# UNDERSTANDING PENSIONS

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Many don't actively manage their investments, but does apathy hinder or help providers?

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One in six people will be over the age of 65 by 2050, so how will this impact pensions?

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FINANCIAL MARKETS

## Reassurance and calm in uncertain times

What impact have so-called black swan events such as a global pandemic had on public trust in investment strategies of the pensions industry?

John Greenwood

When pensions make newspaper headlines it is almost always for negative reasons. The massive stock market losses of the COVID crash, which saw the FTSE100 lose around a third of its value over the first three months of 2020, have been no different. So how has this latest shock to the system influenced attitudes to pensions and how have market players adapted in meeting that most important of all pension industry challenges of maintaining public trust?

Pension providers are adopting increasingly sophisticated risk management strategies to protect savers from the worst of stock market falls and preserve that hard-earned public confidence.

The coronavirus pandemic is the latest in a series of black swan events, unforeseen cataclysmic events that create stock market turmoil and have huge repercussions for the value of assets within pension schemes.

Richard Butcher, chair of the Pensions and Lifetime Savings Association, says: "I sense there are probably more big risk factors now, the increasingly violent reactions of the weather and climate change, feeding into the migration crisis and broader environmental issues.

"Historically no one has been good at modelling risk successfully, but pension professionals are now pricing in risks we can't anticipate. We can't put names on these risks because we don't know what they are. But we can model the impact of extreme scenarios on investment portfolios."

Diversification, also known as not putting all your eggs into one basket, has been around as a concept for years. Defined contribution (DC) pension schemes are addressing pension industry challenges of concentration of assets by ramping up the breadth of what they invest in, going beyond equities, bonds and property, and bringing in private equity and infrastructure.

Diversification protected DC investors during the COVID crash. While the FTSE100 fell 34 per cent between January 1 and the market low of March 24, workplace pension schemes suffered much lower drops. Analysis of seven of the UK's biggest master trust pension schemes by industry publication *Corporate Adviser* shows younger savers, those with 30 years to retirement, experienced drops of 20 per cent over the period.

> The big message was to provide reassurance that the strategies in place were designed to cater for this sort of volatility

The process of lifestyling, where older savers are moved into less risky assets to protect them against market shocks as they approach retirement age, delivered even more downside protection. The average older saver's pot fell just 4.2 per cent over that period. Diversification and lifestyling have been key to addressing these pension industry challenges.

Robert Cochran, senior corporate pension specialist at Scottish Widows, says investors generally responded calmly to the stock market turmoil and trust in the system has largely been maintained. "When the stock market tumbled, we saw a big spike in customers looking to switch out of their funds to more secure options," he says.

"Had they done so they would have locked in their losses and missed out on the rebound. Because pension providers are getting better at communicating digitally with customers, we were able to successfully explain why volatility is not necessarily a bad thing for long-term savers and the majority stayed invested."

That decision to stay put has turned out to be the right one. The rebound in markets has seen the great majority of DC pension funds recover all their COVID-crash losses, with the average workplace scheme delivering a positive return for younger savers of 0.9 per cent in the year to June 30. Older savers, within a year of state pension age, registered a positive return of 2.8 per cent.

Mark Futcher, a partner at pensions consultancy Barnett Waddingham, says: "The big message during the stock market turmoil was to provide reassurance that the strategies in place were designed to cater for precisely this sort of volatility. The industry beefed up its messaging around this and was largely successful; scheme members and employers were broadly reassured.

"At the same time schemes also made it easy for members to temporarily stop their contributions if necessary, recognising that some households might be struggling financially."

Andrew Cheseldine, chair of the board of trustees of the Smart Pension Master Trust, adds: "Markets fell significantly and they bounced back pretty quickly. Lifestyling did its job for older savers. And even if there hadn't been an immediate rebound, for those with 20 or 30 years until retirement, it doesn't matter if the market drops. Falling markets are actually an opportunity for long-term savers to buy assets cheaply."

Pension industry challenges in the area of defined benefit (DB) schemes are different. Some schemes have become more precarious as the assets held within them have fallen in value. Legal & General Investment Management's DB Health Tracker index, which reflects schemes' asset to liability ratio, the demographic risks in the scheme and the likelihood of the sponsoring company becoming insolvent, showed the average DB scheme could expect to pay 91.4 per cent of members' benefits at March 31, down from 96.5 per cent at the end of 2019. But by June 30, some ground had been clawed back, with the index rising to 93.5 per cent.

Cheseldine says: "There are many well-funded schemes out there with the resources to weather the storm. But in struggling sectors, such as aviation, retail and hospitality, there may be schemes whose sponsoring employer goes under and it seems inevitable these will end up in the Pension Protection Fund."

However, no high-profile schemes have fallen over yet and trust in DB schemes has not been eroded so far, say experts.

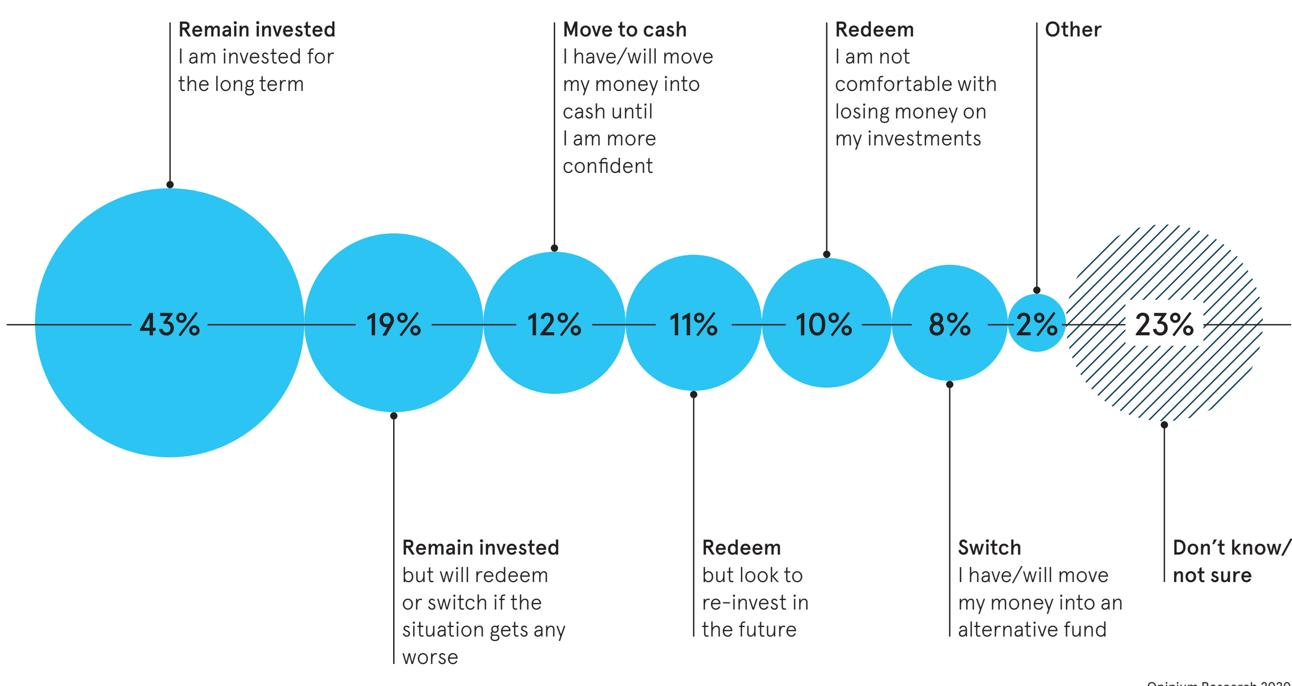
Climate change is seen by the government as one of the greatest of pension industry challenges. New regulations force both DB and DC schemes to challenge long-term investment risk, by making them evidence the science behind their investment decision-making, particularly in relation to environmental, social and governance factors, with a specific focus on climate change.

Industry experts say it is too early to say whether this latest in a series of seemingly increasingly frequent "once-in-a-lifetime" events will change attitudes to retirement. But they do report a longer-term trend towards pensions becoming just a part of a bigger, broader retirement plan.

Cheseldine concludes: "This trend will continue to be driven by the tighter restrictions on the amount you can pay into your pension. Interest in ISAs (individual savings accounts), particularly the Lifetime ISA, is growing, both among employers and members of the public. And for many people, residential property, whether their own home or buy to let is increasingly seen as part of their retirement plans."

### HOW CORONAVIRUS HAS AFFECTED INVESTMENT BEHAVIOUR

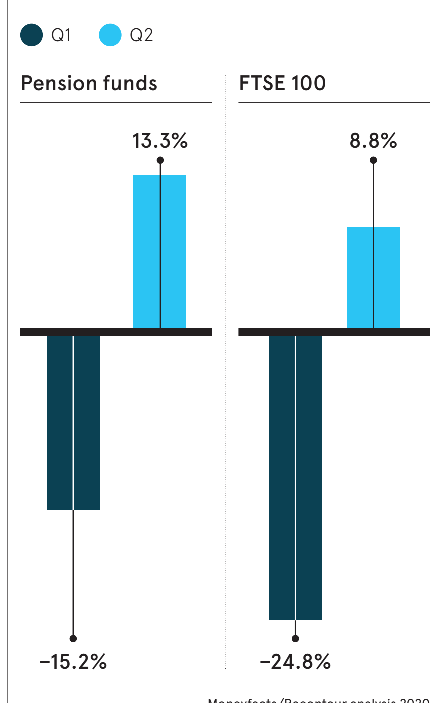
Survey of UK investors at the start of lockdown about personal finances and investments: respondents could select multiple answers




Opinium Research 2020

### PENSIONS RECOVER GROUND

Returns for average UK pension funds and the FTSE 100 in the first and second quarter of 2020




Moneyfacts/Raconteur analysis 2020

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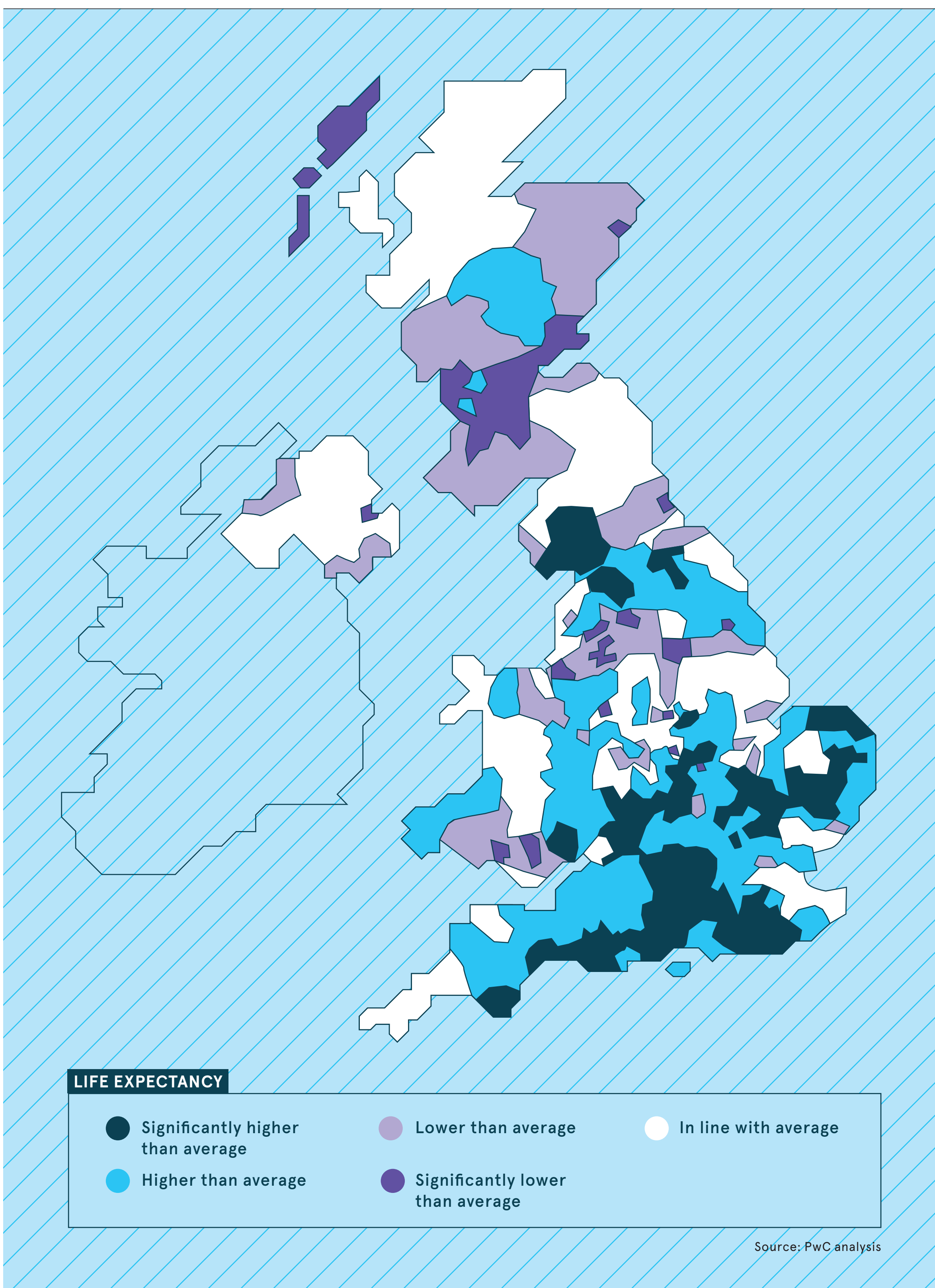
**Brits spend more time picking a car than planning their financial future.**

Read why Legal & General wants you to spend a day planning your retirement on page 8.

Commercial feature




# Designing a winning pension strategy

While defined benefit pension schemes have historically been categorised as a tug of war between the sponsoring company and the trustees, things are starting to change...

COVID-19 has refocused defined benefit (DB) pension schemes on their individual approaches to integrated risk management.

The novel coronavirus has forced stakeholders to look closely at their asset allocation, their longevity forecasts and the support available from the sponsoring company.

As a result, there has been substantial media coverage dedicated to the challenges faced by DB schemes, along with reams of commentary on how trustees are navigating the turmoil.

Some may have been tempted to 'latch on' to this constant news stream, or influenced to make decisions based on what 'the market' appears to be doing. But for Raj Mody, partner and global head of pensions at PwC, now is the time for trustees and companies to keep a level head, to work closely with other stakeholders and take bold decisions, tailored for their scheme.

"There has been a lot of noise which has led to a 'herd mentality' in some parts of the industry," he says. "I feel strongly that there cannot be a one-size-fits-all strategy for the more than 5,000 UK DB schemes. You have to resist the push towards a norm. It may not be right for you."

Mody endorses the approach of renowned investor Warren Buffett who famously proclaimed "We don't read other people's opinions. We want to get the facts and then think."

The PwC partner says DB pension schemes should take the same approach, only making decisions when they understand the data and options that are relevant to them.

Pension trustees tend to agree. "Decisions on the future of pension schemes are complex and nuanced," says Steve Delo, chairman of PAN Trustees.

"Just because something is appropriate for one scheme does not mean it will be effective for another. All schemes have their own quirks and idiosyncrasies, liability profiles, specific rules, legacy of decisions and ways of working," he explains.

### Thinking differently

Mody has become something of a champion for DB trustees and sponsors making bespoke decisions. He advises a range of companies and trustees, and for the decade until early 2020 worked extensively with ITV on its pension scheme.

ITV was one of the early adopters for a variety of interventions, championing a more effective relationship between the sponsor, the trustees and members.

Christine Jackson, ITV's director of reward and pensions, says the new way of working has only been possible because all stakeholders have developed an enormous level of trust. "We believe working together is a better way to think about pensions," she says.

She recognises that it is common for media reports to characterise trustees and the sponsoring company as two sides locked in battle, each trying to secure very different outcomes, but says that isn't usually the case.

"Most of the time the company and the trustees are not on different sides," she says. "All parties want to improve member security, and they want to do it in a way that doesn't adversely affect the sponsor."

ITV has managed its scheme in various, innovative ways over the past decade including completing a longevity swap in 2011, and then in 2018 entering an insurance transaction, both enabling it to reduce unwanted risk. Opting for a partial buy-in for one part of the scheme, with different characteristics, meant that it complemented the previous longevity swap.

**You have to resist the push towards a norm. It may not be right for you**

### A new approach

For Nadeem Ladha, trustee director at 20-20 Trustee Services, pension scheme management has changed and requires more strategy and innovation than it did in the past.

"There used to be a time when trustees took each actuarial valuation cycle one at a time, and the only variables were the mix of equities and bonds, and the prudence of the actuarial assumptions," he notes.

Ladha thinks we are now at a stage where all schemes must have their own plan to succeed. "Each scheme's journey is likely to be unique, reflecting the difference in maturity, funding and the tools available," he says.

The post-COVID world will have seen substantial economic turmoil, so schemes will need to focus increasingly on the needs of their members and not just investing assets, according to Mody.

"People have traditionally seen a liability valuation number, and an assets number. Their focus has been on ensuring the assets number beats the liability number over a period of time. And, if it doesn't work, they ask the sponsor for more cash. But that is not the true dynamic," says the PwC partner.

Delo at PAN Trustees believes trustees and companies need to have a common level of understanding. "This can be critical to properly aligning interests," he warns.

"Too often, I have seen parties that should be aligned being at loggerheads because one party has devoted the time to properly understand the issues, and the other hasn't."

At the same time, trustees and finance directors should be wary of adviser reports which design their guidance around an interpretation of what the Pensions Regulator wants. "That should sound alarm bells," Mody says.

"You cannot run a pension scheme only through a regulatory checklist. The checklist is there for after your decision, not before you have even started thinking about it and understanding your issues."

In his experience, diagnosing a scheme's condition with a fresh pair of eyes, and then creating a scheme-specific strategy, will yield better results and over a shorter timeframe. It's a given that the plan of action has to comply with regulations.

ITV's Jackson recognises that "there will always be" a desire by some to herd towards a regulatory objective, but she thinks the Pensions Regulator has been extremely forward-thinking in recent years in trying to understand the unique position of schemes across the board.

This regulatory position is perhaps indicative of a broader recognition by trustees, scheme managers and finance directors that, through collaboration, they and only they are the ones best placed to serve their members.

"The best outcome for members requires us to work as a team more so than we ever have before," concludes Ladha.

**For more information please visit pwc.co.uk/pensions**

INVESTMENTS

# Balancing activism with apathy

A lot of people don't realise they have the ability to actively manage their pension investments, and many that do choose not to. But does this level of apathy hinder or actually help pension providers?

**Marina Gerner**

Peter Cade via Getty Images

The big success story of pension savings in the UK is auto-enrolment. Insights from behavioural economics were used to create the scheme in 2012 to "nudge" more people into saving a percentage of their income in workplace pension schemes.

Employees can choose to opt out of the pension scheme, but given that many are not aware of the fact that they're saving into a pension automatically, opt-out rates have been very low.

The scheme's success is down to the power of inertia. But the flipside of inertia is that employees hardly engage with their pension savings. Indeed, only a third of workers realise workplace pension schemes are invested in the stock market, according to recent research from Hargreaves Lansdown.

Many don't realise they can actively change what their pension is invested in. Does this level of apathy and lack of understanding pensions hinder or help pension providers?

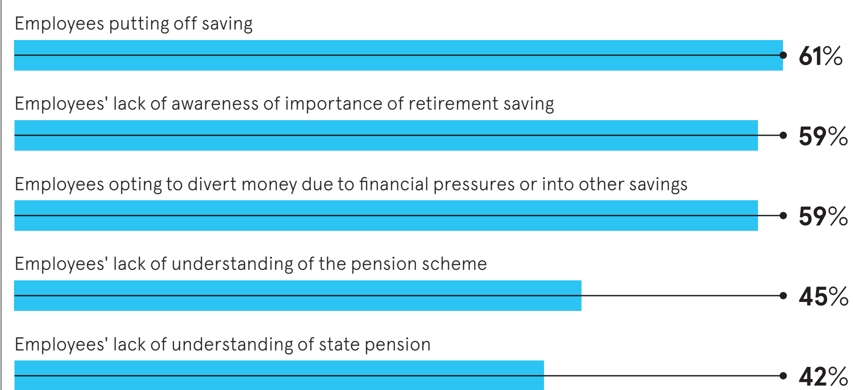
"Pension providers do not encourage their customers to decide to switch to other funds and there seems an in-built assumption that people are not interested and will not bother to make active decisions," says former pensions minister Baroness Ros Altmann.

She notes that the more traditional final salary pensions did not typically permit members to choose their investments and the trustees are responsible for all such decisions, which again means pension savers never needed to engage with investment decisions.

"This lack of engagement can be beneficial to pension providers, because they do not face tough scrutiny from customers," says Lady Altmann. "The complexity of products and lack of transparency have often allowed a proliferation of high hidden charges, which were not in the member's interest."

**BARRIERS TO ENGAGEMENT**

Top five challenges companies face when engaging employees with pensions




CBI/Aegon 2018

**1 in 3**

people know what their pensions are worth

**29%**

know how much money they'll need in retirement

**1 in 3**

don't know whether their pension is invested in the stock market

Hargreaves Lansdown 2020

Most workplace pension schemes will invest employees automatically into the scheme default fund, explains Victoria Rutland, chartered financial planner at EQ Investors. Typically, this means that during the early stages of a person's pension savings, the fund heavily invests in equities and then proceeds to move into lower-risk assets such as bonds or cash, as people approach retirement.

However, as Rutland points out, for most of our working life, our pension is predominantly invested in equities, which means it can fluctuate significantly. "Many people would be shocked to see how much the value of their pension has fluctuated in the last six months in particular," she says. You could therefore argue that people's apathy towards their pension protects them from panicking about their savings when the stock market fluctuates.

Why do providers offer this type of default strategy? Rutland says: "Because it's cost effective. Putting everyone into this type of strategy means that everyone can invest in the same way as others who are the same age as them. Each provider can simply make changes to one portfolio. The cost of providing advice to every single investor in each group scheme would be prohibitive."

But as more people endeavour to live sustainably, attention might turn to the actual contents of their pension pot. In Australia, Dr Bronwyn King, an oncologist, famously persuaded Australian pension funds to divest from tobacco.

"The majority of default funds, including lifestyle strategies, will be invested in 'traditional' investments such as shares in oil and gas companies, tobacco and armaments," says Rutland. "Traditional investments don't usually consider the carbon footprint of the underlying companies or the governance of the business and its supply chain.

"While a lot of opportunities to invest in ethical, ESG [environmental, social and governance] or positive impact portfolios are becoming more and more available on the wider market, workplace pensions are behind the curve."

**I believe the industry should face up to this challenge and help its customers understand and engage with pensions**

With increasing awareness, the tables could turn if people begin to take more control of their pension, changing funds en masse. In the UK, campaigns like Make My Money Matter by Comic Relief's Richard Curtis, could contribute to bringing ESG investing to a mainstream audience by asking what is your pension invested in? But any form of pension activism has to be balanced with people's need for financial literacy and advice.

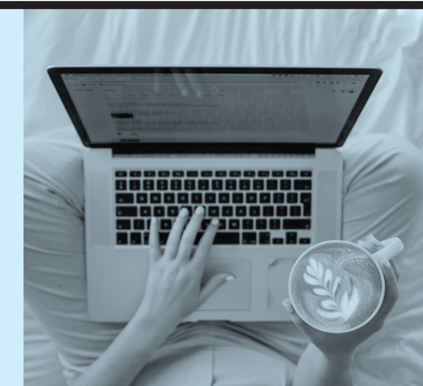
How can the industry find a happy balance between apathy and activist investing? Kate Smith, head of pensions at Aegon, says: "Nowadays, individuals have to shoulder much more responsibility for funding their retirement than ever before, so getting people properly engaged as early as possible in their working life is key.

"We want to see more savers engaged with their pensions, including reviewing their investment choices and monitoring investment performance. This is a good thing for providers and savers. Currently, fewer than one in five UK workers say they have used an investment-risk tool to find out how much risk they are comfortable with when investing in their pension."

She notes that while many providers allow savers to carry out online fund switches, free of charge, few savers take advantage of this. The majority remain invested in the default fund, out of choice or apathy. "In reality, we think it's highly unlikely that savers will en masse make numerous investment fund switches," Smith adds. "And doing so will not necessarily lead to good member outcomes."

For now, apathy and a lack of transparency are still endemic in pensions, despite years of attempts to improve engagement. As Lady Altmann concludes: "Improvements have been achieved, but only very slowly. I believe the industry should face up to this challenge and help its customers understand and engage with pensions."

### Driving engagement



Nest was set up by the government to ensure every UK employer could offer a workplace pension to their employees when auto-enrolment was introduced. It now has more than 9.3 million members and one in three of the working population is expected to have a Nest retirement pot by the late-2020s.

"Our view is that engagement is a necessary tool in helping our members achieve better outcomes in retirement," says Eve Read, Nest's director of business delivery. She argues that a combination of efforts is required. "We issue regular communications on topics that matter to members, which will be personalised to their own situation as much as possible," Read says.

"For some individuals, the way to create engagement is to make it real for them, such as sharing how Nest is committed to tackling climate change, but for others it might be highlighting that they could build their pension pot faster by maximising tax savings or employer-matched contributions." She says greater engagement could help pension schemes gain insights such as their members' desired retirement age or retirement income.

"However, the biggest challenge of a very active model would be that members may then engage in highly complex decisions without fully understanding the profound impact these might have on their financial future. So, when we communicate with our members, we have to think really carefully about what we want them to think, feel and do, so we don't inadvertently drive behaviours that might undermine their long-term goals," Read concludes.

# HAS AUTO-ENROLMENT CLOSED...

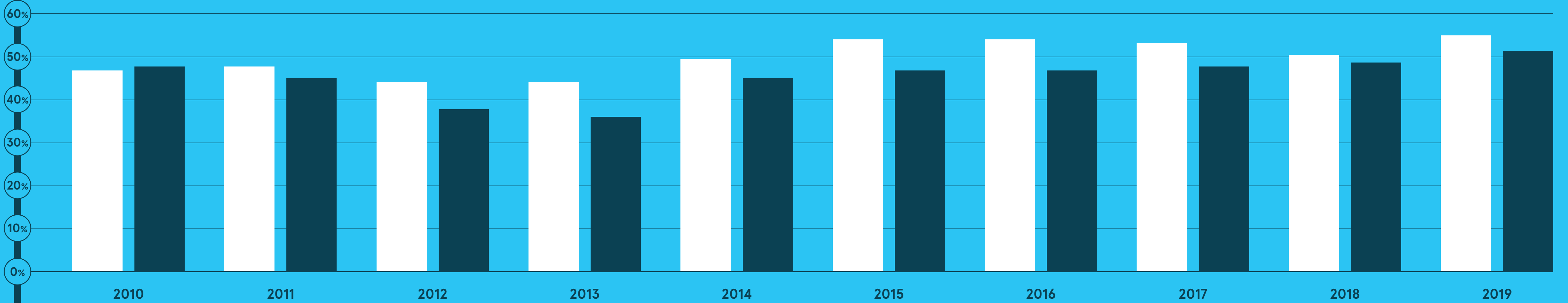
When the UK government introduced the automatic enrolment scheme in 2012, pension inequalities were rife. From gender gaps to ethnicity gaps, retirement for certain segments of the population looked bleak. So has auto-enrolment really worked and levelled the pensions playing field for all Britons?

## THE GENDER PENSION GAP PREVAILS

Percentage of UK adults who have adequate retirement savings (saving at least 12 per cent of income or on a defined benefit scheme)

Men · Women

Scottish Widows 2019

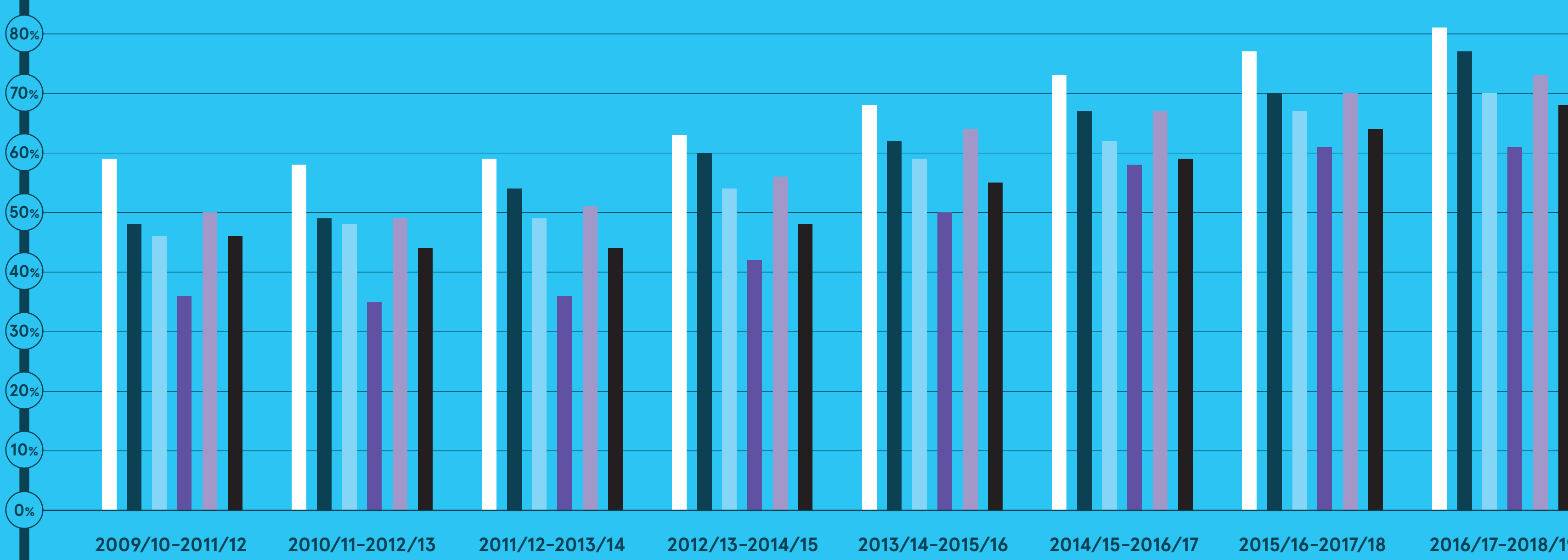



## THE ETHNICITY GAP PERSISTS

Percentage of eligible employees participating in state pension, three-year rolling average, by ethnicity

White · Mixed · Indian · Pakistani and Bangladeshi · Black · Other (inc. Chinese)

DWP 2019




**£3,350**

average income gap between ethnic minority pensioners and other pensioners

**1.2m**

additional employees would be auto-enrolled in a pension if the earnings trigger was dropped to the NI lower earnings limit

**15%**

of these would be ethnic minorities

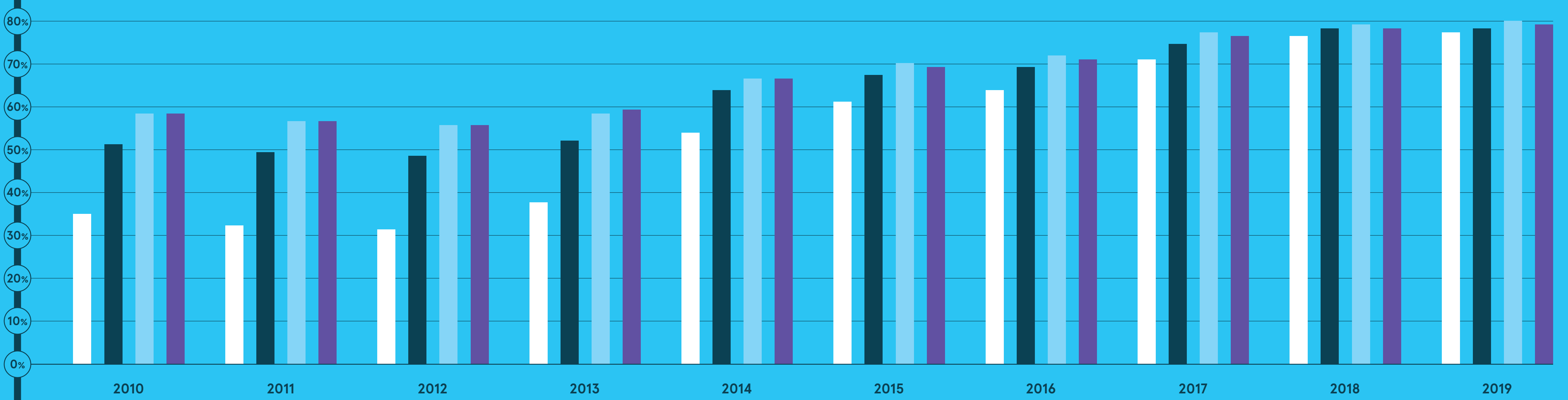
The People's Pension 2020

## AUTO-ENROLMENT HAS CLOSED THE AGE GAP

Percentage of eligible employees participating in pensions, by age

22-29 · 30-39 · 40-49 · 50-state pension age

DWP 2019

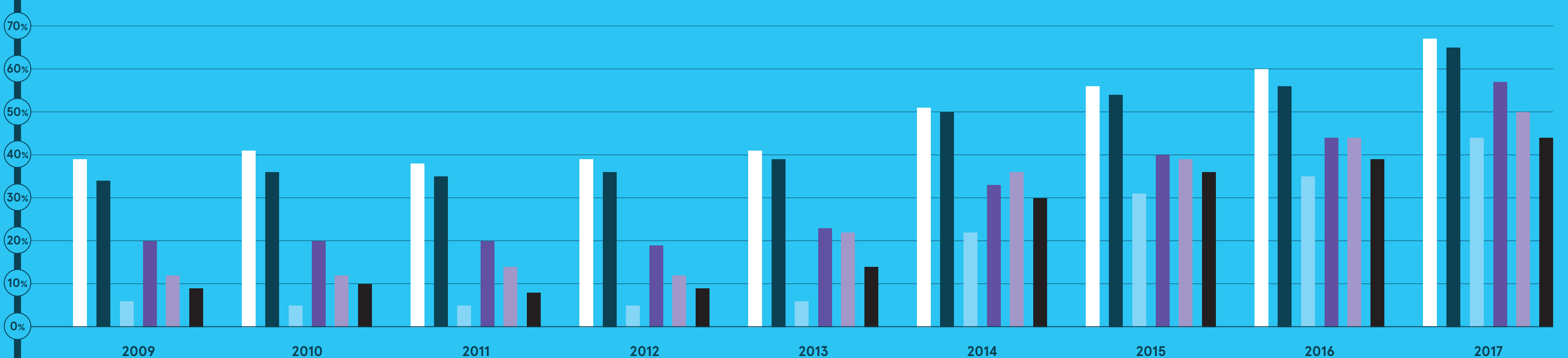



## LOW-EARNER PARTICIPATION HAS INCREASED, BUT HASN'T CLOSED THE GAP

Percentage of employees participating in pensions, by occupation

Professional · Senior management · Care and leisure · Skilled trades · Sales and customer service · Elementary (hospitality, service, construction etc.)

ONS 2018




# ...THE GAP?

ESG

# Investing with conscience and impact

Here are eight things you can do to ensure your pension is investing in funds and causes with environmental, social and governance factors in mind

Rachael Ravesz

Peter Cade via Getty Images

More and more of us are taking a coffee flask to work, ditching fast fashion or becoming vegan. But how many realise that most of our £3-trillion pension money in the UK is invested in industries such as oil, weapons and tobacco? We can change this. By taking practical steps towards a pension fund that focuses on environmental, social and governance (ESG) factors, we can invest in a positive, impactful way and not lose out on financial performance.

### 1 Define what ESG investing means to you

ESG is not a one-stop shop; it can cover everything from a company's carbon footprint to its anti-sexual harassment policy. You may want to avoid tobacco, alcohol and pornography. Or perhaps you are vegan and want to screen out meat production. In a sea of options, you need to understand what your priorities are, but no one ESG pension fund will tick every box. Use independent, online ESG ratings tools to find a pension provider and product that matches your values.

### 2 Ask what you are invested in

Whether you have a workplace or private pension, log on to your online account or dig out the annual statement. Look at the underlying investments and how much it's costing you a year. "The vast majority of pension money is in the standard, 'default' fund so it's really important that these default funds shift to being more sustainable," says Tony Burdon, chief executive of Make My Money Matter. "In the meantime, the bulk of pension investment is causing harm to the planet."

### 3 Discuss ESG investing options

What could the alternative be? "If you're in a workplace pension, ask your human resources department about it. Write to your provider too and ask for a sustainable or a net-zero pension," says Burdon. "It can be hard for individuals and you might not get a good answer at first, but you just have to keep pushing." Make sure, however, that your employer is on board and you will not lose out on their pension contribution – a minimum of 3 per cent of your salary – if you choose another fund, even if it's with the same provider.

### 4 Research the ESG pension fund provider

Your pension fund might be an ESG option, but also look at the product provider. "Who is providing that fund and are they committed to ethical investment?" asks Olivia Bowen, chartered financial planner and partner at Castlefield. "Ideally you want more than one ESG fund on offer so you can be reassured it's not tokenism. You might also want to choose a fund manager who engages with companies he or she invests in – this is called stewardship – and it should be advertised on their website." Another tip is to check if the ESG team at the pension provider is a core part of the fund management team and if the pension provider is a signatory of the United Nations' Principles for Responsible Investment.

### 5 Campaign for change

It's time to act. Sign the Make My Money Matter petition, speak to your colleagues, arrange a meeting with your boss and write to the provider directly. Educate others on the positive impacts of ESG pension funds, for example moving your money to an ESG pension fund can be 27 times more effective at reducing your own carbon footprint than going vegan and avoiding planes. "We know from public surveys that the majority of people would save more in their pension if they knew it did good," says Burdon at Make My Money Matter. "Don't wait. Your money is having an impact every day it's invested."

### 6 Get financial advice on ESG

Somewhere along the way, you may need financial guidance from an independent financial adviser (IFA) who has a special interest in ESG. "If you want to get an extremely well researched portfolio, which can align with your moral values and attitude to risk, going to an IFA is the only way you can get this quickly," says David MacDonald, founder of The Path, a financial advisory firm. "But choose carefully as research shows that a minority of IFAs feel confident advising in this area."

> Most pension money is in the standard, 'default' fund so it's important these default funds shift to being more sustainable

### 7 Switch to an ethical option

It's much easier to switch pensions if you work for yourself, but there are some golden rules. Firstly, make sure you don't lose out on any benefits, especially if the pension you're switching out of is more than ten years old. Secondly, find out what the current value and transfer value is and whether you'd lose money when switching. Thirdly, check if there are any additional costs. "In most cases, switching a fund or to another provider should be easy and you can do it online," says Castlefield's Bowen. "But it's always a good idea to get financial advice."

### 8 Monitor the growing market

Share Action found that 89 per cent of the largest asset managers in the world now offer some sort of ESG investing option. Might another fund or provider be cheaper and more closely aligned with your values in the future? "ESG investment is a fast-moving world and has become more or less mainstream," says The Path's MacDonald. "Fund managers and providers are launching ESG funds every week, so it's a good idea to look at new entrants to the market."

OPINION

## 'The government should think very carefully before reducing the amount of support it provides for pension saving'

The coronavirus pandemic has opened up a substantial hole in the budget as the government has provided vital support for businesses, public services and individuals. There has been much speculation in recent weeks about how this will be paid for and pensions tax relief is reportedly under review by chancellor Rishi Sunak.

Speaking from a pensions' perspective, we would prefer that government find some other way to find the funds. But if the government does choose to raise them from pensions, we would like to emphasise the amounts available are less than often quoted and the consequences less appealing.

Under the current rules, which are designed to incentivise people to lock money away for their retirement, most savers pay no income tax on any earnings they contribute towards a pension. However, apart from a 25 per cent tax free lump sum, they do pay income tax when they come to draw it. So the figures quoted are not all that they seem.

It's often said that pensions tax relief "costs" the government about £40 billion a year. The implication is that if the government changed the rules on pensions tax relief, they could save a significant proportion of this sum of money. The reality is far from this.

About 40 per cent of the amount is allocated to public sector pension schemes so, if the government did reduce fiscal support, it is more likely than not that the employers involved might make up some or all of the resulting fall in take-home pay for the senior nurses, doctors and head teachers affected, especially if we are still battling COVID-19. Obviously, any additional funding would have to come from the public purse.

Around 20 per cent of the sum is tax not levied on employers who are making up the pension deficits in traditional final salary schemes. These contributions are generally used to make sure pension promises, to former and current employees for work done in the past, are honoured. Amending this part of the regime would simply add a tax on business and make the pensions of millions of people less secure.

The remainder goes to the minority of people in the private sector that are contributing to a final salary pension and the many millions of others, nearly all in the private sector, who have a money purchase or defined contribution pension. We estimate the total savings to government available from this part of pension saving is under half of the £40 billion so often quoted and, of course, the government would not want to remove all support from people saving for retirement. So the total "savings" for the public purse will be far, far lower.

Reducing fiscal support might be a reasonable approach, if people in the UK are already saving enough for retirement. However, this is not the case.

In 2016, the Pensions and Lifetime Savings Association (PLSA) undertook a research project that examined the likelihood that current workers would have a pension equivalent to the pension targets identified by the 2006 Pensions Commission.

Using their targets, the PLSA's research found that just over 50 per cent of the working population, or 13.6 million people, were at high risk of failing to meet their target replacement rate. Moreover, it is the middle-aged savers of Generation X, today aged around 40 to 55, and the young millennials, aged around 25 to 39, who are most likely to be not saving enough.

So the government should think very carefully before reducing the amount of support it provides for pension saving.

However, if the government is determined to alter pensions tax relief, then we would urge them to ensure that any change is primarily designed to help people save enough for retirement. Ideally, any change would also be simple to adopt and administer, and should be sustainable over the long term. Everyone knows that the current system is not perfect, so the pensions sector is open to consider how it can be improved. But let's keep our eyes on the prize: everyone having an adequate income in retirement.

Nigel Peaple
Director of policy and research, Pensions and Lifetime Savings Association

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MASTER TRUSTS

# Competition heats up among master trusts

Sergio Souza/Pexels

Master trusts now account for a significant proportion of workplace pensions and are still gaining momentum, but what are the implications for the rest of the market? And are there alternatives?

Stephanie Hawthorne

Since the auto-enrolment revolution of 2012, millions of workers have begun retirement saving for the first time, often with a master trust pension. Indeed, more than 16 million people have put £38.5 billion into these schemes.

A master trust pension is a trust-based scheme that a multitude of unassociated employers can join, sharing resources and reducing costs, in particular, administration, trusteeship and investment management, through bulk purchasing. They are closely supervised by the Pensions Regulator which has authorised 38 master trusts.

They range from the giant Nest, with more than nine million members which has a public service obligation to take all comers including many large retailers with transient workers, as well as the traditional pension providers such as Legal & General, Aegon and Scottish Widows. Employee benefit consultancies, including Willis Towers Watson, with LifeSight, and Aon, are also moving into this space.

Master trusts are not yet the dominant force in workplace pensions, but there is irreversible momentum in this direction because "employers are sandwiched between the need to reduce costs at the same time as the Pensions Regulator is expecting more from trustees", explains Roger Breeden, partner and workplace savings proposition lead at Mercer, a pension consultancy.

> **Competition is fierce and we are seeing some very competitive deals put forward by providers**

Analysis by Broadridge, a financial research company, estimates that by 2028 assets under management for master trusts will grow to approximately £424 billion, although some weaker and smaller master trusts may fold along the way.

In the meantime, there is a land grab among the master trust pension providers, as they try to reach scale as quickly as possible. Paul Leandro, partner at pensions consultancy Barnett Waddingham, says: "Competition is fierce and we are seeing some very competitive deals put forward by providers. Some are even offering to foot the bill in terms of transaction costs when moving assets across. We hope these proposed charges are not bordering on the unsustainable.

"We do seem to be following the trends seen in Australia, which uses a pension framework codified on the UK system and where master trusts are by far the dominant form of pension arrangement, and where consolidation has been fierce. The number of schemes reduced from about 3,000 in 2002 to 230 in 2017. Assets in the Australian superannuation system are around $3 trillion. It is not unfeasible to see the UK going in the same direction."

According to data from the Pensions Regulator, there were 1,050 defined contribution (DC) single-employer trusts and only 370 of these had more than 100 members. Jon Parker, head of DC and financial wellbeing at Redington, says: "Over the next five years, a large proportion of these will transfer to master trusts, leaving around 150 remaining as open employer trust-based arrangements."

Wills Towers Watson *FTSE 350 DC Pension Scheme Survey 2020* shows 39 per cent of FTSE 100 companies have contract-based pensions, 39 per cent have trust-based pensions, such as a single-employer trust, and just 22 per cent have master trusts, while the *Aon DC Survey 2020* shows 35 per cent of participants with their own DC trust were looking to move to master trust pensions within the next five years.

Tony Pugh, DC solutions leader, Europe, Middle East and Africa, at Aon, says: "Perhaps the main advantages triggering the majority of movement from own trust to master trust are the significant costs and resource savings available to employers that move."

Emma Douglas, head of DC at LGIM, adds: "Many provide additional guidance and support to help members with their financial wellbeing and equip them to make better-informed decisions on contribution rates, investment options and their income needs in retirement."

High on the list of desirable options for a master trust will be low charges, online tools, apps, newsletters, a good range of funds, including environmental, social and governance considerations, guidance and access to retirement options, with all the pension freedoms available such as in-scheme drawdown and uncrystallised funds pension lump sums or flexible withdrawals.

Yet assets under management in single-employer DC trusts and contract-based schemes outweigh master trusts by a significant amount. "At the end of 2018, there was £33.4 billion in assets under management in master trusts compared to £184.5 billion for single trusts and £170.6 billion in contract-based schemes," notes Douglas.

On the flipside, Kay Ingram, director of public policy at LEBC, an independent financial adviser, feels that master trust products may have limitations, specifically regarding features, functionality and fund options.

Aon's Pugh forecasts: "For employers wanting a highly tailored solution and who have the resources and scale to ensure costs charged to members are reasonable compared to the alternatives, their single-employer trust will continue into the long term."

Many small and medium-sized employers favour group personal pensions (GPPs), which are also evolving at pace with providers. Indeed, Ingram says: "GPPs are probably a step ahead with their technological solutions, with sophisticated online access, online pension transfer capability and integration with personal banking solutions and apps such as Hummingbird, which are independent of any one provider."

The master trust providers continue to focus on asset gathering, rather than helping members in how to draw money away from their pension pots and the market is still catching up with the introduction of the pension freedoms introduced in 2015. One increasing worry is that members at retirement are leaving master trust pensions for higher-charging retail alternatives or because advisers are incentivised by increased fee revenues to recommend complex transfers out.

This is caused partly by a big disconnect between financial advisers and the master trust market. Breeden at Mercer says: "In some cases, retirees are taking their money out of institutionally priced master trusts into more expensive personal pensions because of a perceived lack of flexibility in the master trust or because it doesn't fit well with the advisers' wealth management service."

The leading master trusts do provide some support to members as they approach retirement, but some do not give enough, cost-effective support after a member retires. Leandro at Barnett Waddingham stresses: "People using drawdown are still members of the master trust and the trustees still retain fiduciary responsibility for these members' assets.

"Helping people to and through retirement remains a major challenge for the industry. At the moment there is a cohort of retirees being left out in the cold, unsupported at a time when they're making extremely important decisions about their pension savings." ●

**MOVING TO MASTER TRUSTS**

Survey of defined contribution pension schemes

**39%** of FTSE 100 companies have contract-based pensions

**39%** have trust-based pensions such as a single employer trust

**22%** have master trusts

Willis Towers Watson 2020

**35%** of companies with their own DC trust are looking to move to master trust pensions within the next five years

Aon 2020

Commercial feature

# Pension de-risking: why it pays to de-risk your DB scheme

De-risking DB pensions will increase in importance for companies and will often be a win-win solution for both companies and scheme members

Defined benefit pensions, known as DB pensions, have long been heralded the gold standard of pension funding, but their appeal has come at a price for sponsoring employers.

A perfect storm of fiscal policy measures, increased regulation, market volatility and changing life expectancy has added new layers of complexity and pressure to the market, and for many employers, pension liabilities have grown to become a significant source of financial risk.

**Rise of pension de-risking**

While the number of active DB scheme members has fallen dramatically in recent years, with the majority of schemes now closed to new members and/or future accrual, DB schemes remain an important part of the UK pensions landscape, and their future viability has become a pressing concern for both sponsors and trustees.

Sarah Parkin, managing associate at Linklaters, says: "Pension liabilities are one of the greatest financial challenges facing companies today. As the majority of DB schemes mature and have a shortfall between their funding and the level of benefits promised, there is growing interest from sponsors seeking to effectively remove or minimise their exposure to risk while improving the security of members' benefits."

The good news for sponsors, trustees and members is that growing demand has prompted exponential growth in the de-risking market with a wealth of solutions to suit schemes of all shapes and sizes.

At one end of the de-risking spectrum, trustees may simply look to minimise risk through investment strategies, while at the other end, there is the option to transfer risk to an insurance company through a bulk annuity policy, known as a buy-in or buy-out. Between them on that spectrum, a longevity swap deals specifically with reducing the risk of members living longer than expected.

**Sarah Parkin**
**Managing associate, Linklaters**

**Philip Goss**
**Partner, Linklaters**

Parkin explains: "Buy-outs have historically been viewed as one of the most secure ways of ensuring members receive their benefits. A buy-in or series of buy-ins will typically precede a buy-out and this can be an important step in the scheme's journey to fully securing members' pensions. But as with any transaction, it is vital that schemes consider all options before they conclude on and execute their strategy."

Simply put, a buy-in is an insurance policy that covers a proportion of the scheme's liabilities. The scheme operates as usual, paying members' pensions, but to do so funds are put in by a regular stream of matching payments from the insurance company under the insurance policy.

In contrast, a buy-out transfers all the responsibility of paying members' benefits to the insurer, removing risk and liability from the sponsor and trustees. Members cease to be members of the pension scheme and become policyholders of the insurer. If all benefits are bought out, the scheme typically winds up.

De-risking transactions are not only about removing liability and risk from the employer, but are often equally focused on improving the security of members' benefits. This will be an important factor for trustees in considering strategy and de-risking options.

**Preparation is paramount**

The initial stages leading to a de-risking transaction require detailed and strategic planning, and a deep understanding of the goals and risks that need to be managed. Sponsors and trustees should be aligned on what they want to achieve and how they expect to get there, looking at factors such as benefit security, the scheme's funding position, target timescales and the accounting impact on the sponsor.

Parkin says: "For trustees to be in a position to capitalise on opportunities they must have a clear objective and thorough preparation in place. Insurers are increasingly looking for evidence of well-prepared schemes. Those that have an understanding of insurers' investment processes and appear serious about reaching their end-game will attract the best pricing available."

Closely aligned with price are the contractual terms. As Parkin explains: "Sponsors and trustees, who have a strategy and plan ahead, will maximise their ability to negotiate favourable terms. And better terms mean better risk reduction."

Arguably one of the most important components is data. Carrying out a thorough data cleanse to ensure member data and the benefit summary used in the policy are accurate will remove ambiguity for insurers, which could affect the price and place the scheme in a better position to move quickly.

Member communications is also a key factor. Members may feel apprehensive about change, particularly at the buy-out stage. However, moving to a buy-in or buy-out scenario can represent an improvement in the security of members' benefits. All insurers are regulated by the Financial Conduct Authority and Prudential Regulation Authority. In the extremely unlikely event that an insurer becomes insolvent, 100 per cent of the value of members' benefits will be protected by the Financial Services Compensation Scheme.

"It is important that schemes communicate the changes to members as soon as feasibly possible," says Parkin. "Members may incorrectly assume any change to their pension arrangements is bad news, so companies must clearly explain what the changes entail. This gives them the opportunity to understand more about the process and the benefits for them."

> **Sponsors and trustees who have a strategy and plan ahead will maximise their ability to negotiate favourable terms. And better terms means better risk reduction**
>
> Sarah Parkin
> Managing associate, Linklaters

**Act now or hold tight?**

The financial and economic fallout from the coronavirus crisis has naturally begged the question whether now is a good time to de-risk.

According to Philip Goss, partner at Linklaters, appetite for de-risking has remained buoyant and the ongoing market volatility has created attractive pricing opportunities, particularly for those schemes that are well prepared.

"Counterparty risk and how the sponsoring covenant compares to what will be provided by the insurer always requires consideration, although the current environment does introduce additional complexities," Goss explains. "What we have seen is schemes that had already made the decision to transact and were well progressed in preparing for a transaction have continued and have been able to capitalise on more competitive pricing.

"However, for schemes that are still at earlier stages of planning or preparation, our recommendation would be to keep going. Being well prepared will pay dividends, even if it is some way down the road."

With the economy continuing through a period of deep uncertainty, there is the potential for further attractive pricing opportunities and, says Goss, well-prepared schemes would be best placed to take advantage of opportunities in such an environment.

Looking ahead, it is likely the regulatory framework around DB pension schemes will further strengthen sponsors' resolve to de-risk.

As part of the Pension Regulator's new funding code, all schemes will be required to set a long-term funding target and document how they expect to reach their target end-game.

Goss concludes: "What is clear going forward is that de-risking solutions will increasingly form a critical part of pension scheme management, in many cases offering a win-win solution for both scheme sponsors and members."

**Linklaters act regularly advising corporates, trustees and insurers on de-risking DB schemes. For more information please visit http://www.linklaters.com/en/client-services/pensions/de-risking**

Linklaters

DASHBOARDS

# Data standards critical to dashboard success

Pensions dashboards could transform the way people interact with their pensions, but the accuracy, reliability and security of customer data will be instrumental in their long-term viability

Pádraig Floyd

Maskot via Getty Images

The employment market has changed dramatically over the past two decades. No longer can a worker expect to spend their entire career at one employer. Workers may even have several careers during their working life. As a result, it became apparent that millions of UK workers were not saving enough, if anything at all, for their retirement. So, in 2012, the UK government introduced auto-enrolment.

This required employers to place most of their employees in a qualifying pension scheme. As of March 2019, there were more than ten million more individuals saving for a pension than before the launch. But more jobs means more pension funds per individual. There was a danger there could be a proliferation of orphaned funds as workers left jobs and lost track of their pensions. So the idea of a pensions dashboard was born.

The concept of a pensions dashboard is simple: it is an online search engine that enables consumers to find old pensions they have lost track of and have to try and understand how much they have saved in them.

The initiative was formally announced in the 2016 Budget with the government proposing it would launch a pensions dashboard that was designed and funded by the industry by 2019.

This first deadline was seemingly lost between Brexit and a change of administration. By last year, Department for Work and Pensions had taken control and given the Money and Pensions Service the responsibility of delivering the project.

Delivering new technology systems is never simple and the passing of the original deadline resulted in claims that the industry has dragged its feet on keeping pace with technology. Coronavirus has certainly given notice to the pension sector that any who resist the harnessing of technology "need to stop procrastinating and just get on with it", says Lesley Carline, director of KGC Associates and president of the Pensions Management Institute.

But she says the notion of the pensions dashboard project being delayed is a misconception. Although the Pension Schemes Bill has been delayed, the project is continuing and, like a lot of large projects, will take time, she says.

The Pension Schemes Bill, once passed, requires every pension scheme and provider to have a suitable technology solution that will provide dashboard users with access to their data. There are, however, a number of challenges that must be addressed.

"There is always a note of caution when we talk about technology being the answer to everything and that note is data," says Carline. "Unless the data is there and accessible, technology is useless."

> There is always a note of caution when we talk about technology being the answer to everything and that note is data

Pensions are no different to other branches of financial services when it comes to problems with data. Accuracy, reliability, security and whether it can be accessed easily, without adding the delay and cost of human intervention, are as relevant to banking and insurance as the pensions dashboard project.

The matter of data standards – having all providers singing from the same hymn sheet – is currently being addressed and good progress has been made, despite the disruption of COVID-19. But there are more fundamental considerations for those managing this data.

"Put simply, can you handle the data?" asks Chris Connelly, who is the propositions and solutions director at technology and outsourcing provider Equiniti, and as a data expert is representing the Pensions Administration Standards Association in its work with the dashboard project.

Many, and in particular pension schemes, should not focus on their own membership, but look at the overall size of the market. "Everyone who goes to a dashboard will generate a search, so you must consider the overall usage," says Connelly.

If the dashboard is a success and millions of individuals use the dashboard a year, will your organisation be able to handle that in house or will you need to work with a technology partner to manage that traffic?

Data quality issues will not only impede the process of servicing dashboard requests, but increase the cost of providing responses. The data must be found, provided in a specified format so it can be presented to a consumer in a way for them to understand their pension savings.

But once the data standards are set, there is no guarantee that the assumptions used to arrive at the data will be standardised to provide consumers with information they will understand.

This is a major concern for former pensions minister Baroness Ros Altmann, who fears that without simplified standard, there is little chance of delivering a meaningful consumer dashboard. A meaningful dashboard for Lady Altmann would include figures that a consumer can either understand or trust to make an informed decision about their retirement saving.

But how will that be achieved when there is no consensus on standardising the simplest of paper- based pension statements?

"A dashboard would potentially help consumers, but it needs to be accurate and introduced in a way that consumers can be confident in security and reliability," says Lady Altmann. "Standardised simpler statements, simplified terminology, better financial education and more guidance or advice will be needed to deliver a new approach that consumers can relate to."

Before COVID-19, a growing number of employers had begun to evolve their benefit structures. They were moving from specific milestones such as retirement to encompass a holistic approach and focusing on how finances affected not only wealth, but the mental and physical health of their employees.

Programmes usually focus on clearing debt and setting goals for short-term saving. The ultimate objective is to give the individual not only sight of potential objectives, but empower him or her to achieve them. Some believe pensions dashboards will only succeed if they are integrated into consumers' everyday financial dealings.

"If it links with open banking and banking or budgeting apps, and we can integrate patient information with money information, it will become more mainstream, says Sir Steve Webb, former pensions minister and partner at LCP. But this remains a long-term project, he says, and we are years away from achieving that level of engagement.

But dashboards present the opportunity to transform the way people interact with their pension, making it simple and easy for them to find out basic information at the touch of a button or stroke of a key.

Development has been slow, but progress is now being made in creating the dashboard ecosystem, and this momentum must be maintained, says Darren Philp, director of policy and communications at technology business Smart Pension. "This project doesn't have to be a moonshot," he adds. "Starting simple and getting basic information to people that they can use to help plan their retirement would be a positive first step."

**PENSION DASHBOARDS GOALS**

According to the progress update from the Pension Dashboards Programme published in April 2020

1. Connect people with all their pensions
2. Present information clearly in plain English
3. Show a comparable estimated retirement income for each pension
4. Signpost people to impartial guidance and/or regulated advice
5. Enable people to understand the information they're seeing
6. Increase people's confidence, making them feel more capable
7. Empower people to make more informed choices about their pensions
8. Contribute to people's overall financial wellbeing

OPINION

## 'We are about to watch a massive acceleration of corporate social evolution'

No one will disagree, coronavirus has changed the game, turning the world on its head. And while we haven't really begun to see the long-term ramifications of 2020, one thing is for sure: there is a sea change happening and with it comes the opportunity to do things differently.

Over the past decade, I've watched environmental, social and governance (ESG) issues move from a small consideration for a select few to occupying centre stage, integral to all decisions and the key risk lens investors use to measure, monitor and evaluate their portfolios. Despite this previous shift, however, the advancement of ESG over the next 12 months is going to make the evolution of the past decade look tiny.

COVID-19 has taught us how quickly the world can mobilise and the resources that can be brought to bear against a specific threat. In a matter of months, governments changed the social contract and, by and large, populations played their part when locked down.

Trillions upon trillions of dollars were spent to support economies until the storm clouds seemed to clear. It shows what can be done when faced with a monumental challenge and it gives me hope that a force of similar magnitude can be galvanised against climate change, helping us move towards a more sustainable future.

Many companies used to pay lip service to the "S", but not anymore. People will remember how you treated others in times of acute stress and customers will understand what a company's true values are, not just words flashed across a website. Employees will want to work for companies that truly look after their teams and customers will only want to buy from companies that treat not only their employees fairly, but also their entire supply chain.

Companies that do both will emerge the winners and companies cutting corners in the short term will ultimately go the way of the dinosaurs. We are about to watch a massive acceleration of corporate social evolution. While already underway, how companies behave in the next 12 months will speak volumes about who they really are, what they really believe in and how far they are really willing to go.

Lockdown showed the difference between companies talking a good game on governance, compared to those that actually had robust structures in place. Think back to the end of March; the economy went into hibernation, offices closed, pubs and restaurants stopped trading. It was as if someone hit the pause button on life, but businesses still had to fight for their survival and do it remotely.

Those that took governance seriously worked long hours, but it was hours spent on building their business to be even stronger and more robust. While those that did not were simply bailing out water from a sinking ship.

In the not too distant future, the head of ESG will be as powerful as the chief information officer. How investors manage risk will change significantly and the questions they ask before making an investment will be different.

The fiscal and monetary support will eventually start to wane and companies will find themselves in a different environment. As investors, we have a golden hour to fundamentally change the industry, creating a better outcome for the environment, wider society and people's retirement. But this window will soon shut, so let's not waste this time.

**77%**

of UK pension schemes and their consultants said investment and reputation risk is the main driver of ESG adoption

mallowstreet 2019

Stuart Breyer
Chief executive, mallowstreet


Commercial feature

## How to spot tech risks in company pensions

Companies have historically assumed that company pension scheme risks are limited only to the investment strategy or the funding model. But many are overlooking another major critical risk: ageing platform technology

Executives are being urged to review the technology supporting their workplace pension scheme, amid concerns that providers' ageing legacy systems are expensive, delivering members a poor user experience and making scaling up tricky.

The limitations of incumbent systems have become a discussion point as finance directors and pension scheme managers future-proof their businesses. It comes against a backdrop of emerging risks, such as vast regulatory changes and an increasingly difficult economic climate.

Smart Pension, a global platform provider with its own UK master trust, is urging those responsible for company pensions to review their incumbent provider's technology and ask whether it offers the service, efficiency and resilience their scheme requires.

"Most pension administration systems were written at least 15 years ago, in programming languages that people don't use anymore. It is expensive, unreliable and isn't scalable," says Will Wynne, co-founder and group managing director of Smart. "In today's world, there shouldn't be a need for people to push pieces of paper around or do manual reconciliations; members are not receiving value for money."

**Time for change**

Wynne's assessment of the industry has captured the attention of big names around the world, with his company attracting nearly a hundred million pounds in investment from companies who agree the global pensions administration landscape is ripe for change.

To date, the company has seen investment from financial behemoths, such as J.P. Morgan, Legal & General, Natixis and Barclays, in its various funding rounds.

The company, founded in 2014, has been growing rapidly with international clients signing up to the Smart platform, such as Bank of Ireland's New Ireland Assurance and the Dubai International Financial Centre. The company is currently on course to have ten million members on its platform by the end of 2022.

The appeal is multi-faceted. It offers seamless integration with payroll software, a mobile app and website for scheme members, a corporate website for the scheme manager and the ability to power the pensions of the future in the UK and abroad. The core focus is retirement technology, working with the best pension providers to turbo-charge their proposition.

Incredibly, many companies are using several, separate platforms to administer their pension for employees around the world, because the process cannot be managed by one central point due to the limitations of legacy systems.

Similarly, member administration can be slow, often requiring manual interventions, which means companies have to pay for teams to handle these requests.

Wynne explains that the Smart Pension platform allows scheme managers to be much nimbler in handling administration and meeting compliance requirements, and enabling them to embrace more sophisticated investment strategies.

"Everything manual has been removed," he says. "In a traditional system, huge intervention is required. With Smart Pension a team of fifty can become a team of five. It takes away a substantial chunk of costs of managing a pension administration platform."

**Spotting regulatory risk**

In the world's largest defined contribution pension markets of the UK, United States and Australia, there has been substantial regulatory change in recent years. Much more is anticipated. Increasingly, companies are recognising they need to move away from systems which make regulatory reporting a difficult process. Ultimately, it is another corporate risk that can be eliminated.

"There is huge regulatory change happening globally in retirement right now," says Wynne. "In the United Arab Emirates, they have pushed forward with reforms in Dubai, while in the UK, the Financial Conduct Authority is focused on its Retirement Outcomes Review."

While global regulators have afforded some extra time for businesses to prepare for the incoming rule changes due to the coronavirus pandemic, the regulatory burden is increasing. In the years ahead, companies will need modern systems which can handle even greater volumes of front and back-office data.

"We have taken every process required by regulators and made it as efficient as possible," says Wynne. "What used to take several weeks can now be done in minutes online. We have built massive scale in the background so our platform can handle tens of millions of members, billions of transactions, and can reconcile across multiple territories."

Smart Pension's co-founder believes companies are now waking up to the dangers lurking in their providers' elderly technology. He hopes that by encouraging them to explore the limitations of their existing systems, they may become aware of the risks to which their business is exposed.

**SMART'S CURRENT TARGET DC PENSIONS MARKETS AND THEIR RESPECTIVE ASSETS UNDER MANAGEMENT**

| Market | Assets |
|---|---|
| US | £16trn |
| AUSTRALIA | £1.7trn |
| EUROPE | £600bn |
| UK | £440bn |
| HONG KONG | £100bn |
| MIDDLE EAST | £45bn |

**For more information please visit smartpension.co.uk**

Smart Pension

ADVICE

# Moving with the times

Thomas Barwick via Getty Images

What is the future role of financial advisers in the pension sector? And how are they using technology to improve clients' financial wellness?

Marianne Curphey

As a result of the coronavirus pandemic and lockdown, many financial advisers have woken up to the benefits of embracing new technology and how it can improve a clients' experience and enhance their financial wellness.

Over the past six months there has already been a substantial change in the way financial advice is delivered with meetings held via Zoom and digital signatures becoming widely accepted.

Technology also shifts the value of the financial adviser, not solely focusing on products but on the holistic financial planning they are offering, says Gemma Harle, managing director of Quilter's advice business. "The value of a financial adviser will increasingly be in the advice they give and not the products based on that advice," she says.

Derrick Dunne, chief executive of Beaufort Financial, says that over the next two years more financial advisers will be investing in technology to better serve their clients. "Technology and investment platforms will complement the wider investment plan, helping the adviser execute and deliver for the client," he says.

For many people, the last six months have been challenging mentally, physically and financially. Personal finances have become a source of anxiety and life has often felt out of control.

"A key thing for all of us when thinking about our financial health is that we have to be honest and realistic," says Heidi Allan, senior financial wellbeing consultant at LCP. "Seeking guidance, support and advice can be critical in enabling us to feel in control of our financial health."

Financial wellness should not be looked at in isolation and should include physical, mental and social aspects of our lives, says Jason Green, head of workplace research at FTRC and Benefits Guru.

"Advisers who are embracing technology to carry out all the number-crunching and admin tasks can free up more time to do what their clients value, that is looking after them properly and giving a more personal service," he says.

There has been a growth in robo-advice, which is the use of technology to recommend asset allocation at a lower cost than traditional financial advice.

Green says a small number of highly sophisticated automated advice systems are beginning to emerge that are likely to play a major role in delivering retirement planning to consumers with modest personal assets.

"Within the next few years, it should be possible for consumers to access comprehensive retirement advice, exploring and contrasting the options," he says. This could revolutionise financial advice, making complex advice available for as little as a few hundred pounds, compared to a possible fee of ten times that level for a human service.

However, when it comes to tax and retirement planning, a more personal touch still has a place, particularly for older customers with substantial assets.

"With the continuous rise of technological solutions and robo-advice, the pension space is definitely shifting," says Chris Ball, managing partner at Hoxton Capital Management. "However, the generation that is currently coming into retirement might still value the advice of a financial adviser and will not completely trust algorithms and computers."

The use of investment platforms and model investment portfolios, as well as the shift to virtual client meetings, has increased the amount of time advisers spend speaking with and advising clients.

"For them, this is where our true value lies," says Leigh Philpot, head of wealth at Kingswood. "We have all embraced it to different extents and we all have further to go."

A combination of human advice and powerful technology could be the key to delivering the best long-term outcomes, says Colin Dyer, head of proposition and private client management at 1825, the financial planning arm of Standard Life.

"What technology can't do is provide the personal touch and marry life goals with attitude to risk, the investment strategy, tax efficiencies, like making the most of lifetime and annual pension allowance, and ultimately agreeing the desired target income," he says.

The adviser of the future might therefore harness the best of technology with the understanding of a client's personal and financial circumstances.

"Pension advice has traditionally been a face-to-face interaction that might cost 2 per cent of your pension each year," says Chris Rudden, investment consulting manager at Moneyfarm. "Now it can be done quickly, easily and accurately from a phone or computer."

As factors in your life change, you simply update the app. This brings the costs down hugely. "More often than not, there is a team of advisers on the other end of the phone or computer that they can speak to," he says, predicting a hybrid model is key to the future of the industry.

True financial wellness comes from understanding the client and their needs, and helping them to live happy and fulfilling lives through creating well-thought-out financial plans, says David MacDonald, founder of The Path, a financial advisory firm with an emphasis on ethical investment.

"Robo-advice will become more accurate and sophisticated as time goes on," he says. "However, there is a long way to go before robo-advice can cope with complex moral and ethical dilemmas and 'soft' counselling."

> Those embracing tech to carry out number-crunching, admin tasks can free up more time to do what their clients value

### Top tips for financial wellness from the experts

"Pay yourself first; set up a monthly standing order to a savings account that leaves your current account on payday. Spend some time thinking about how money presented itself in your early life. Think about the things that make you truly happy and spend your money on those things."

**Jeannie Boyle,** director and chartered financial planner, EQ Investors

"The earlier you start a pension the better, no matter how small the contributions might be in the early years. If your employer offers a workplace scheme, ensure you enrol as it will be low cost. Look at your level of contributions and whether that level is sufficient to fund your retirement."

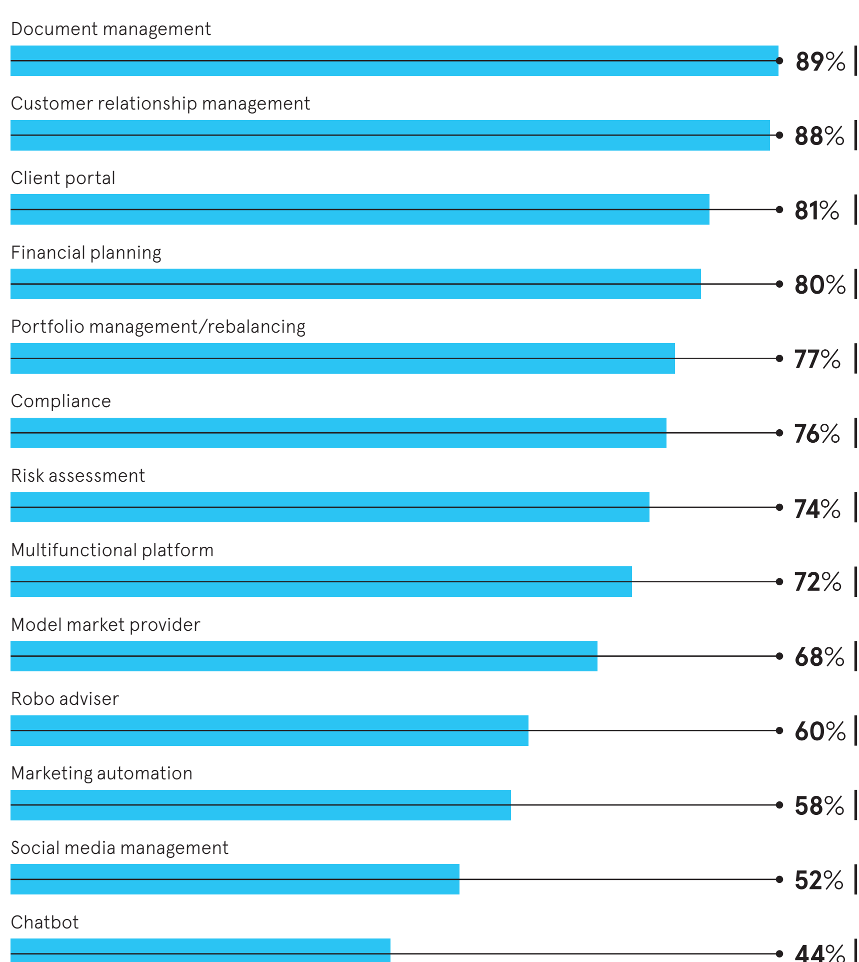
**Anna Murdock,** head of wealth planning, JM Finn

"Invest in yourself, in terms of your health, your skillset and your qualifications. Educate yourself so you understand your finances; this will help you connect emotionally with your financial goals. Establish more than one income stream and be creative about how you earn your money."

**Jamie Smith,** financial adviser, Foster Denovo

### MOST POPULAR TECH FOR ADVISERS

Share of UK financial advisers that use the following tools




Financial Planning 2020

Commercial feature

# It's time to confront the pensions data problem

Asset owners and managers are grappling with a series of data and operational challenges preventing them from achieving better investment returns, efficiencies and reporting

Extended life expectancy and decreasing birth rates in the developed world are forcing pensions to rethink their operating and investment models. The shift from defined benefit to defined contribution pension plans shifts the onus for retirement planning from corporations and governments to families and individuals. Public and political resistance to much-needed reforms, such as raising the retirement age, lowering state benefits or mandating increased contribution rates, further complicates the pensions landscape.

From a returns perspective, nominal interest rates at or below zero prohibit asset owners from generating low-risk returns in line with anticipated future liabilities. In the meantime, shrinking public markets, as more corporations delist, are resulting in capacity constraints for pension funds that invest strongly in publicly traded securities and strategies, driving growing asset owner fund flows into private assets that present their own challenges.

New regulations around liquidity risk management and collateralisation of over-the-counter derivatives can add another layer of difficulty. The latest International Financial Reporting Standard, for example, has resulted in the additional recognition of fair value changes that will probably see an increase in the impact of market value on asset owners. As asset owners diversify more of their holdings globally in the pursuit of better risk-adjusted returns, they also will be caught by supra-national regulations such as MiFID II (Markets in Financial Instruments Directive II). Trading errors from stale or inaccurate position data can trigger compliance violations.

As asset owners struggle with these issues, they are looking to their asset managers for innovative solutions. "Against a backdrop of margin compression and competition for asset owner allocations, asset managers need to offer differentiated services, investment insights or seamless access to data," says John Plansky, global head of State Street Alpha[SM], State Street's front-to-back investment servicing platform for global investment managers, wealth managers, hedge funds, asset owners and insurers. "However, cost-effectively managing these new offerings creates a number of operational challenges for firms constrained by legacy technologies, which are ill-suited to handling complexity."

Amid these mounting challenges to achieve better investment returns, realise greater efficiencies and deliver more accurate, timely reporting, assets managers and owners urgently need a clear view of cash and positions across the enterprise at any given time. But doing so requires a strong and reliable data foundation, which many don't have.

For asset managers, differentiating their value proposition to pensions involves offering increasingly sophisticated derivative-based yield enhancement strategies, volatility-capped funds, and targeted environmental, social and governance mandates. Cost-effectively managing these strategies and communicating risk and performance on a daily basis to clients requires shared access by asset owners and their managers to a holistic and up-to-date reporting platform.

State Street's 2020 survey of asset owners confirmed these trends, with more than half of respondents concerned their organisations will lose competitive advantage if they fail to improve data integration. Asset owners polled in the study also noted their challenges with fragmented IT systems that fail to adequately support their investment activities.

"It's not hyperbole to suggest that a strong data foundation is an existential issue for asset owners and managers globally," says Plansky. "Without control over and access to their data, pension schemes are potentially flying blind, unable to shift course, leverage new investment opportunities, or hedge their liabilities during periods of market turmoil and against long-term trends impacting their beneficiaries.

"Asset managers with trading desks across multiple time zones and geographies require fast and flexible reconciliation as they 'pass the book' from region to region, which is increasingly important for pensions allocating globally. Meanwhile, compliance teams need the ability to retrieve and reconstruct historic positions for faster, better-informed responses to regulatory inquiries. Many back-office systems are unable to do this, which forces firms to perform time-intensive manual position reconstruction."

Liquidity challenges caused by the coronavirus pandemic make real-time views of exposures, cash and holdings even more important. The sell-off in global equity markets during the initial response to the pandemic exposed a number of vulnerabilities facing asset owners that were almost inconceivable previously. When lockdowns and quarantines resulted in sudden mass unemployment, and government mandates permitted members to access retirement savings, pension funds responded by selling equities to raise cash.

Recent market turmoil has focused attention on the deficiencies of liquidity sourcing assumptions in asset owner operating models. Reports of external investment managers refusing asset owners' redemption requests have surfaced, highlighting the unintended consequences of outsourced asset management in a liquidity crunch. Constrained liquidity is further complicated by the opaque and complex fund structures employed by many asset owners involving multiple external asset managers, sub-managers and pooled funds.

With its unified investment management platform, State Street Alpha, the company provides institutional and wealth management firms with a front-to-back asset servicing solution. Alpha lets clients manage any assets in any market and streamline their day-to-day processes, helping to facilitate innovation, better inform investment decisions, optimise returns and improve business operations. Alpha delivers a "single source of truth" across both asset owners and their internal and outsourced asset management teams and asset servicing providers.

Many asset owners managing assets internally will manually transform back-office data into their start-of-day cash and position view, a process fraught with risk and the potential for serious errors. Alpha's Investment Book of Record and middle-office services provide a highly automated solution to this vexing problem. Meanwhile, State Street's partnership with Solovis enables clients to calculate performance at every level of a portfolio with all available data points, calculate liquidity on select investments or for their entire portfolio, and analyse exposures across public and private assets.

> It's not hyperbole to suggest that a strong data foundation is an existential issue for asset owners and managers globally

"The asset management industry is experiencing a major shift," says Plansky. "Historically, investment data was consumed in the moment. Storing and curating historic data was prohibitively expensive and operationally intensive. Cloud-based data warehouses have shattered that barrier. These platforms capture the volume, velocity and variety of data generated from trading, risk, compliance and portfolio management systems, capabilities that seemed impossible just a decade ago." Complementary services leveraging both human and artificial intelligence to validate, curate and enrich these disparate data sources enable asset owners and managers to make better and faster data-driven decisions.

Plansky concludes: "The ability to quickly and accurately reconstruct a complete picture at any point in time of cash, positions, exposures, securities on loan and encumbered collateral is a game-changer, enhancing asset allocation and hedging strategies. By providing a real-time, end-to-end view of asset owner and manager data, State Street Alpha enables more profitable securities lending, optimised collateral and cash management, and better-informed corporate actions elections aligned with long-term investment policies and strategic allocations. These are key enablers to confronting the challenges facing pensions globally."

> Cost-effectively managing these new offerings creates a number of operational challenges for firms constrained by legacy technologies, which are ill-suited to handling complexity

**For more information, please visit statestreet.com**

Commercial feature

# Time to plan your pension

Whether it's the new school year, or just the chill in the air, autumn is strangely invigorating. It's a time when many of us feel the need to reset our lives and lay some plans for the future

**Emma Byron**
**Managing director, Retail Retirement, Legal & General**

Autumn is certainly a good time to tackle a job you may have been ignoring. Few of us enjoy taking a clear-sighted look at our financial future, but spending a day on retirement planning is essential financial maintenance. We can't do it for you, but Legal & General has produced a range of resources that can help at any stage, whether you're starting to learn or wanting to brush up your knowledge.

We do understand just how overwhelming retirement planning can feel. Our research shows that people spend more time choosing a car than designing the last third of their adult life; a bit odd, when you consider that planning your later life is probably the most important piece of financial planning you will ever undertake. We know the coronavirus has increased uncertainty and brought financial worries to many; more than a million of those over 50 are now considering delaying retirement. So it is more important than ever to understand your options.

By spending just one day on retirement planning, you can make a significant difference to your future. It might be short-term pain, but it's very much long-term gain, with some juicy rewards to look forward to. So, what's the best way to start, apart from pouring yourself a big mug of coffee?

Following the old proverb, that the best way to eat an elephant is to take it one bite at a time, the best way to tackle pensions is to break it up into manageable-sized bites. You may already have a lot of the information and knowledge you need, but key to making decisions is understanding. The better you appreciate your choices, the more confident you will be in taking the route that is right for you. Pensions aren't as complicated as sometimes appears and there are many resources out there, from the simplest online calculator to more formal learning programmes.

We believe there are five elements to consider:

- understanding how to work out the income you'll need in retirement;
- understanding how your pensions and the state pension operate, and how much income they should provide;
- understanding the different options for providing an income in retirement, and the pros and cons of each option;
- understanding the options available if your pension income is unlikely to provide sufficient income for you in retirement;
- understanding what other plans you need to manage your finances later in life.

These five elements are covered in a free online course, produced by The Open University in collaboration with Legal & General. You can find the course, *Retirement Planning Made Easy*, at open.edu/openlearn/retirement-planning-made-easy.

> By spending just one day on retirement planning, you can make a significant difference to your future

It should take about three hours to work through the course, although you don't have to do it all in one go. It sets out the steps to a financially secure retirement through a mixture of reading, short videos and activities.

But we all learn in different ways and you may prefer listening to a podcast while you go about your daily life. Legal & General has teamed up with *Strictly Come Dancing* judge Shirley Ballas, who turned 60 this year but is certainly dancing into later life with a great deal of energy and pizzazz, to produce a series of podcasts on topics ranging from how coronavirus might impact your retirement income to sharing money with the family.

Shirley is a brilliant interviewer, who chats to other retirees and would-be retirees, as well as tapping a panel of experts for explanations of some of the trickier pensions jargon. The podcasts, which each last around half an hour, are such an easy way to take in a lot of knowledge while you soak in the bath, go for a run or finish your commute. Find the whole *Rewirement* series at legalandgeneral.com/podcasts.

You can also find *Your Guide to Retirement Income* online, our 20-page guide to a more colourful retirement. This is a straight-talking guide that sorts fact from fiction. Did you know there is a 25 per cent chance that a woman aged 65 today will live to the age of 94? Or that about 250,000 Britons aged 65 and over live overseas?

The guide helps you envisage your own, unique later life. Let's face it, there are so many different ways of enjoying life; retirement is no longer the cliff-edge moment it used to be and you might be looking forward to part-time work, volunteering or studying for a degree. There are so many possibilities and this guide might be the best way to indulge in a bit of creative, blue-sky thinking.

One of the problems with financial planning, of course, is that you don't know how your life is going to pan out. This is where online calculators can prove useful; many give you the option of playing with retirement dates or pension pots. Would you rather retire now on less or retire later with more? How much later and how much more? Maybe you'd rather aim at a specific goal; a calculator can show you what extra savings you need to retire in style.

You can also compare the annuity on offer from your current provider with others. If you are aged 55 or over with a pension pot of at least £2,000, try annuityready.com to compare quotes and learn a bit more about what's on offer.

**Attitudes to retirement (among over-50s)**

**1m+**
are considering delaying retirement

**73%**
agree increasing life expectancy makes it more important to plan for later life

**58%**
of workers over 50 are concerned about the impact of the pandemic on their long term savings

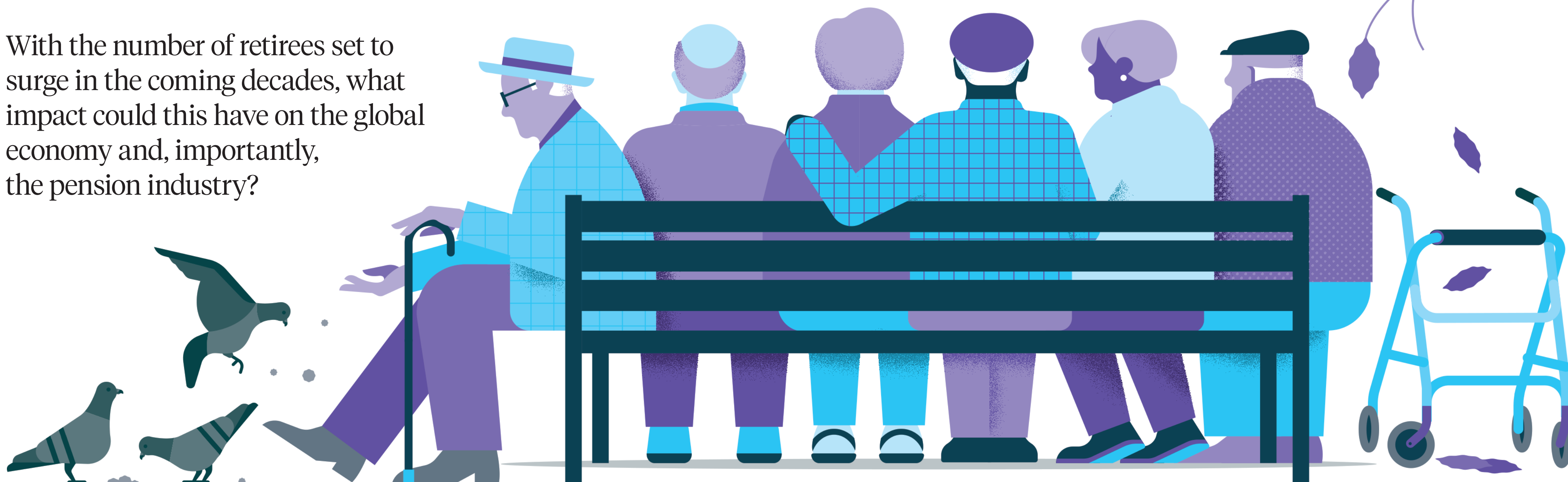
Finally, don't forget there is personal help and guidance out there. If you prefer, you can speak to a financial adviser. Ask around for recommendations or go to unbiased.co.uk, which shows all the regulated advisers in your local area. There's also a directory of advisers at the Money Advice Service (moneyadviceservice.org.uk), the government-run website offering free and impartial money advice. You can even get a free consultation with Pension Wise (pensionwise.gov.uk), which is also a government-run service to help you understand your pension and explore your options.

**For more information please visit legalandgeneral.com/retirement**

AGEING

# How to cope with the pensioner boom

With the number of retirees set to surge in the coming decades, what impact could this have on the global economy and, importantly, the pension industry?



**Alec Marsh**

As you read this there are some 7.7 billion people in the world. Not only is that figure increasing by the second, but so is the average age of our fellow planet-dwellers. Come 2050, the United Nations estimates this upward trajectory will have added another two billion people to the Earth's population.

Significantly, some 1.6 billion of these 9.7 billion souls will be over 65, which means that in 30 years one in six people will be of retirement age. That compares to just one in eleven today.

Of course, the planetary greying will not be evenly distributed: one in four people in Europe and North America is expected to be over 65, while the population of over-65s will double elsewhere. Meanwhile the number of people over 80 is expected to rise from 143 million today to an astonishing 426 million in 2050. That's not far off the present population of the entire European Union.

Against this backdrop, 55 countries or regions will see their populations decline, many markedly, all helping to reduce the proportion of workers to dependents.

Already in Japan that ratio is 1.8, so each pensioner is supported by fewer than two workers. In 30 years, 48 countries will have ratios under two. "These low values underscore the potential impact of population ageing on the labour market and economic performance, as well as the fiscal pressures that many countries will face in the coming decades as they seek to build and maintain public systems of healthcare, pensions and social protection for older persons," the UN warns.

In other words, it's not looking good. And it gets worse when you consider studies have shown that an ageing population will also reduce levels of economic growth. For evidence of this, look no further than the insipid economic performance of Japan over the last two decades.

> It's something that people know about and most people recognise it's a problem, but in terms of solving it, it's baby steps

Mark Williams, chair of the pensions board at the Institute and Faculty of Actuaries, puts the scale of the pension problem this way: "It's a little akin to climate change in a sense that it's something that people know about and most people recognise it's a problem, but in terms of solving it, it's baby steps," he says. "At the moment, the pace of change is too slow for us to have a situation where things are going to improve in a way that isn't going to lead to a pretty big car crash at some point."

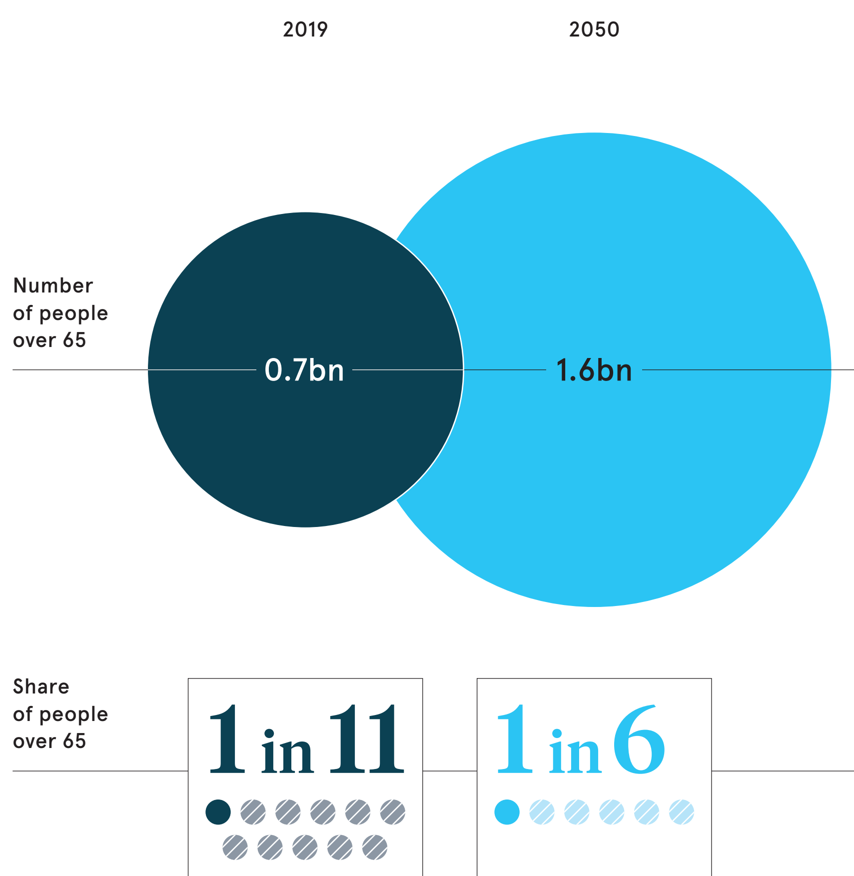
So just how bad is the pensions shortfall? "There is no doubt that there is a generation of people who are not going to be able to afford to retire at any sort of sensible age based on current projections," says Williams. "The implications of that are enormous."

Just one is that even though the population of over-65s will soar, the numbers who actually retire will start to lag. "I would certainly expect that people will need to work into their seventies," says Williams.

Across countries in the Organisation for Economic Co-operation and Development (OECD), the official long-term retirement age average for those entering the workforce now is 66, while in the UK it's 68. But if Williams is right, this could just be the tip of the iceberg. If people can't afford to retire, they won't.

Another factor in play is the economic health of those retiring in 2050; currently new retirees might reasonably expect to have paid off mortgages. But you might not be so lucky in the 2040s and this is not just a British problem either. "The trends for an ageing population and for there being an adequacy problem around pension saving in a money purchase form are certainly issues that are prevalent around the globe," warns Williams.

**OLDER POPULATIONS SET TO SURGE**




So what needs to be done? Most importantly, more money needs to be saved for old age – actuaries say it's £800 a month in the UK – which will probably need to come from increased employers' contributions as well as employees' themselves, and the state. "If everyone does something there is a set of circumstances that means you are not in a doom-and-gloom scenario," Williams adds. "But there is no doubt this means quite a big change, just as it does for climate change.

"This is a massive issue facing our industry. The first step is to recognise it, then take the steps. But it will take a bit of pain and a lot of work."

Monika Queisser, the economist who is head of social policy at the OECD, doesn't deny the challenges, but takes solace in the fact that effective retirement ages are increasing and labour-force participation among the elderly and women is rising.

"There's no silver bullet," says Queisser. "Working longer remains the most effective way to deal with the challenge. By working longer you're reducing the time you have to be paid a pension and you're increasing the resources that go into the pension system through contributions."

But she does not think people will continue to work into their seventies in great numbers, mainly because for many, such as manual workers, it won't be an option. Similarly, while many countries have scaled back their pensions promises to balance the books, she says: "There's limits to how far you can go because obviously people need some sort of meaningful replacement of their earnings in retirement."

This leads to her main concern: the prospects for old-age inequality. "This is something that countries should be worrying about a lot more. It's also one of the reasons why increasing retirement ages is so unpopular because there's so much inequality in life expectancy, where you have people from high socio-economic groups who live much longer than people from lower socio-economic groups. This compounds over the life cycle," says Queisser.

When you consider that income inequalities in developing and emerging economies are typically higher than in OECD countries, as indeed are the health inequalities, then you begin to see the scale of the problem. And that's before you account for the much higher proportions of the workforce in informal parts of the economy, many of whom are unlikely to fall within a pensions system, in developing countries. That's a figure which is as high as 80 to 90 per cent in India, for instance.

"If those countries don't succeed in lowering health and income inequalities and education inequalities over the life cycle, they're setting themselves up for even more dramatic inequalities in old age," Queisser warns.

In short, it could be a bumpy ride. So start saving and buckle up.