pensions (Advanced)

25 - 27 Sept 2023
Secretary to the Trustee (Basic)

28 - 29 Sept 2023
Secretary to the Trustee (Advanced)

4 October 2023
PensTech & Admin Summit (virtual)

12 Oct 2023
Retirement Matters Training Taster Session

2 Nov 2023
Trustee Workbench

23 Nov 2023
The Pinnacle Awards

7 Dec 2023
ESG and Climate Summit

PMI Activities

PMI Pathways

Gareth Tancred
Chief Executive Officer, PMI

Unlike many other professional bodies, PMI caters for a wide variety of different professionals. It seems odd therefore that our core qualification, the Advanced Diploma, has for many years been more aligned to certain parts of the profession than others. This was the only route to Associateship and ultimately Fellowship. Coupled with that, we've had a complicated member grade structure – 9 grades in total! Some grades seemed like a dead-end with no opportunity for progression, for example, if you passed a certificate or diploma level exam, you could become a Certificate or Diploma level member respectively. However, these grades didn't lead directly to Fellowship – you still needed to complete the Advanced Diploma. For trustees completing our trustee exams, there was no higher recognition than Certificate, unless they took the Advanced Diploma separately. As the body with more trustee members than all others combined, this made no sense. In fact, it seemed we had lots of different qualifications, all for different careers, but only the Advanced Diploma, which seemed to lend itself to one career path, led to Fellowship.

But now, that all changes.

Benefits

Part of our new Strategic Plan is to simplify our offering and to be more inclusive. What better way than to rationalise our member grade structure and open the route to Fellowship to as many as want to achieve it regardless of their chosen career or specialism. Pathways opens up five routes to Fellowship based on which career path you're following. Exams and modules are grouped into career paths relevant to your chosen career. Pathways also condenses and simplifies the grade structure so progression from Student to Professional to Associate and on to Fellowship is easy to follow with no dead ends.

Vision for Pathways

Pathways demonstrates that we are committed to your success. We will support your career progression though high-quality education including qualifications. We are relevant to your present and will prepare you for the future. If you're already an Associate or Fellow, Pathways won't affect you directly. However, we'll still support your learning needs through excellent Continuing Professional Development.

By the time you read this, Pathways will be live, and you'll be able to log into the member portal and see your journey so far. You can plan your way forward with modules and exams in your chosen pathway and supplement your learning with events.

I'd like to thank our members and learners for your input to this project over the last 18 months; also, our staff and volunteers who have worked tirelessly to bring Pathways to reality. We're very excited about other aspects of our new Strategic Plan, and we'll be unveiling a lot more soon – watch this space.

PMI Activities

Educating to invest or investing in education?

Dr. Keith Hoodless
Director of Lifelong Learning, PMI

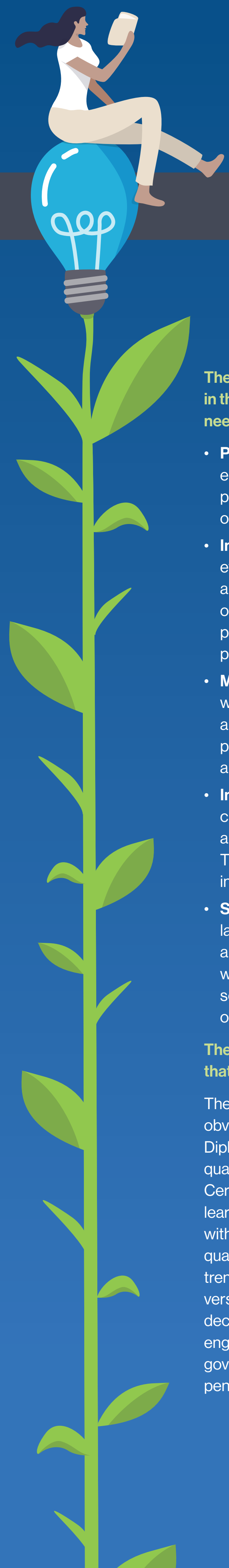
Pension funds are a cornerstone of the economy, helping scoop up huge amounts of stocks and bonds issued by companies that need cash to operate and grow.

With the recent LDI crisis and the rush to sell 'the family silver' it is now evident that investment strategies have to be realigned and rethought. LDI has worked in times of steady markets and rates, but has been found wanting when markets move suddenly, potentially freezing pension funds as happened recently.

The right investment strategy for a pension fund should strike a balance between generating high returns and managing risk. Investing too conservatively may result in low returns that may not keep up with inflation, while investing too aggressively may expose the fund to significant losses that can jeopardise its ability to meet future obligations.

Therefore, selecting the right investment mix, diversifying the investments, monitoring performance, and adjusting the strategy as needed, are essential components of managing a pension fund effectively. This is why correct investment is important to pensions, and why educating Investment Managers and Trustees is ever more important in that mix of events.

Investment Managers and Trustees are expected to manage the pension fund's investments in accordance with the fund's investment objectives, risk tolerance, and other guidelines established by the trustees or managers of the pension fund. They are also required to adhere to any legal or regulatory requirements that may apply to the fund. The main fiduciary duty of any trustee is to work in the best interests of the scheme member(ship) and for that they need the necessary tools and knowledge to be able to do so, and now in a more ethically responsible way than ever before.



The PMI offers a lot of education and training in this area and is developing more to meet the needs of regulation:

- **Professional development programs:** Those engaging can participate in professional development programs, such as courses and training programs offering webinars, training sessions or conferences.
- **Industry events:** Those engaging can attend industry events, such as conferences and seminars, to learn about the latest trends and developments in the field of pensions and investments. These events also provide opportunities for networking and sharing best practices with other investment professionals.
- **Mentoring programs:** Those engaging can be paired with experienced mentors who can provide guidance and support as they navigate their roles. Mentoring programs can help those engaging develop the skills and knowledge they need to succeed in their roles.
- **Investment research and analysis:** Those engaging can stay up to date with the latest research and analysis on investment strategies and asset classes. This includes reading academic research papers, investment reports, and industry publications.
- **Special Interest Groups (SIGs):** A community within a larger organisation with a shared interest in advancing a specific area of knowledge, learning or technology where members cooperate to affect or to produce solutions within their particular field, such as Trustees or Master Trusts.

The PMI also has a number of qualifications that support the market in this area.

The Diploma in Pensions Trusteeship (DPT) is the obvious starting point, as well as units of the Advanced Diploma, however we are at the delivery point of a new qualification in Environmental and Social Governance (at Certificate and Diploma level). This qualification will allow learners to develop knowledge of responsible investment within the pensions sector. As they progress through the qualification they will be able to recognise ESG issues, trends and themes and compare traditional analysis versus ESG analysis and how this relates to investment decision making. It identifies the role and outcomes of engagement, the key material impacts of corporate governance, and the requirements for ESG reporting for pension schemes.

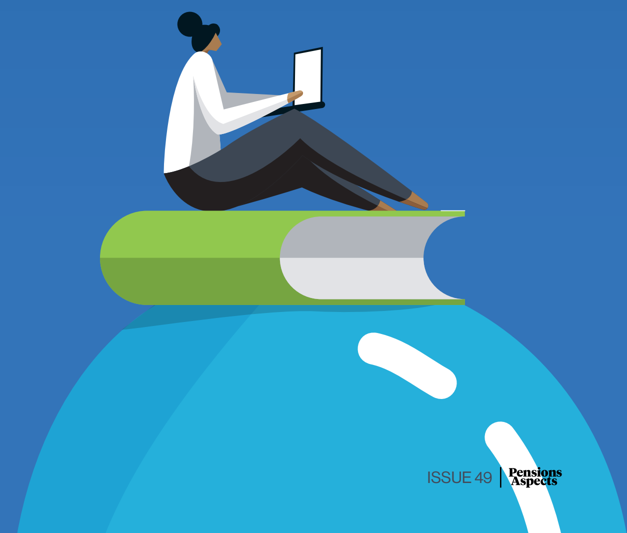
We have also developed a Level 4 qualification in TNFD requirements (which is inclusive of TCFD training). This purpose is to provide the knowledge necessary to build a risk management and disclosure framework that can be used by organisations of all sizes in all jurisdictions to identify, assess, manage and disclose nature-related dependencies, impacts, risks and opportunities. It is designed to support more informed and robust capital allocation decisions and active ownership strategies based on clarity, confidence and trust in data relating to nature-related risks.

Having qualifications and training can also demonstrate expertise and professionalism, which can enhance the credibility and value of the individual or organisation managing the pension fund. It can also provide confidence to stakeholders that the pension fund is being managed appropriately and with the necessary knowledge and skills.

It's not all about the qualification though, as experience plays a large part, and we are not shy of that understanding. Pension fund managers and Trustees need to make informed investment decisions to ensure that the pension fund is well-funded and can meet the obligations to those who rely on it for retirement income.

The PMI, providing services to over 1000 trustee members, has the firm belief that a combination of formal education (i.e. a qualification or training) combined with this experience, professional development and involvement (e.g. via a SIG) can help those Managers and Trustees engaged in the investment of pension scheme funds to develop the skills and knowledge they need to make these informed investment decisions and manage pension fund assets they control more effectively.

Please contact me if you require any further details: khoodless@pensions-pmi.org.uk



Feature

Smoothing risk transfer transactions

Rachael Savage
Client Director, Cardano

Most UK defined-benefit pension schemes have found themselves in a situation where their "endgame" is now far closer than previously anticipated. Due to improving funding levels – principally driven by higher gilt yields and lower longevity assumptions – the pace at which schemes are seeking access to the insurance market (or other forms of risk transfer) has increased.

A vital component to success of any transaction will be having the right structure in place for the scheme's investment portfolio. A forward-thinking approach can help improve cost-efficiency, reduce execution risk and make the scheme more responsive to changing market conditions. A significant part of this transformation can be done through the scheme's LDI portfolio.

What are the issues in preparing an investment portfolio for the endgame?

1. The allocation between growth assets and matching assets.

Growth assets and matching assets play different roles as the scheme's journey plan progresses:

- Growth assets generate excess returns to help close a funding gap alongside deficit repair contributions made by the scheme's sponsor
- Matching assets stabilise the scheme's funding ratio by mimicking the performance of the scheme's liability benchmark

Ahead of settlement, the proportion of the overall portfolio that is dedicated to growth assets can be wound down. As the funding gap is extinguished, and settlement becomes feasible, the growth assets have done their job.

Winding down the scheme's growth assets (or 'de-risking') shouldn't be thought of as a one-off exercise. A gradual approach is often useful. Investment risk should reduce in step with the scheme's improved funding position. This is particularly true when illiquid investments have been used.

A pre-planned approach to de-risking can make the latter stages of the journey plan more predictable as the overall investment portfolio collapses into a composition entirely made up of matching assets.

2. The purpose of the matching assets

As settlement nears, the role of the scheme's matching assets subtly changes.

Throughout most of the scheme's journey plan matching assets have been mimicking the performance of an actuarially calculated liability benchmark.

When close to settlement, the matching portfolio needs to closely replicate the agreed portfolio of assets that dictate how the insurer's premium will move in the weeks before the transaction (the 'price-lock' portfolio).

This change needs to be reflected by a rebalancing of the portfolio of matching assets. How accurate this rebalancing can be depends upon the structure of the scheme's portfolio (and how the chosen insurer(s) and the scheme's investment manager(s) work together).

3. The structure of the portfolio of matching assets

There are two general approaches to how matching portfolios are structured – segregated and pooled.

Pooled funds are often thought to be cheaper and operationally simpler than the segregated approach. But, this is not always the case. Whilst the drawbacks of pooled funds came into focus during the gilts market crisis of 2022, there are also reasons why the segregated approach has benefits during risk transfer transactions:

- The precise rebalancing that is required is more easily achieved with a segregated approach – particularly when the matching portfolio comprises both government and credit securities
- Insurer's price-lock portfolios are typically a specific basket of gilts and corporate bonds or interest rate swaps. The use of pooled funds can therefore introduce greater risk of divergence between the premium payable and the value of the scheme's assets over the price lock period.
- An in-specie transfer of scheme assets to an insurer is a more practical option when they are held in a segregated portfolio

Please get in touch if you have any questions or would like to discuss how Cardano can help you.

Feature

New Opportunities to Champion Social and Policyholder Responsibility

Adrian Smith, OBE
Chief Executive, Reclaim Fund Ltd

The successful Dormant Assets Scheme is expanding beyond banks and building societies, with dormant insurance and pensions assets next in line. Joining the Scheme is a unique way of demonstrating social responsibility and harnessing dormant assets for good, with nearly £900m already distributed to social and environmental initiatives across the UK.

There are many reasons why people lose track of pension and life insurance policies – and why providers lose track of policy holders. Many of us move house many times in our lives, we lose paperwork or simply forget about old policies. After a number of years, these funds become 'dormant'. But what happens to this money? And if people do discover old paperwork, either for their own policy or for someone who has died, can they get it back? As of this month, pensions and insurance companies can use dormant policies to benefit good causes across the UK – whilst making sure that policy holders or their beneficiaries can reclaim their money at any time in the future..

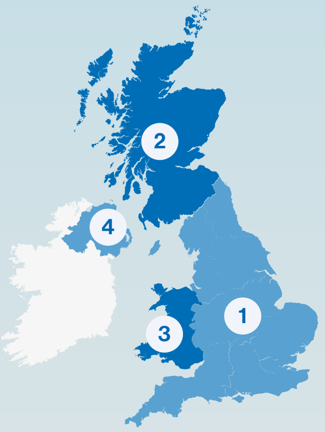


Figure 1.
Where does the money go?

1. Financial inclusion; Youth; Social Investment; Community Wealth Fund
2. Young People (Youth Start Programme)
3. Climate change; Environmental; Sustainability; Young People
4. Increase the capacity, resilienceand sustainability of the VCSE2 sector

About the Dormant Assets Scheme

In 2011, Reclaim Fund Ltd, or RFL, first launched the voluntary Dormant Assets Scheme to banks and building societies. Those that have chosen to participate – of which there are now over 40 – including all the major high street banks, first try to reunite dormant accounts with their owners or beneficiaries. Where these efforts fail, they transfer the value of dormant accounts to RFL. At RFL, we do two things:

First, we guarantee the rights of account holders or beneficiaries to reclaim the value of their account – plus any interest that has accrued – at any time in the future. We do this by retaining a portion of the value of dormant assets that have been transferred to us.

Second, we transfer the money that is not required to cover future reclaims to the National Lottery Community Fund, which distributes these funds to charities and social initiatives in each of the four countries of the UK (figure 1).

Up until 2022, banks and building societies transferred over £1.6 billion to RFL, of which nearly £900m has been distributed to over 2,500 social and environmental initiatives across the UK, transforming communities and changing lives.

Demonstrating social responsibility

Based on the success of the Scheme, the government passed the Dormant Assets Act 2022 to expand this opportunity to dormant assets held by other financial institutions, starting first with the insurance and pensions sector. Aviva plc has been committed to supporting the expansion effort and pave the way for the start of an exciting new chapter. Kirsty Cooper, Group General Counsel and Company Secretary, Aviva says,

"We have been working proactively with RFL and the wider dormant assets ecosystem for an extended period to expand the hugely successful Dormant Assets Scheme to the insurance and pensions sector. It is great to see this work reaching fruition, and we hope that Aviva's support will encourage other companies to take part. The more companies that choose to do so, the greater the positive impact that dormant assets can have on our society."

Initial, conservative estimates suggest that as a result of expanding the Scheme to new sectors, a further £880m could be available for good causes, at a time when many people are struggling with the cost of living.

There are many reasons why insurance and pensions providers may choose to join the Dormant Assets Scheme. Firstly, these dormant assets are no longer held on the balance sheet, and the liability for future reclaims passes to RFL. Secondly, and most significantly for most participants, harnessing the value of dormant assets for good is a unique way of furthering companies' environmental social and governance (ESG) agenda and demonstrating social responsibility - both towards policy holders and society more widely – at no cost to the participating organisation.

"The Scheme is a perfect example of what happens when the public, private, and civil society sectors come together, in partnership, to drive change and support those most in need."

Lucy Frazer, KC, MP, Secretary of State, Department of Culture, Media and Sport

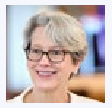
Participating in the Dormant Assets Scheme is straightforward. All participants have the same agreement in place, which outlines both RFL's and the financial institution's responsibilities. Every year, a participant can choose to transfer the value of assets that have become dormant to RFL. Having done so, if a customer subsequently comes forward to reclaim their money, the financial institution repays the customer as required, which RFL in turn reimburses.

If you would like to find out more about the Dormant Assets Scheme, and harness dormant assets in your organisation for good, please contact me or my colleagues at RFL.

How is dormant assets funding allocated?

Dormant assets funding is allocated in line with spend priorities determined by the Secretary of State for the Department of Culture, Media and Sport, and must be subject to the principle of additionality. That means that dormant assets cannot be used to fund government obligations. In England, the government recently confirmed that funding would continue to be used for financial inclusion, youth and social investment, together with a new community wealth fund. There are four organisations that distribute dormant assets funding: Fair4All Finance, Youth Futures, Big Society Capital and Access – Foundation for Social Investment.

"I'm delighted with the Government's new announcement on future dormant assets funding. The expanded Scheme will help to make a real difference to the lives of those people who need it most across society, freeing up millions of pounds at a time when financial hardship is a real cause for concern, and I welcome the news that financial inclusion will receive additional funding to support this."



Kirsty Cooper, Group General Counsel and Company Secretary, Aviva

INDUSTRY CHAMPION FOR THE INSURANCE AND PENSIONS SECTOR

INTRODUCING RECLAIM FUND LTD (RFL)

RFL has managed the Dormant Assets Scheme since its inception in 2011. Its purpose is to unlock the potential of dormant assets to enhance communities and enrich lives, whilst safeguarding the rights of dormant asset holders.

RFL is a not-for-profit public body owned by HM Treasury. It operates as an independent legal entity, acting at arm's length from the government with a separate Board of Directors. RFL is FCA-regulated, with the rights of dormant asset holders guaranteed by the UK government.

A final word from RFL's Chief Executive

"The Dormant Assets Scheme has always been about people: protecting the interests of consumers by ensuring the perpetual right of reclaim, and harnessing dormant assets funding to empower individuals and communities to achieve their potential. Through the expanded Dormant Assets Scheme, we expect that a further £880 million - and potentially far more, could be made available to dormant asset organisations who fund vital work in our communities."

How to go about aligning a pension scheme's approach to climate change to the Sponsor | Feature

Feature

How to go about aligning a pension scheme's approach to climate change to the Sponsor

Martin Mannion
Director, Mannion Pensions Ltd

Key points.

- Sponsors and pension scheme trustees should have much common ground in setting and meeting their climate change objectives. However, there are many legal and operational reasons why their approaches may have to differ.
- Setting a common net zero target date is a common aspiration that is not always possible or sensible to do.
- Both need to be aware of each other's beliefs, policies, and strategies and to be able to reconcile them and to be able to communicate them.
- The process of comparing and aligning views will help both in their risk approaches by identifying exposures that need to be managed.

The comments below are aimed at private sector schemes with commercial employers; public and third sectors will have their own similar and additional challenges.

The trustee's view.

Trustees of pension schemes in the private sector are rightly confused about what their obligations are towards climate risk. The core obligations of a trustee remain, be they fiduciary, statutory, or arising from the scheme deed and rules. The law and guidance impose some specific obligations towards considering the risks and opportunities arising from climate change along with governance and disclosure obligations.

What these additional regulations neither require nor permit are for the trustee to pursue any objectives or strategies that are not consistent with their overriding purpose of funding benefits. Trustees cannot pursue climate-based goals to the detriment of their fiduciary and other obligations towards members.

The sponsor's view.

Sponsors, particularly those who are not based in the UK, often struggle to fully appreciate how different running a scheme is from running a commercial company. This is leading to climate strategy setting becoming a contentious area as sponsors seek to get trustees to align their strategies to the corporate view. It is important to consider why a sponsor would want to do this:

- **Commercial risk:** Pension schemes usually have a wide geographic spread of assets to diversify sources of rewarded risk and return. This brings a very wide exposure to unwelcome ESG risks including climate change.
- **Reputational risk:** Climate change failures can lead to damage to brands and relationships and a loss of enterprise value.
- **Value alignment:** Many companies now "live" their values rather than seeing them as part of a brand or image.

Why are sponsors and trustees so different?

The main differences are set out in the table below:

	Pension Scheme Trustees	Sponsors
1. Activities	Investments in external companies.	Production, sale and distribution of goods and services.
2. Governing law and duty of care	Fiduciary duties with detailed supporting legislation and guidance.	Large amount of commercial freedom subject to local laws.
3. Resourcing	Most activity is performed by external providers: investment managers, custodians, banks, etc.	Usually operational entities, often with own fixed assets base and employees or control over outsourced activities.
4. Advisory Framework	Obliged to take and consider advice on funding and investments.	Generally free to set their own strategies and policies subject to local laws.
5. Time Horizons	Defined benefit funding is driven by a 3-year actuarial cycle linked to a longer scheme life and driven by market cycles.	Business cycle for revenue is often more annual with longer time horizons for funding and capital expenditure.
6. Geographic exposure	Usually global.	Can vary but most supply chains are global.
7. Ability to act	No operational control so influence is through corporate governance or divestment.	Freedom to change business models.

What are the benefits and drawbacks of aligning the climate change views?

Given that sponsors and trustees have such strong economic reliance upon each other, having a more detailed knowledge of each other's current risk positions and future plans can only help both to reduce their own and each other's risks across sectors, geographies, and counterparties.

What should sponsors and trustees be doing?

Trustees can develop their view on how the employer might be impacted by climate change in a number of ways:

- Corporate Reporting: Be aware of what the sponsor is saying and committing to in their reporting.
- Covenant impact: Every sponsor will go through its own climate change transition. The new draft funding regulations explicitly call this out as part of the covenant assessment.
- Corporate planning: Have an early dialogue with the sponsor; articulate to them what our views and plans are, why they are so and seek to have early sight of their plans.

Aside from the obvious covenant issues outlined above and the TCFD reporting, the trustee also needs to consider the following:

How can it factor in climate change into overall risk levels of investment and funding strategies? Climate change does not lend itself to traditional (or any) risk modeling so the trustee cannot consider them alongside the various other quantitative and qualitative risk models that it uses.

How can it identify opportunities? There are potentially large gains to be made from both financing parts of the solution to climate change as well as changing the product and service base to meet new needs. There may be equally large losses to be made from overstaying in legacy industries which do not adapt.

Conclusion

Trustees have a lot to do on climate change and TCFD reporting. Whilst the immediate concerns are around reporting, the actual heart of the issues are ones of governance and risk management. Early, frequent and meaningful dialogue with the sponsor is key to this.

Feature

Investment issues for pension schemes – a shifting landscape

Neil Bowden
Partner, Allen & Overy LLP

Investment issues are always high on the agenda for pension scheme trustees – it's a fundamental part of the job. Fiduciary duties and trustee powers have remained fairly consistent over the years, but market conditions, political pressures and regulatory changes make this area more complex (and more interesting) than ever. This article takes a look at some of the latest issues.

Sitting down to write this article, I wondered how an AI tool would summarise current investment issues for pension scheme trustees. So I tried it, and it suggested that I should talk about stewardship, engagement, and incorporating environmental, social and governance (ESG) factors into pension scheme investing. Of course, that's all fine as far as it goes – but it only goes as far as September 2021, which is the cut-off point for the information on which current iterations of ChatGPT and its next-gen cousins (such as Allen & Overy's Harvey) base their responses.

Although trustee fiduciary duties on investment have remained broadly consistent for decades, the agenda has changed significantly in the last 18 months, and trustees are working hard to keep pace with a period of significant disruption and heightened regulatory focus on investment issues. In this article we'll focus on three key themes: liquidity, illiquidity and sustainability.

Liquidity – the ripple effect continues

First, liquidity. Trustees of defined benefit schemes will think immediately of the crisis in the gilt markets in autumn 2022: most schemes were impacted one way or another, with the most acute issues affecting schemes with significant liability-driven investment holdings. In some cases, the LDI crunch exposed deficiencies in cash management plans and processes, a lack of clear information about the relative liquidity of investments, or a need to plan for contingency cash calls. The balance of liquid to illiquid investments is likely to have changed for affected schemes, and may require a wider review – particularly with further regulation anticipated around minimum collateral requirements and, in the bigger picture, a new DB funding framework due to go live shortly.

The headline impact on DB schemes does not mean that DC schemes and savers were unaffected, of course. Market volatility, falling bond values and rising inflation and interest rates make a difficult mix for DC members who are close to accessing their savings. The Pensions Regulator (TPR) has issued guidance on supporting DC savers in the current economic climate including an expectation that trustees will review their investment advisers' remit and objectives to ensure that delivering good saver outcomes is a priority, rather than just keeping costs and charges down. DC pensions are a long-term investment, but this may be a good time for a review of your scheme's strategy and fund choices. Above all, good communication with members is key: market swings may make cash look like a 'safe' alternative, but members may underestimate the negative impact of high inflation rates.

Gains in illiquids?

Secondly, illiquid assets - in a counterpoint to the liquidity concerns above, the government is keen to see DC schemes exploring long-term illiquid investment as part of a diversified portfolio. 'Illiquid assets' here means assets 'of a type which cannot easily or quickly be sold or exchanged for cash', including any such assets held in a collective investment scheme. The government's goal is to release capital to invest in tech start-ups and infrastructure, but it suggests this can also offer greater returns for pension savers - a potential win/win. Regulations to support this are now in place: relevant DC schemes are required to disclose and explain their policies on illiquid investment in the next revision of their default fund statement of investment principles after 1 October 2023, and the percentage of default fund assets allocated to different asset classes must be disclosed in the chair's statement for the first scheme year ending after 1 October 2023.

Sustainability – now and next

Climate change has been a key investment theme in recent years; master trusts and all schemes with £1bn+ in assets are now within scope of detailed TCFD* reporting requirements relating to the climate change impact of their investment holdings. TPR's review of reports published to date flags a number of pitfalls that could lead to penalties, and is a must-read for trustees of all in-scope schemes. And trustees of schemes that are not in scope still need to be aware of TPR's 2023 initiative to check compliance with broader ESG and climate change reporting requirements in their scheme's statement of investment principles and in implementation statements.

But TCFD reporting is only the start of the story: the government's updated Green Finance Strategy recognises the key role of pension scheme trustees (governing over £3 trillion in UK pension investments) and that climate change and the actions that governments globally take to tackle it, present a financial risk/opportunity for pensions. Coming back to where we started, a new working group will look at clarifying trustee fiduciary duties in relation to taking non-financial factors into account in investment decisions. This matters because wider reporting on sustainability issues is firmly on the cards for the future. A new Taskforce on Social Factors (TSF) was formed in February, aiming to help trustees seize the opportunities of the 'social' element - the 'S' in ESG - in the context of pension scheme investments. This goes beyond environmental and climate change issues to include issues such as workforce conditions and supply chains, community engagement, consumer protection and modern slavery.

So – a whole range of complex issues is on the trustee agenda, requiring careful work with your investment and legal advisers. Let us know if we can help!

* Taskforce on Climate-related Financial Disclosures

Feature

Adapting to meet a lower growth outlook

Derek Steeden
Portfolio Manager, Invesco Solutions

Paul Jackson
Global Head of Asset Allocation Research, Invesco Solutions

Following a year characterised by inflation, aggressive central bank hiking and geopolitical turmoil, it was clear to many that the outlook for 2023 would hinge on inflation. Specifically, had it peaked? And, if so, when would central banks start slowing, pausing and ultimately reversing rate hikes.

Some of the challenges in the banking sector underscore the policy tightrope that central banks face: they must think as much about financial stability as inflation. Further tightening means the risk of an earlier and potentially deeper recession. But if central banks do not hike rates, inflation moderation going forwards may not be satisfactory enough. In turn, this would force the resumption of a more aggressive and/or lengthier tightening cycle which could threaten financial stability further, prolonging the time before an economic recovery could start.

It will be 12-18 months before we know for sure whether the central banks got it right. In the meantime, an estimated £60-90bn of defined benefit pensions will have been paid, a similar amount transferred to insurance companies and £30-50bn new defined contribution assets invested[1]. How can pension schemes adapt?

[1] Source: Office for National Statistics as at 31 September 2021

Our base case scenario

Our views on asset allocation reflect our thinking that we're now in the 'contraction phase' of the economic cycle. The global economy, simply put, is entering a period in which economic output declines.

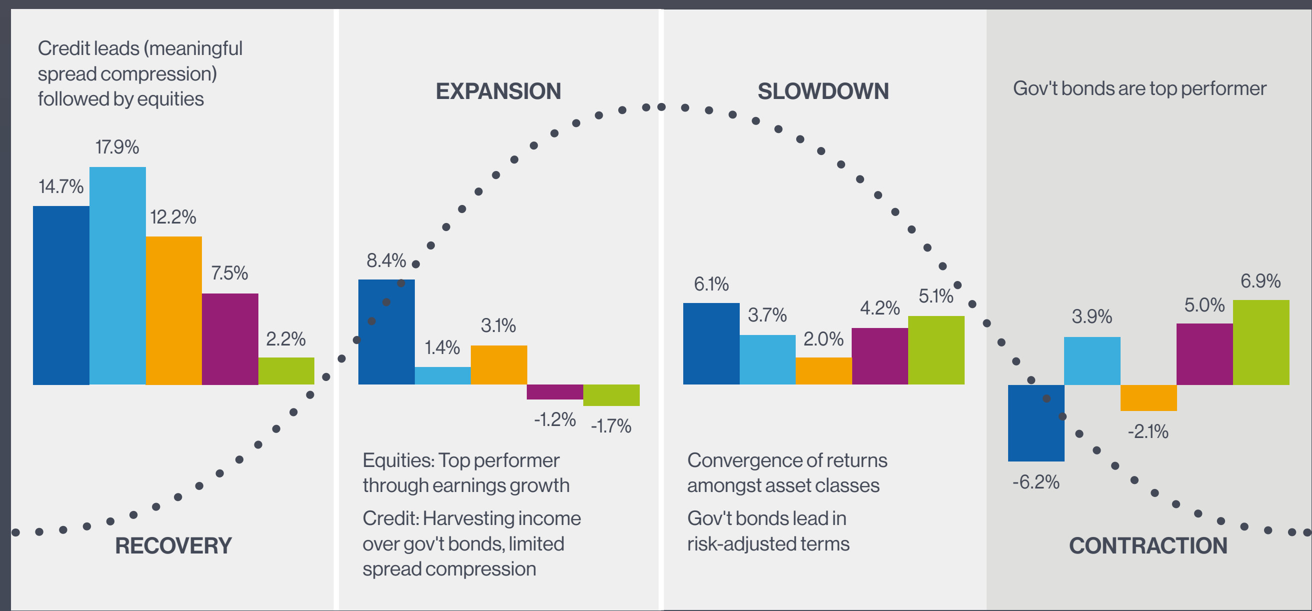
We think the US Federal Reserve interest rates will likely be lower in 12 months (even if they rise in the meantime), European rates little changed and that major Asian policy rates could be marginally higher.

Underpinning our projections for the next 12 months are the following views:

- Global economic growth continues to slide, with China an obvious exception
- Global inflation will fall but remain above many central bank targets
- Commodities struggle as the global economy slows (except agricultural products)
- The US dollar weakens as the Federal Reserve ends its rate increases

In this contraction environment, equities have historically struggled, with fixed income and especially government bonds performing strongly. Should recessionary concerns rise and interest rate expectations fall, defined benefit schemes' funding gains will fall and bulk annuity pricing rise (all else equal). Defined contribution members seeking to buy an annuity could see the income they can purchase fall from a combined equity fall and bond gain, with the impact more mixed for funds in steady state with a diversified mix of assets.

Historical excess returns on US assets during the economic cycle



Notes: Index return information includes back-tested data. **Returns, whether actual or back tested, are no guarantee of future performance.** Annualised monthly returns from January 1970 - December 2021, or since asset class inception if a later date. Includes latest available data as of most recent analysis. Asset class excess returns defined as follows: Equities = MSCI ACWI - US T-bills 3-Month, High Yield = Bloomberg Barclays HY - US T-bills 3-Month, Bank loans = Credit Suisse Leveraged Loan Index - US T-bills 3-Month, Investment Grade = Bloomberg Barclays US Corporate - US T-bills 3-Month, Government bonds = FTSE GBI US Treasury 7-10y - US T-bills 3-Month. For illustrative purposes only.

Sources: Invesco Investment Solutions' proprietary global business cycle framework and Bloomberg L.P.

Alternative scenarios

We see three other potential challenges that could up-end our base case.

1. Deeper financial stability issues

The prolonged period of low interest rates shaped how many investors, especially some banks, measured risk. Resulting decisions will have been many and varied, but a common theme is that large and sudden changes in interest rate expectations were simply not in the data set - whether smaller US banks deciding not to hedge duration risk when investing customer deposits or pooled LDI funds when setting governance processes.

The US now has additional deposit guarantees to stem bank runs and the Bank of England have issued their advice on higher LDI liquidity buffers. But we suspect these may be a case of learning too specifically and central banks may not have foreseen all potential problems.

2. Persistent inflation

Our view that inflation is likely to moderate could be wrong. Limited and specific trade barriers such as semiconductors, grain and oil could become more widespread and permanent if geopolitical tension in Eastern Europe and between the US and China deepen. Aggressive interest rate hikes could become unavoidable despite the recessionary impact. We believe such a dramatic scenario would benefit the US dollar and US assets. We suspect that Asia (including China and Japan) could be sheltered to some extent under such a scenario due to their low inflation, thus allowing their equity markets to outperform.

In this scenario, exposure to real assets will be important. Index-linked gilt yields have risen dramatically in the last 12 months and now offer positive real returns at some maturities. Nevertheless, most DC and DB schemes aspire to growing assets above inflation. Real estate is a key source of real returns, but careful thought to the fund vehicle used is essential to manage liquidity risks as well as ensuring the client base is not overly concentrated towards pension schemes who might wish to exit at the same time.

3. Challenges around diversification

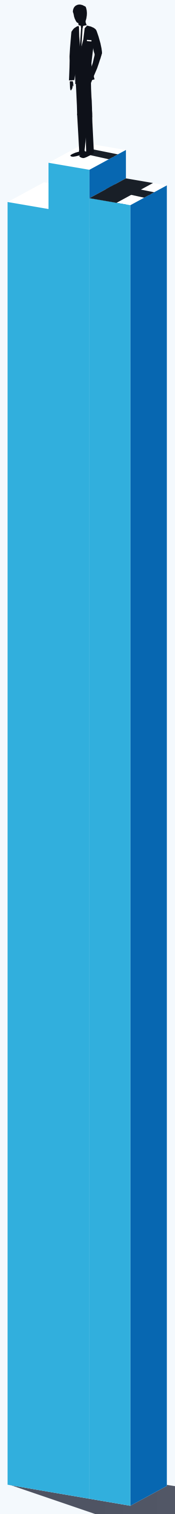
2022 may have been a poor year for traditional diversification, with a 60/40 equities/bonds portfolios having the worst annual performance for a century to October 2022. But we may not be out of the woods yet – if a second wave of interest rate hikes in 2024 do turn out to be required to tame inflation, bond and equity returns could again be simultaneously challenged.

In this environment, alternative investment strategies may be needed to enhance portfolio diversification, by increasing exposure to alternative sources of returns such as specialist underwriting, investment in harder-to-access fields or smaller enterprises.

For portfolios in decumulation, a close focus on sequencing risk is vital. Portfolios which continue to pay out through negative performance struggle to recover as the lower residual balance must work harder to recover the loss. Cash and short-duration investment grade assets are clearly a key part of the toolkit, but they are unlikely to keep pace with inflation and can simply bring forward the time at which losses are crystallised. Holding bonds to maturity can provide material defence against sequencing risk as mark-to-market movements are not crystallised, allowing the credit spread to be earned to maturity.

Whatever the future holds, we expect to see continued focus on appropriate governance for this new world, with a greater focus on simplification, specialisation and collaboration between stakeholders.

EPMI Column



Why the PMI is important to me

Girish Menezes
Head of Pensions Administration, ISIO

The Pension Management Institute has been a major part of my professional growth for over fifteen years. The journey began following a chance conversation with Anne Jones of Ross Trustees, which led to my decision to stand for election to the PMI's London Regional Group committee. The vibrant and dynamic nature of the Group resonated with me and I found the engagement extremely fulfilling over the years.

My professional journey had been varied and I took an untypical route into my career in pensions administration. It began at Fergusson College, where I studied for a BA in Philosophy, Psychology & Economics. Swiftly after, I began working towards my Masters in Analytical Philosophy where I focused on Eastern/Western mysticism whilst working full-time managing a marine processing plant. Following this, I completed my second Masters, studying Management & Strategy at the London Business School.

Throughout my education and proceeding into my professional career, I found events essential for professional and personal networking. I have found PMI events to be well attended and an excellent opportunity to build a large network of like-minded people. Some of my closest friends in the pensions industry sat alongside me on the committee or were regular event attendees.

On the recommendation of former PMI President and London Group Chairperson, Mike Sullivan, I began exploring different positions within the committee. The experience offered me a holistic understanding of how the group supported the PMI membership. As such, I intermittently held the Business, Social and Membership Secretary roles, going on to Committee Secretary and then Chair. The experience was incredibly valuable and I am indebted to so many people who supported and coached me through that journey. Tim Middleton – who now works for the PMI – was a key supporter who helped me understand the processes that enabled the committee to function optimally.

During my time on the PMI London Regional Group, I would revisit the APMI examinations regularly. While I was never able to commit, I remain a firm supporter of the PMI examinations and actively encourage my administration team to study for both the Certificate in Pensions Essentials and the Certificate in Pensions Calculation.

Senior staff, especially those evaluating a move to pension consulting, are pointed in the direction of the APMI. Building a future for the next generation of pension administrators is a responsibility I welcome; having supported Colin Fowler of WTW to establish the Pensions Apprenticeships we have a flourishing programme in our business at Isio.

After my resignation from the Chairmanship of the PMI London Group, Lesley Carline co-opted me onto the PMI Advisory council. However, becoming eligible for the EPMI allowed me to achieve a prolonged personal goal to become a full-fledged member of the Institute.

EPMI Column

EPMI Testimonial

Andy Seed
Interim Head of Business Development Investment, Phoenix Standard Life

So this year I celebrate 25 years in the pensions & financial services industries. My very own silver jubilee in a coronation year, with hair certainly more silver than it was when I started! Having originally begun my career post university selling pianos for Steinway & Sons in London, my first job in financial services was actually in response to a Sunday Times advert for trainee financial advisers at the Prudential. Relocating from London to Scotland, I studied for my FPC qualifications at the CII and originally trained as a financial adviser.

Here I stayed through several firms, before turning a more specialist hand to corporate advice at a firm called 3 Sixty Financial back in London, who at the time had been engaged by CIMA (Chartered Institute of Management Accountants) to advise their membership on the legislative impact of the introduction of Stakeholder pensions back in 2000. It was here I first met the senior leadership of the PMI (Vince & Terry, whom many of you will know) and begun studying for PMI. From here, I stayed within corporate pensions advice and spent the last 10 years of my consulting career at Mercer, Deloitte and KPMG (now Isio).

In some ways, I consider Mercer to be my spiritual career home, having stayed at Mercer between 2005 and 2011 where I also met my wife! However, having seen through the start of auto-enrolment at KPMG, I decided to change tack slightly and take my business development skills and knowledge of investment plumbing to asset management, starting at JP Morgan Asset Management. Here I led the distribution of their UK DC initiative, which was an exciting place to be at the start of the evolution of target dated funds.

From here I moved back to work for a pension provider, initially running strategic partnerships for the Zurich Workplace pensions business, before being rapidly promoted to lead the business through acquisition by Lloyds Banking Group in 2018. From there, I moved again to another workplace pensions provider in Aviva, before returning to asset management and leading the Aviva Investors c.£45bn UK DC franchise.

When I look back on my career, it's fair to say it's sometimes been a turbulent road, but an infinitely fulfilling one – in spite of the many tee shirts I now own. Despite having worked at several large and global actuarial firms, I have also managed to largely avoid the world of DB, which in the modern era gives me a longevity of experience in DC which I am proud to have accrued. Similarly, having worked in consulting, in asset management and at pension providers, I have something of a unique commercial perspective on how the industry plugs together and the market forces at play. Perhaps most important of all though, I have met some truly fabulous people who have become extremely good friends as well as professional contacts. Whilst my own story most certainly hasn't been a straight line, I hope it gives the readership a glimpse of a less conventional route through the industry!

Month in Pensions: Administration

Financial uncertainty in uncertain times

Mark Futcher
Partner, Head of DC and Workplace Wealth, Barnett Waddingham

Several new pieces of research from Barnett Waddingham have highlighted how the ongoing economic crisis has seen many people cut back on their retirement planning to keep outgoings down.

Below, we'll present the findings our new research has unearthed, and use them to highlight the key considerations employers and the Government need to make to protect pension provisions in the months and years to come.

The Employer

Almost half of UK adults aren't confident they'll have enough saved for a comfortable retirement.

- **Participation in workplace pensions has increased from 55% in 2012 to 88% in 2021**
- **Despite this, a massive 46% of people we surveyed are still not confident that they'll have enough for a comfortable retirement.**

Employers play a major role in how their employees cope during economic downturns, and not just in the obvious ways like pay. Providing an environment where employees feel confident to invest in their retirement plans is not only the right thing to do, but can incentivise them to stick with a company that has shown them support even when times are tough.

Next steps: Start gathering feedback from employees, ideally in face-to-face settings, to find out what can be done to help them maintain their pension savings (such as restructuring benefit packages).

The Government

Restrictive laws are allowing too many people to fall through the auto-enrolment gaps.

- **13% of working Brits are excluded from auto-enrolment altogether due to their income structure**
- **Of those entitled based on income – that is, in at least one job earning £10k a year – 11% have a DC pension which they're not paying into**

Too many people are being needlessly excluded due to restrictive legislation. Of the 13% of Brits excluded from auto-enrolment, 10% have one job which earns less than £6,240 a year (below the lower level of qualifying earnings - LEL), while 4% have multiple jobs all of which earn less than £6,240 a year. This is led by those in part-time work (30%) but is still true of almost one in ten full time workers (9%). It rises to 18% of those aged 55+ (and still working).

Next steps: There are two core problems with auto enrolment: not enough people saving, and people not saving enough. We would urge the Pensions minister to consider raising the auto-enrolment minimum threshold, and increasing the minimum employee contribution rate by 1% to push people towards the recommended 12% saving rate.

* Barnett Waddingham conducted a survey amongst 2,000 UK adults via Opinium Research. The survey was nationally representative and conducted in December 2022. Two separate surveys to 2,000 UK adults were conducted with the same question for Barnett Waddingham in June and September 2022.

Month in Pensions: Legal

ESG: Refinement and Revolution?

Andrew Black
Associate, Eversheds Sutherland

Since 2021, the largest pension schemes have needed to identify, assess and manage climate-related risk and opportunities and report on these.[1]

The new regime has made a huge difference – in providing a standardised framework, metrics and targets for pension schemes (and corporates / financial institutions more generally) to use to get under the skin of climate change considerations.

This complements other changes in pension scheme reporting requirements (for example, to schemes' statements of investment principles) which apply more broadly and place greater emphasis on environmental, social and governance issues – and their impact on members.

With the dust beginning to settle on these regulatory changes, now seems like a good time to reflect on what might be next in the ESG space.

Refinement

A key theme over the next year is refinement of climate-change reporting, as access to data improves and regulatory expectations evolve over time.

As the industry gains experience, the drive for better data (particularly in private markets and alternative asset classes) should help all schemes make more informed decisions.

One upcoming initiative in this space is the FCA's Sustainability Disclosure Requirements, which are aimed at clamping down on 'greenwashing' – this may improve the quality of information that trustees can collect on investments.

Additionally, the Transition Plan Taskforce, which was launched by HM Treasury in April 2022, provides a more robust proposed structure for pension schemes (and others) targeting net zero.

With the regulatory framework in place, and more data and tools likely to become available over time, the Pensions Regulator has said it will expect more from trustees over time.[2]

Revolution

Alongside refinement, we expect there to be more radical change as trustees broaden their focus onto other ESG issues.

An initiative of particular interest is the Taskforce on Nature-related Financial Disclosures (TNFD), which will allow companies and financial institutions to develop a better understanding of the issue of natural capital, and how their operations or investments impact or depend on nature. This Taskforce is due to issue its final recommendations in September this year.

While the TNFD requirements won't be subject to the same statutory and regulatory requirements (at least for now), the recommendations of the TNFD will provide a framework that trustees can use to take account of nature-related risks and opportunities in their investments.

While TNFD is most obviously next on the horizon, we expect frameworks and standards to develop across a range of ESG issues.

Ultimately, this is a case where the journey and incremental improvements matter, but so does ambition. We hope that the combination of incremental improvement and ESG expansion continues to improve outcomes for members and society at large.

[1] The Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021

[2] Great expectations: why trustees must be ready to step up on ESG and climate reporting | The Pensions Regulator Blog

Month in Pensions: Actuarial

High inflation – Pensioners are paying the price for our short-termism

Andrew Overend
Head of Investment, First Actuarial

A narrow focus on balance sheet stability combines with layers of legislation to shut down longer-term responses to inflation that worked well in the past. This short-sighted view is causing real damage to pensioners.

There is growing consensus that the current inflationary pressures will ease quickly. In years gone by, the inflation spike we're seeing today would have been a relatively trivial matter for pension schemes. They would have hedged inflation with investments in equities, with the expectation that these would outpace price increases in the long run.

Sadly, that long-term perspective has gone out of style. While the primary purpose of invested assets – to pay benefits as they fall due – remains unchanged, more immediate concerns now take priority. Trustees are keen to avoid any volatility that might result in tricky recovery plan negotiations. Sponsors, meanwhile, want to report a stable scheme funding position in their company accounts.

Investing in equities as a long-term inflation hedge holds little appeal. Protecting the short-term position is the order of the day, which is why LDI strategies remain popular.

At a time when schemes have never been so well funded – and the likelihood of paying benefits in full has never been greater – why is the dominant investment objective to reduce short-term risk?

The reality is that every layer of legislation makes it harder for trustees to take a long-term view. And it looks like the new funding code will only exacerbate this.

A sensible long-term investment approach would be to invest across a range of asset classes including some, such as equities and infrastructure, that offer a measure of inflation protection. That's exactly what I would expect from a Defined Contribution default strategy.

When it comes to Defined Benefit investment though, it's hard to avoid short-term pressures, and LDI – or even just index-linked gilts – are the best way of alleviating those. Any trustee daring to take a different approach is likely to fall foul of The Pensions Regulator's suggested low (short-term) risk approach once the scheme reaches significant maturity.

Most investment strategies are working as intended. And in a world where balance sheet stability is king, I'm not aware of any schemes that have suffered from the recent inflation spike.

But in the real world, there is one scheme stakeholder that is suffering – the pensioner.

Pension caps mean that recent increases have fallen well below inflation. With longer-term investment approaches, schemes may have awarded discretionary increases to help members through the current inflation period. The legislative framework makes it difficult to take a long-range view on investments, but doing so may be in members' best interests.

Feature

Best ways to invest in this environment

Lorant Porkolab
Trustee Director, Law Debenture

Well, the title above is a bit misleading, and potentially sensationalist. Realistically, there is never a single best way to invest, whatever the environment might be.

Yes, investment decisions are influenced by market conditions and the economic environment, and of course changes in these conditions can lead to changes in views on risks and opportunities, and in turn these can easily affect asset allocations. But investment decisions are also influenced by a host of other factors than market conditions, such as – to name only a few – your objectives, financial constraints, and investment time-horizon, and some of these may have a more material impact on your portfolio construction than shifts in economic conditions.

From the perspective of a defined benefit pension scheme in the UK, the best ways to invest is likely to be heavily dependent on your answers to the following questions:

- What is the role of your scheme in terms of benefit provision? Is it closed or open to new members? What are the cash flow characteristics and needs?
- What is your end-game strategy? Is it insurance buy-out as soon as possible or running on the scheme longer? Are you interested in a capital-backed journey or a potential transfer to a consolidator?
- What is your current funding position, and how far are you from your end-game target?
- How strong is your sponsor covenant? How much risk is the sponsoring employer able and willing to underwrite for the scheme?
- What is your risk tolerance or risk appetite? How much volatility can the scheme withstand?
- What are your liquidity requirements, in the short - or mid-term, as well as longer term?

I consider the investment implications of some of these on the next page, and how they may affect your asset allocation.

Feature

Targeting the "gold standard"?

For many pension schemes, the "good-old-tried-and-tested" insurance buy-out – often referred to as the "gold standard" – seems to remain the preferred end game target, despite recent innovations in our industry and the increasing number of options available.

This specific target can heavily influence and drive your investment objectives and decisions, especially if the expected time horizon to get within reaching distance of this target is all of a sudden materially shorter than what you expected. Many schemes have found themselves in this position, which is nice, but it also means that they need to revise their investment strategy promptly to reflect the shorter investment time horizon and ensure that the scheme can be ready to transact sooner than previously planned for. Often that means dialling down the risk of the overall portfolio to control the funding volatility and reducing allocation to less liquid assets, despite their attractive long-term risk return characteristics. After that your portfolio may not be optimal in the classical risk-return Markovitz framework, but rather tilted to reflect your time constraint.

This particular end-game target may also lead some schemes to invest over the run up to their insurance transfer in a way that is similar to the investment strategies of those insurers that the scheme is likely to transact with, as this may reduce the pricing volatility.

In light of the above, it would not be surprising to see those pension schemes that are targeting the gold standard over the next 3-6 years reduce their allocation to infrastructure and other private credit assets, either now or gradually, and shift their focus towards high-quality corporate bonds and more liquid fixed income investments. Some may still keep a relatively modest allocation to developed market equities that are highly liquid and well diversified, with the expectation to generate some extra return and bridge the gap between the scheme's current financial position and the "gold standard".

Having the luxury of time?

If you are not in any hurry to get to the gold standard, either because you don't have to or you cannot, and expect to have at least a couple of economic cycles on your hand to invest over, then you have potentially more flexibility and more options available to construct your portfolio.

For instance, if your scheme is open to new members or future accrual of benefits, or your employer covenant is sufficiently strong and you are likely to run on the scheme longer, then you can afford to have a higher allocation to illiquid assets, including infrastructure, real estate, private credit and private equity. Some of these assets attracted considerable attention prior to the turbulence in the gilts market last year, but with the implications on LDI portfolios and the need or desire to increase liquidity, many pension schemes disinvested from these illiquid investments. They are still attractive from a risk-return perspective, and should be ideal for pension schemes, or at least those that have sufficient time to hold them over a longer period.

The increase in supply from asset managers over the last 5-10 years, combined with the recent drop in interest in these assets among pension schemes due to the shift in their liquidity needs, should mean that there are currently plenty of opportunities for investors that can lock away a proportion of their assets for a good number of years. Some pension schemes with a longer investment time horizon can make a tactical opportunistic move now and hoover up some attractive illiquid investments that became available in secondary markets with their prior owners becoming forced sellers either due to their need to enhance their collateral pool or to accelerate their buy-out strategy.

Some of the private market investment opportunities provide fairly secure contractual income to investors, which will particularly appeal to those schemes that wish to pursue cash flow matching strategies.

If you have a longer investment time horizon, it is not just liquidity where you have more flexibility, but you are also more likely to be able to withstand short-term volatility. In this case, having an allocation to emerging markets may easily be justified, as a means of increasing diversification and adding an extra source of return. Current valuations in these markets are attractive and the expectation is that many of the local currencies will appreciate; hence some schemes – with the right circumstances – may feel that now is a good time to dip into these markets or increase existing allocations. Some of these schemes may even consider a separate standalone allocation to China, given its size, special circumstances and dominance of EM indices. China has not suffered from the recent high inflation seen elsewhere and will not need to apply the same monetary tightening as many other countries, and this will potentially amplify the diversification benefits it can offer.

Overall, in the current environment, investment strategies for an increasing number of DB schemes will be less driven purely by the traditional risk-return characteristics of asset classes, and more by the schemes' liquidity needs and investment time horizons.

Feature

How good is your free lunch?

Chris Inman, CFA CAIA, Partner and Head of Aon's DC Investment practice

Joe Moore, Associate Partner, Aon's Retirement practice

Diversification is a key cornerstone of many investment strategies, with the Nobel Prize laureate, economist Harry Markowitz, reported to have said, "Diversification is the only free lunch in investing".

While we agree with this assertion, we are not convinced that defined contribution (DC) savers in the UK have received the full benefits that diversification can provide. The 'diversification' (and similarly 'growth') benefits that has been marketed to DC savers by Diversified Growth Funds (DGFs) have been disappointing. Moreover, the significant reduction in some of the fees being charged by DGFs in recent years may be evidence that these fund managers also recognise this.

What is diversification?

At a high level, diversification can be achieved by investing your money across different asset classes and investment styles with the goal of lowering your portfolio's volatility/risk and producing a more stable return.

Why does diversification matter for DC savers?

Within the UK DC market, most members invest in the default option - which is usually a lifestyle strategy that changes the asset allocation as members move closer to retirement/accessing their savings. As such, the design of the default investment strategy is a key priority.

The default investment strategy needs to be tailored to mitigate the risks members face while attempting to achieve their financial goals – no small task! As risks evolve over a member's lifetime, so does the typical investment strategy of DC default options, with diversification increasing in importance in the lead-up to retirement/members accessing their savings.

When retirement is still a long way off, members' ability to tolerate risk is typically high. A key risk is failing to generate sufficient investment returns to support future retirement goals. Accessing the equity risk premium in a cost-efficient way is the focus here. Diversification of equities (e.g. by geography, or investment style) is important but diversification by asset class is less so. Therefore, we argue that DGFs should not play a role here.

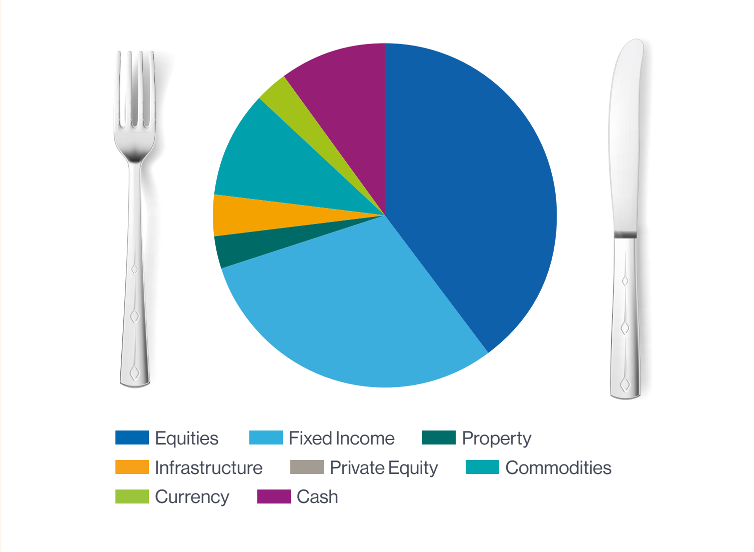
By mid-career and as members approach retirement, the risk of falls in capital value starts to have increasing importance; the default strategy should focus on protecting savings and reducing capital loss through considered diversification.

Nearing retirement, the investment strategy needs to be aligned to the specific risks of the chosen retirement strategy (e.g. annuitisation or drawdown), while looking to manage any inherent inflation risk. Again, diversification should play a key role for DC savers.

	DECATHLON									
	10.12s	13.36s	47.48s	4m 31.08s	8.24m	2.02m	4.90m	14.80m	48.67m	63.44m
EVENT	100m	110m hurdles	400m	1,500m	Long Jump	High Jump	Pole Vault	Shot Put	Discus	Javelin
	9.8s	13.04s	43.85s	3m 28.32s	8.41m	2.37m	6.02m	23.3m	68.90m	87.58m
	SPECIALIST									

Remind me, what's a DGF?

At a high level, DGFs invest across asset classes with the aim of achieving returns above inflation or cash, with a lower volatility than equities - no magic there. You will see colourful pie charts like below showing how diversified they are. But is this really the case when you need it?



What's the issue with using DGFs?

Historically, DGFs have tended to provide diversification when savers do not need it - when markets are going up. When equities are rallying, a saver would prefer to fully participate in this as opposed to being diversified into other, lower returning asset classes. However, there will be savers willing to give up some of the 'upside returns' for protection when markets are falling. Unfortunately, our analysis highlights that most DGFs used by DC schemes tend to diversify more on the way up (average correlation of c.0.66) than on the way down (average correlation of c.0.80)! This is not ideal and definitely not worth paying a premium for!

DGFs were initially introduced as a simple access route to diversification - they are not necessarily a bad idea and may continue to have a place within portfolios in particular circumstances. For example, less 'directional' DGFs can offer a reasonable level of diversification, although their returns have been disappointing and we believe that their performance targets remain ambitious. Investors should be aware that the landscape has evolved significantly in recent years - higher conviction solutions now exist that we believe can offer better value and diversification benefits.

You're better working with a specialist

Many DGF managers are generalists and large elements of their portfolios are made up of 'in-house' products. Few, if any, of these managers can claim to be leading in every area of the market. A fun way of illustrating how generalists can fall short of specialists is by looking at the outcomes of the events in the Decathlon (generalists) vs their standalone competitions (specialists). The above table shows how the results for the men's gold medallist at the Tokyo 2020 Olympics of the Decathlon really don't come close to the gold medallist in each of the standalone events. (See table above.)

We believe that the best way to implement a diversified multi-asset portfolio is through a truly open architecture solution that invests in best of breed managers for each component.

What areas should I focus on?

Aon's recent DC Today survey found that many DC schemes are reconsidering their asset allocations, with one in ten currently making changes to investment design with a further three in ten actively considering it. But how should DC schemes go about it?

We believe that diversification across asset classes, investment styles and managers is beneficial from both a risk and return perspective. Such strategies that we argue should appear more in DC schemes include:

- Multi-Asset Credit.
- Absolute Return Bonds.
- Risk Parity.
- Private Markets - being careful to first understand your objectives then selecting an appropriate specialist manager to deliver on this. Private markets are not a homogenous group of asset and a multi-asset approach could lead to similar 'failure of expectations' that DGFs have suffered.
- Further ESG integration.

What about DB schemes?

While the pooled nature of defined benefit (DB) assets means that diversification is less critical at an individual saver level, optimising the risk vs return profile of your investment strategy is clearly still important at a scheme level. For many (particularly smaller) DB schemes, diversification has also historically been accessed via DGFs, and we therefore believe that many of our observations and comments above are equally valid for DB investors.

Feature

Getting what you pay for

Claire Collier
Senior Associate, Linklaters LLP

The Government has published a consultation which sets out proposals for a new value for money (VFM) assessment framework. Under the proposals, trustees of defined contribution (DC) occupational pension schemes and the providers and Independent Governance Committees (IGCs) of workplace personal pension schemes would be required to disclose, assess and compare the VFM their scheme provides.

The framework is intended to provide a standardised understanding of value via clear metrics, allowing more transparent comparisons to be made between schemes and driving more effective competition. The intention is that the framework will build on, and in time replace, the VFM assessments that schemes with assets of less than £100m are currently required to complete.

It is proposed that the framework will initially apply to the default arrangements of workplace pensions, but consideration will be given to extending the framework to cover self-select options, non-workplace pensions and DC pensions in decumulation at a later date.

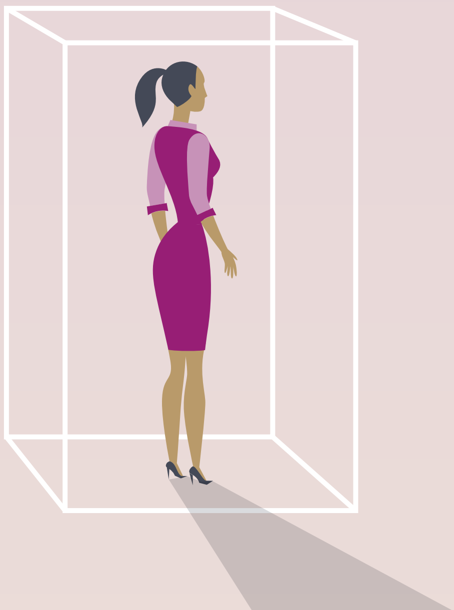
The consultation document identifies the key elements of the VFM framework as investment performance, costs and charges, and quality of services. It is proposed that schemes will be required to disclose data against the three metrics using a prescribed reporting template, with two alternatives under consideration for publishing the data: a decentralised approach (where schemes are required to publish their data on a publicly accessible website) or via an official centralised portal. It is proposed that the data would have to be reported as of 30 June and published by the end of the first quarter of the following year.

Schemes would then be required to publish their VFM assessment results by the end of October. The consultation document considers two alternative approaches to VFM comparisons: regulator-defined benchmarks, or comparisons against other schemes and industry benchmarks. If the latter are used, the Government proposes a mandatory step-by-step process for assessing VFM.

It is proposed that schemes could fall into one of three categories as the result of the VFM assessment: VFM; not currently VFM but with identified actions to improve; or not VFM. The published VFM assessment would include this result, as well as an explanation of the assessment and comparisons behind the result, in sufficient detail to allow independent (or regulatory) challenge.

The consultation document sets out the next steps a scheme would be required to take following assessment outcomes, as well as potential compliance and enforcement mechanisms. If the outcome is that the scheme is not VFM, it is proposed that trustees will be required to consider wind-up and consolidation. If schemes don't do this, the Pensions Regulator would have the power to enforce wind-up and consolidation.

The consultation closed on 27 March 2023 and a response is currently awaited. While the use of standardised metrics should allow for more straightforward comparisons between schemes, there is a risk that focussing on quantifiable metrics ignores the value of more qualitative aspects such as the quality of scheme governance. There is also a concern that schemes will be subject to an additional administrative burden without necessarily delivering any benefit to members.



Pension Conundrum

Pension Conundrum

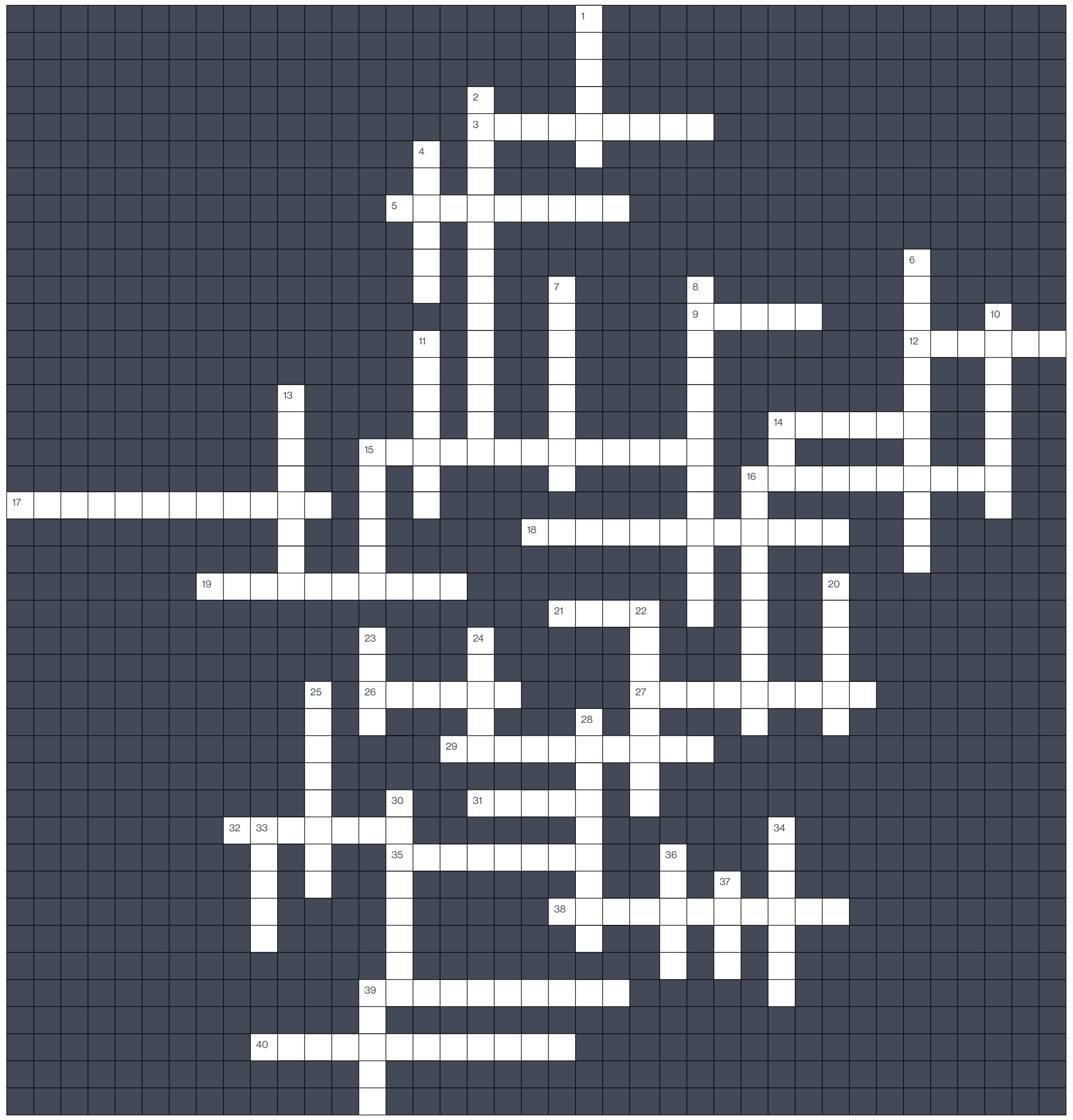
Crossword

Across

3. Instilling knowledge (9) **5.** Growth (9) **9.** Come together (5) **12.** Cause recollection (6) **14.** Kin (6) **15.** Degree of risk an investor is willing to endure (4,9) **16.** Perfection of a process (10) **17.** Statement of assets, liabilities and capital (7,5) **18.** Variety of species (12) **19.** Showing care and forethought (10) **21.** Steadfast (4) **26.** Dedicate oneself (6) **27.** Build (9) **29.** State of change (10) **31.** Mid-day meal (5) **32.** Accumulation over time (7) **35.** After a set duration (4,4) **38.** Statement in support of an individual or group (11) **39.** Original thought (10) **40.** Premium quality (4,8)

Down

1. Digital gateway (6) **2.** Intended to provoke (14) **4.** High-end (6) **6.** Tendency to focus on the near future (5,7) **7.** Owing another (8) **8.** Lending outside of the banks (7,6) **10.** Offset, reduce (8) **11.** Tiers (6) **13.** Tailored to a specific requirement (8) **14.** Type of chart (3) **15.** Tough (6) **16.** Use of risk to determine investment allocations (4,6) **20.** Something's effect (6) **22.** In conformance (8) **23.** Mechanised seal (4) **24.** Before (5) **25.** Following today (8) **28.** Advanced (4,5) **30.** Reduction of pace (4,4) **33.** Adopt a policy for one's own application (2,3) **34.** Classifications or rankings (7) **36.** Sudden statistical rise (5) **37.** Majority of (4) **39.** Dispense (5)



Answers from Issue 48

Across

3. concept **6.** solution **7.** compliance **13.** seminar **16.** legislate **17.** split **20.** guard **21.** standardisation **22.** nostrum **24.** find **27.** error **29.** host **31.** boundary **33.** laurel **35.** ecosystem **36.** staging date **37.** ahead **39.** remember **42.** charge **43.** respect

Down

1. symposium **2.** bucketing **4.** cricket **5.** hint **8.** format **9.** view **10.** multitude **11.** liaise **12.** bulk **14.** mandatory **15.** guidance **18.** thought leader **19.** waves **21.** specialist **23.** odd **25.** panacea **26.** arise **28.** relevance **30.** tools **32.** degree **34.** phase **38.** technology **40.** block **41.** optional **44.** tip

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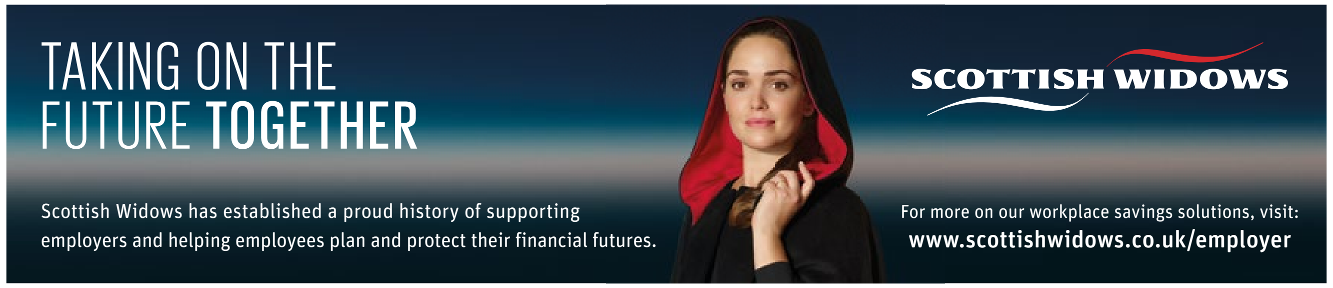

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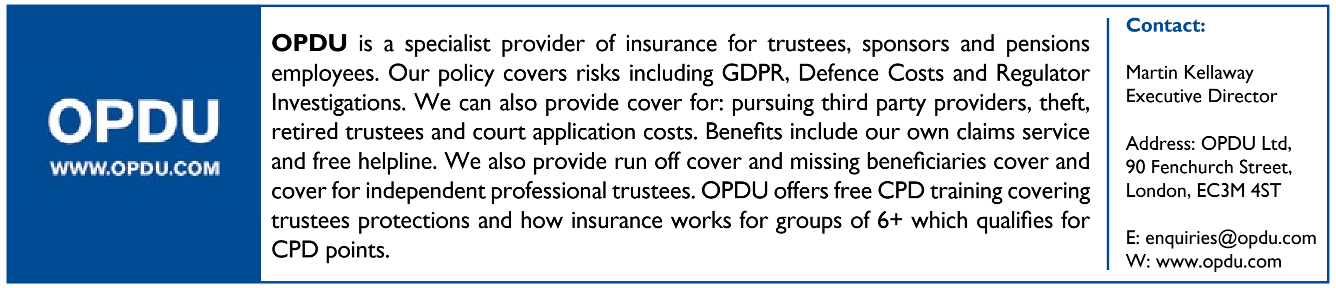

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Contact Dianne Beer (DB)
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