Media Comments 2015

Charge cap 'nonsense' as hidden costs hike up fees, by Rebecca Shahoud, Professional Pensions, 21 December 2015

The 0.75% charge cap has been branded 'nonsense' after government research found most providers could not calculate charges not covered by the limit that members were paying.

The research, carried out on behalf of the Department for Work and Pensions (DWP), surveyed 12 providers, including eight of the top ten by market share.

It found most qualifying schemes run by these firms already complied with the cap, although just a quarter of non-qualifying contract based schemes, and half of non-qualifying trust-based schemes had charges below 0.75%.

The research also found that just five providers could give figures for fees such as transaction costs that fell outside the cap, which was introduced in April.

Critics accused the government of trying to bury the figures. SCM Group founding partner Gina Miller said: "I find it interesting that the DWP published such an important paper at a time of year when most people won't read it."

Of the three master trusts that gave information on ongoing transaction costs, one said members incurred fees of 0.01% a year.

In the other two schemes, 72% of assets attracted additional fees of 0.75% or more.

Miller said: "The 0.01% or less must be a lie, as even index funds have trading costs for buying and selling that account for more than this.

She added: "It's shocking that, where infrequently declared, 72% of assets have transaction costs of over 0.75%, which means the fee cap is nonsense.

"The most amazing thing is how few of the contributors seemed to be capable of actually completing the templates or understanding the charges, including transaction costs."

Many providers surveyed struggled to calculate fees. Four of the 16 originally approached found the data gathering process "too onerous", and didn't participate.

Of the 12 providers that participated , only three found completing the research straightforward. These were all master trusts set up specifically as auto-enrolment vehicles.

Estimates of different transaction costs varied from provider to provider, with some arguing that their members did not incur any charges for fund entry, while another

confirmed that entry costs led to a reduction of up to 0.40% of the value of each member contribution invested.

Pensions Institute director **David Blake** said costs outside of the cap could not be ignored.

“These are genuine costs, borne by the consumer, and it’s ridiculous to have a charge cap that only accounts for part of those charges,” he said.

The DWP survey found that members of smaller schemes were the worst off, as members typically paid more in charges than members in larger schemes or with larger employers.

1,000 defined benefit pension plans ‘unlikely’ to pay in full, by Josephine Cumbo, Pensions Correspondent, Financial Times, 14 December 2015

About 1,000 private-sector pension schemes, including 25 of the largest in the UK, are “highly unlikely” to pay their members’ pensions in full, new analysis suggests.

The stark findings, in a paper published on Monday by the Pensions Institute, a research body, suggest the number of troubled pension schemes is far higher than officially acknowledged.

In the UK, there are more than 6,000 “defined benefit” schemes, where the employer promises to pay a pension typically based on a proportion of final salary to the member, and then to a spouse or dependent after the member dies.

But these pension schemes, with about 11m members, have come under pressure from low gilt yields, which increase the cost of the pension promise, and increasing life expectancy. They have aggregate liabilities near £1.1tn.

The paper suggests 1,000 of these schemes, with a combined deficit of £45bn, are subject to “unmanageable” financial stresses. As a result, 600 will “never” pay full pensions, and a further 400 may see their sponsoring company sink under the weight of the pension scheme burden.

The number of “stressed” schemes in the paper represents 15 per cent of those potentially eligible for compensation from the Pension Protection Fund, the lifeboat scheme for defined benefit scheme members when an employer goes bust. This compares with a PPF estimate of 10 per cent of schemes.

“For political and economic reasons, the crushing reality of the situation in which trustees of stressed schemes find themselves is not publicly acknowledged,” said report co-author, David Blake, Professor of Pensions Economics and director of the Pensions Institute, which is attached to London’s Cass Business School.

“If this situation is not addressed urgently, the future pensions of members and their dependants may be reduced over the next five to 10 years, during which time we anticipate the sponsoring employers may become insolvent.”

The analysis indicated that a new regulatory objective, which allows employers to divert pension contributions to invest in business growth, was in “direct conflict” with their role to support trustees and simply served “to kick the [pension deficit] recovery can down the road a few years”.

The report made a number of radical proposals to avert the “worst case” scenario of 1,000 schemes becoming insolvent, including allowing stressed schemes to introduce conditional indexation of pensions, or the power to restrict members’ benefits, including pensions in payment.

This scenario, would be likely to give members, particularly younger ones, a higher pension than the one they would receive from the lifeboat fund if their employer failed, said the paper.

“This report raises some well-known issues which we have drawn attention to in the past; we absolutely agree on the challenge of poorly funded schemes with weak sponsors,” said Alan Rubenstein, chief executive of the PPF.

“Trustees of weak schemes shouldn’t be asleep at the wheel and we know colleagues at the regulator are focused on these issues.”

Ros Altmann, the pensions minister, said that over the years both the Pensions Regulator and PPF had “fulfilled their duties admirably”, with far fewer schemes than expected actually failing.

“The recommendations in this report would lead to much lower pensions for many scheme members,” said Baroness Altmann. “The government, the PPF and the regulator are . . . aware that some schemes are backed by very weak employers, but that does not mean they should be pushed into cutting members’ benefits.”

The Pensions Regulator said it recognised that a “minority of schemes” were stressed. “However, we believe that appropriate funding agreements can be reached in the vast majority of cases without the need for direct regulatory intervention, and that most members will receive their full benefits,” said the regulator.

Pension providers in survival of the fittest showdown as market merges, with a small number of players controlling most of the total assets under management by 2020, by Hayley Kirton, City A. M., 30 November 2015

The market for auto-enrolment scheme providers will be dominated by a handful of major players by 2020.

According to a report released today by the Pensions Institute at Cass Business School, fewer than 10 organisations will form a premier league of providers, controlling 90 per cent of total assets under management.

“By 2020 several well-known life companies will no longer exist in their present form, or at all,” said Dr Debbie Harrison, visiting professor at the Pensions Institute and co-author of the report. “Some will be bought wholesale by more competitive life companies; others will be sold-off piecemeal as a series of books of business.”

However, far from creating a marketplace devoid of competition and congested with bad deals for the consumer, the report instead predicts that firms will strengthen their offerings by specialising, warning that “the days of making money from being a ‘jack-of-all-trades and master of none’ are over.”

Speaking to *City A.M.*, Clive Bannister, chief executive of the Phoenix Group, whose company sponsored the research, said: “My observation is that there will be continued consolidation, which will result in fewer, larger players that will represent an oligopoly. An oligopoly can, in real sense, deliver value of clients. Why? Because the oligopolies are larger and then can pass on the benefits that that scale brings.”

The level of assets under management is also expected to nearly double over the next five years, going from £280bn to £550bn.

Consolidation to create pension provider 'premier league', By William Robins, Citywire, 30 November 2015

A ‘premier league’ of life companies will be created by ‘massive’ consolidation in the market according to a major pensions report.

According to a report by the Pensions Institute a raft of recent reforms and changes to the market, such as the retail distribution review, auto-enrolment and the pension freedoms, have ‘broken [the] near monopoly’ held by UK life companies.

It said the resulting consolidation, with businesses leaving the market or going under, would concentrate £550 billion of assets into the hands of a few remaining players, which it described as a pensions premier league.

While auto-enrolment will push up total assets from the current £280 billion to £550 billion, the report said 90% of these assets would be concentrated in a maximum of 10 life companies with contract-based workplace schemes and 70 providers of master trust schemes.

Debbie Harrison, visiting professor at the Pensions Institute and co-author of the report, said: ‘By 2020 several well-known life companies will no longer exist in their present form, or at all. Some will be bought wholesale by more competitive life companies; others will be sold off piecemeal as a series of books of business.’

Life companies faced competition from emergent master trusts such as NOW: Pensions and the National Employment Savings Trust.

The report said the premier league will be dominated by large-scale, multi-trust defined contribution schemes.

It said policy and regulatory changes such as changes to the rules on commission payments had ‘broken the life companies’ historic monopoly in the “value chain”’.

It also said an ISA-style system of pension taxation, where contributions are taxed but income is paid tax free, as opposed to the current exempt-exempt-taxed system where only income is taxed, would remove the requirement to save using a pension wrapper

'eliminating one of the few remaining benefits to the traditional life company business model'.

The move was floated by chancellor George Osborne in his Summer Budget this year.

He said: 'I am open to further radical change; pensions could be treated like ISAs. You pay in from taxed income but it is tax free when it is taken out and when it is in there it receives a top-up from the government.'

Pensions 'premier league' to dominate as some life cos disappear – report, Professional Adviser, 30 November 2015

A ‘premier league' of ten or so providers will emerge to control most pension assets within the next five years as mass consolidation sweeps across the life company sector, according to a report.

The retirement reforms introduced in April plus far-reaching regulatory changes, as well as the emergence of new providers in the auto-enrolment space, are threatening to transform the industry, a Pensions Institute study seen by the *Financial Times* concludes.

The report predicts that, between 2016 and 2020, assets held in workplace pension schemes for auto-enrolled workers, and managed by some life companies, would increase from £280bn to £550bn.

But it concluded that, by the end of that period, the number of players in the private sector pensions market would drop from about 80, including ten life companies, to a ‘premier league' of about ten providers controlling 90% of those assets, according to the *FT*'s analysis of the report.

The ‘relegated' providers will include mid-tier life and pensions companies and smaller master trusts that "do not have the scale and deep pockets to succeed in a market characterised by scale and a cut-throat pricing war", according to report co-author Dr Debbie Harrison.

A series of "major policy and regulatory changes has broken the life company's historic monopoly of the ‘value chain'," the report reads.

"Some will be bought wholesale by more competitive life companies; others will be sold off piecemeal as a series of books of business."

"The premier league will be dominated by large-scale, multi-trust DC schemes," said the report.

The report by the Pensions Institute at London's Cass Business School is set to be published on Monday.

Pensions Institute predicts large scale consolidation among life companies, by Rebecca Shahoud, Professional Pensions, 30 November 2015

Research from The Pensions Institute predicts the demise of many life companies, while assets under management (AUM) are expected to double to £550bn

The research - *The Meaning of Life: An uncertain future for the traditional life company business model in the UK's private sector pensions market* - anticipates that fewer than ten organisations will be in the 'premier league' of auto-enrolment (AE) scheme providers.

These organisations will control 90% of total AUM.

The report published today recommends that life companies need to reconsider the design of their business models.

It calls for clearer guidelines from the government, and a change from its "piecemeal approach to pension reform to one that is coherent, integrated and reflects a long-term cross-party policy consensus".

It says that unless consolidation in the AE market is well-governed by the government and regulators, there will be market instability.

This consolidation trend is expected to intensify as further reforms come into force. It also predicts that AE will fail both employers and members.

The introduction of freedom and choice will have an impact on the defined contribution (DC) pension system. It says the DC system will no "longer work as a corporate retirement-management tool".

The report also highlights concerns that the regulator's rules for master-trusts are not tight enough, and member protection if a provider defaults is unclear. These concerns are particularly pertinent given the expected large number of exits from the small and medium-sized master trusts.

The People's Pension director of policy and market engagement, Darren Philp said: "This report from the Pensions Institute provides a welcome overview of the state of the UK pensions market, and throws down the gauntlet to the industry to reform and modernise.

"Consolidation will happen and will happen quickly. We think the DC market is at a crossroads, and that consumers deserve better.

"It is more important than ever that we ensure people are put in good value schemes that put people first and deliver for members."

Visiting Professor at the Pensions Institute and co-author of the report, Dr Debbie Harrison said: "By 2020 several well-known life companies will no longer exist in their present form, or at all. Some will be bought wholesale by more competitive life companies; others will be sold-off piecemeal as a series of books of business.

"At this watershed in the long history of UK life companies, clarity of understanding of market conditions, together with a clear vision for the future, is essential for survival."

Life sector warned over pensions ‘premier league’, by Josephine Cumbo, Pensions Correspondent, Financial Times, November 30, 2015

The UK’s life company sector is headed for “massive” consolidation over the next five years with several well known names expected to exit or fold and a “premier league” of pensions providers emerging to control £550bn in assets, warns a new report.

The predictions — in the first independent review of the pensions market since the government’s overhaul of the sector in April — could prove uncomfortable reading for the industry and painful for pension savers.

Life companies, which have their roots in selling insurance policies, also sell long-term savings and investments as well as workplace pensions. They include well-known names such as Legal & General, Standard Life and Aviva.

But recent reforms, including the 2015 pension freedoms, and a shake-up of commission and charging models, have “broken their near-monopoly”, according to the report published on Monday by the Pensions Institute at London’s Cass Business School.

The analysis said life companies were also under threat from a powerful new breed of providers targeting the lucrative automatic enrolment pensions market, operating under light-touch regulation.

“By 2020 several well known life companies will no longer exist in their present form, or at all,” said Dr Debbie Harrison, visiting professor at the Pensions Institute and co-author of the report.

“Some will be bought wholesale by more competitive life companies; others will be sold off piecemeal as a series of books of business.”

The report forecast that between 2016 and 2020, assets held in workplace pensions schemes for auto-enrolled workers, and managed by some life companies, would swell from £280bn to £550bn.

But by 2020, the number of players in the private-sector pensions market would be slashed from about 80, including 10 life companies, to a “premier league” of 10 or so providers controlling 90 per cent of those assets, the report predicted.

“The premier league will be dominated by large-scale, multi-trust DC schemes,” said the report.

“The ‘relegated’ providers will include ‘mid-tier’ life and pensions companies and smaller master trusts that do not have the scale and deep pockets to succeed in a market characterised by scale and a cut-throat pricing war.”

The research warned that life companies were “at a crossroads” and faced stiff challenges from “master trusts”, or newer pension schemes run for multiple employers such as Now Pensions and The People’s Pension. Unlike life companies, master trusts were not shackled by legacy “back books” of policies.

But a series of “major policy and regulatory changes has broken the life company’s historic monopoly of the ‘value chain’,” said the report.

The report warned consolidation could be painful for millions of members of workplace pension schemes unless it was “well-managed by the industry and the regulators to avoid market instability”.

“There are particular concerns about the expected large number of exits from the small and medium-sized master trust market,” said the report.

“This report highlights the two-speed system of regulation that sees trust-based schemes subject to much less regulation than private schemes,” said Yvonne Braun, a director at the Association of British Insurers. “We have been calling for this to be addressed for some time.”

The potential for a “messy” shake-out in the automatic enrolment sector, which is set to expand from 5m to 10m members by 2018, has been acknowledged by both the government and regulators.

Concerns were expressed that the entry level barriers for the new breed of master trusts were low, capital requirements were weak and no safety nets were in place if the provider collapsed or failed.

In October Baroness Altmann, pensions minister, said she recognised these concerns and “doing nothing was not an option”.

In response to the report, Baroness Altmann said: “It is essential that the right protections are in place to address the risks of members losing out in situations like this, but equally we should not scaremonger.

“There are some very well-run schemes out there, but I want to make sure every master trust is good enough to be used for automatic enrolment.”

Phoenix Group, a life company that sponsored the report but did not influence its recommendations, said the analysis would be uncomfortable reading” for life companies.

“But the industry needs to acknowledge and address them,” said Clive Bannister, chief executive of the Phoenix Group.

High fees hurt pension savings for millions of Europeans, by Chris Flood, FTfm, 27 September 2015

Excessive charges on pension savings products are said to be destroying the hope of a comfortable retirement for millions by eating into investment returns.

According to Better Finance, the Brussels-based investor rights group, pension products in many European countries have delivered disappointing or even negative long-term returns despite the positive performance of equity and bond markets since 2000.

"It has become increasingly clear that the main culprit for the disappointingly low returns of pension savings products is the excessive level of fees and commissions charged," said Guillaume Prache, managing director at Better Finance.

Mr Prache said neither savers nor supervisors were properly informed about the true performance of pension products once fees, taxes and inflation were taken into account.

The absence of a comprehensive official analysis of real after-tax pension returns for all EU countries meant European regulators "do not know the actual performance of the services they are supposed to supervise", said Mr Prache.

Better Finance will on Wednesday publish an updated analysis of the European pension market that has been extended to 15 countries, with net real returns data going back to 2000.

The report shows substantial variations in pension performance between countries. Pension funds in Denmark, Poland and Romania delivered the strongest performance since 2000.

Pension funds recorded negative annual returns in countries including Spain (-0.62 per cent between 2000 and 2014), Bulgaria (-0.77 per cent for occupational schemes between 2004 and 2014) and Latvia (-0.82 per cent for state-funded schemes between 2003 and 2014).

David Blake, director of the pensions institute at Cass Business School in London, said he wants pension funds to adopt a standardised method of reporting performance net of costs.

"But this would need to cover more than visible costs, such as fees and commissions. There are a whole range of hidden costs that can amount to 80 per cent of total costs for very actively managed funds," he said.

Better Finance has also recommended that hedge funds and other alternative investment funds be forbidden within pension products sold to retail investors.

It said policymakers should proceed with plans to introduce a simple and cost-effective pan-European personal pension plan that would be accessible to all without the need for a financial adviser.

Benefits of UK pension scheme mergers outweigh risks for Treasury, by Madison Marriage, FTfm, September 20, 2015

Plan faces resistance from failing funds as well as ones wary of taking on underperforming peers

People could be forgiven for assuming the pension market is a boring place compared to the scandal-ridden world of banking, the film industry or the rapidly changing technology sector.

Yet this assumption overlooks the fact pension funds are at the heart of some of the most vociferous political debates in modern society.

A bitter war looks set to engulf the UK's 150 public sector pension schemes that are under increasing pressure to cut costs by pooling their resources. Most pension experts agree it is critical these schemes — many of which have long been accused of squandering taxpayers' money and delivering bad returns to pensioners — merge.

David Blake, director of the Pensions Institute at London's Cass Business School, says the majority of these funds are "run by amateurs".

"The bulk of the trustees just don't have the expertise to run these schemes and are taken for a ride by fund managers," he says.

Andrew Clare, professor of asset management at Cass Business School and trustee of the £2bn Magnox Electric pension scheme, agrees: "It makes no sense to have a myriad of plans chasing separate investment strategies, paying multiple levels of fees to advisers and in many cases getting limited access to the best investment funds. [Merging schemes] is a no-brainer for the taxpayer."

The UK government appears to have come to the same conclusion. In its July Budget statement, the Treasury warned local authorities to come up with credible plans for improving efficiencies across the 101 local government pension schemes or face the threat of forced mergers.

Boris Johnson, Mayor of London, upped the ante by declaring the combined schemes could form Britain's first sovereign wealth fund. His hope is that a £180bn "citizens' wealth fund" would be capable of providing pensions for the UK's ageing population, as well as plugging the country's vast infrastructure spending gap.

The schemes could save hundreds of millions of pounds a year in fees by merging, according to one academic, who adds: "We could build a lot of hospitals by doing this correctly."

Edmund Truell, the veteran City dealmaker, has been enlisted by the mayor to persuade public pension funds to merge voluntarily. He has already been instrumental in encouraging the Lancashire and London local authority schemes to form a £10bn partnership. Yet none of the pension consultants, advisers, councillors or trustees consulted by FTfm believes any of the UK's remaining local government pension

schemes will voluntarily agree to merge or join the Lancashire London Pension Partnership within the next 12 months.

Trustees, consultants, advisers, actuaries and lawyers overseeing underperforming schemes stand to lose work if these funds are folded into more professionally-run equivalents. Those in charge of well-run schemes, meanwhile, are wary of taking on underperforming peers.

Kieran Quinn, chair of the Greater Manchester Pension Fund, the largest LGPS scheme with £18bn of assets, says: "Why would you force the Greater Manchester Pension Fund to fundamentally change 25 years of solid investment returns because another scheme in another part of the country hasn't had the same return?

"The Treasury wants to up the speed of change and I accept some of the resistance has been too strong. But we shouldn't all be dragged down because of one or two badly managed funds that are not being run for the benefit of their pensioners."

For some, Mr Johnson's sovereign wealth fund idea — or the alternative option of forming six regionally-focused £30bn schemes — will transpire only if the government risks angering local authority workers by legislating that the funds merge.

This now seems likely. Last week the advisory board of the LGPS published a report stating that the government's "intention is for all [of the schemes'] assets to be pooled" within five years. A final consultation on how this could be achieved is expected in November.

Given the benefits UK taxpayers stand to gain from bringing these schemes together, taking a forceful stance is clearly a risk worth taking.

Pensions must give realistic valuations, by Chris Flood, FTfm, September 20, 2015

Millions of workers are being kept in the dark about the possible threats to their retirement because of the failure by companies to provide realistic valuations for their defined benefit pension schemes.

According to Cass Business School in London, current valuation methods used for pension fund deficits do not properly account for the investment risks assumed by different pension schemes.

The City University school believes those investment risks — such as having more equities in a portfolio compared to bonds — have to be considered when assessing whether companies can meet final salary pension promises.

It has called on regulators to look at accounting standards for defined benefit schemes.

Companies generally use AA rated long-term corporate bonds yields to value pension liabilities. But Cass said using this single yardstick is misleading. It wants liabilities and investments to be calculated simultaneously.

"Our approach brings significant advantages to all pension plan stakeholders compared with current practice," said David Blake, director of the pensions institute at Cass. "Staff taking out pensions will have a clearer picture of the true value of their pension promise," he said.

Shareholders, said Mr Blake, would also be able to value companies more accurately.

To illustrate, Cass examined the position of General Motors, the US car manufacturer, in December 2002. GM's share price had dropped by half over the previous three years, and its pension plan was in distress after a period of falling stock markets and interest rates.

Cass concluded GM employees should have been told to expect a 15 to 20 per cent drop in pension payouts as the true position of the pension fund was far weaker than reported.

Managing financially distressed pension plans in the interests of beneficiaries: Inkmann, Blake, Shi.

Edmund Truell: 'I wear a lot of hats and I am lucky', by Madison Marriage, FTfm, 14 Sep 2015

Edmund "Edi" Truell, the newly appointed pensions and investment adviser to Boris Johnson, the mayor of London, has the daunting task of encouraging the UK's 39,000 disparate local authority pension schemes to come together.

The 53-year-old is in the final stages of putting together a board of international pension experts to guide the schemes — many of which Mr Truell believes have been mismanaged — on pooling resources and cutting costs.

The theory behind the project is that the combined funds could form the nation's first sovereign wealth fund to invest in homes, roads, railways and cover the cost of an ageing population, an idea floated by Mr Johnson last year.

Mr Truell, who made his fortune as founder of Duke Street, the private equity firm, in 1998, appears enthused. "Everyone is excited by the idea of creating a UK sovereign wealth fund that can invest in infrastructure to benefit UK [companies] and make a return for pensioners," he says.

The veteran City financier later admits, however, that not everybody is as excited by the idea as he is, namely the pension schemes that are under pressure to merge and their advisers who like the current set-up.

He says: "The feedback [from pension funds] has been absolutely poles apart. Some have said 'wow' about getting access to the world-class advice from the advisory board; others have said they will merge 'over my dead body' and that the people of Norfolk's money should be managed out of Norfolk. I find it incomprehensible. I just don't get it."

Yet Mr Truell is confident he has the energy to push ahead with the project in the six hours a week he plans to dedicate to the role, alongside his many other jobs.

These include vice-chairman of Tungsten Corporation, the struggling digital invoicing company he launched in 2012, and chairman of Disruptive Capital Finance, a hybrid family office and asset manager focused on private equity-style investments.

Mr Truell is also chairman of Atlantic Supergrid, a company that wants to build a 1,000km electricity cable to transport power from Iceland to the UK, and trustee of the Truell Charitable Foundation, which supports the conservation of endangered animals, notably penguins in the Galápagos Islands.

Speaking from the plush headquarters of his family office in the City of London, decorated with a number of small statues of penguins, Mr Truell denies he is spreading his time too thinly. “I don’t do holidays or weekends too much,” he says.

Is the workload tenable? “I’m still alive,” he adds. “I wear a lot of hats and I am lucky. There are a lot of good people who work with me and that is key.”

Mr Truell landed his latest position two years after the mayor of London appointed him as chairman of the London Pension Funds Authority.

The LPFA, which at the time of Mr Truell’s appointment managed £4.5bn of assets on behalf of 20,000 retired Greater London Council employees, was in dire need of a “shake-up”, according to the private-equity specialist.

“In the words of Boris, there were a lot of people sucking at the udder of the state,” says Mr Truell in reference to the “uninspired” advisers and consultants on which the LPFA relied on before his appointment.

He quickly set about overhauling the running of the LPFA. Many trustees were ousted and contracts with external consultants wound down.

“Not everyone was delighted, let’s put it that way. Clearly I do not get too many Christmas cards from the consultants,” he says of his reputation among those professionals today.

Mr Truell also sold the scheme’s entire portfolio of UK gilts due to their low return prospects, ended most of the fund’s relationships with 27 “dreadful” fund of fund managers, and raised its exposure to alternative asset classes such as housing, private equity and infrastructure.

He seems most proud of the LPFA’s decision last year to pool its assets with the Lancashire County Pension Fund to create a £10bn commonly managed scheme, now called the Lancashire and London Pensions Partnership.

Mr Truell estimates the merger will generate £75m of savings over the next five years. He hopes other local authority schemes will follow these schemes’ lead and merge to eventually form a national “megafund”.

Surprisingly, Mr Truell appears ill-versed on many strategic aspects of his new role.

He will not comment on who will join the panel he is setting up to advise the LLPP, which will initially be named the strategic investment advisory board, other than to confirm they will be "very high-powered" appointees.

When asked how much it will cost other pension funds to receive advice from the panel, which is being set up as a not-for-profit organisation, he says: "We need to cover our running costs."

When pressed, he adds: "The board members might earn fancy salaries in their day jobs, but they are essentially doing this for free. Basically a good lunch is all they will get out of it."

How the board is funded is also ambiguous. Mr Truell says he is personally covering the cost of setting it up, such as legal fees and flights, while he waits for his budget to be confirmed from "somewhere in the depths of London".

"It is a matter of some frustration. I am still trying to find out who [will provide the budget]. I would quite like it to be paid by the Treasury as I do not want [the advisory board] to be perceived as a London-centric thing," he says.

There is also no clear answer on how quickly he expects the 39,000 local pension schemes to begin pooling their resources. "I would be very surprised if [in 12 months] more had not got together in some way now [Lancashire and London] have broken the barrier," he says.

David Blake, director of the Pensions Institute at London's Cass Business School, warns that Mr Truell could "easily alienate the other local authority pension fund chairs" in his endeavours.

Yet Mr Truell does not seem to mind. "Hundreds of millions of pounds can be saved from consolidation, which [at the moment] is just a waste of taxpayers' money," he says.

Age Partnership launches data collection service for underwritten buy-ins, By Michael Klimes, Professional Pensions, 10 September 2015

Age Partnership has launched a service to gather member information for schemes exploring a medically underwritten bulk annuity deal.

The offering - Age Partnership Underwriting Services (APUS) - will rival MorganAsh, which has been the main player in the market, and help trustees run competitive tendering exercises.

APUS will obtain health and lifestyle information on members and their dependents, which will then be passed to insurers to quote on.

The data will allow the insurers to assess longevity risk, which could reduce the cost of the deal - research from the Pensions Institute found early transactions saved 10%.

APUS head Adam Carnall said: "One of the potential areas for major growth is the addition of health and lifestyle underwriting as part of the bulk purchase annuities process, but what stood out for us is the lack of options scheme trustees had when looking for a partner to engage with their members to collect this information."

The service has been backed by the two main providers of underwritten bulk annuities, Partnership and Just Retirement. The two firms announced their intention to merge after seeing their individual annuity business shrink following the 2014 Budget.

Just Retirement director of defined benefit (DB) solutions Tim Coulson said the announcement was good news for employee benefit consultants, their clients and providers.

He said: "Wider choice and competition should encourage further innovation in this exciting and fast growing segment."

His counterpart at Partnership Costas Yiasoimi added: "Age Partnership is a welcome addition to the fast growing medically underwritten bulk annuity market."

Earlier this year the market reached £700m in liabilities insured.

Cass Researchers Find Wide Potential in Swiss Re Longevity Bond, by Robert O'Connor, Best's News Service via Bestwire - July 07, 2015

LONDON - After analyzing what it described as the "world's first longevity trend bond," researchers at Cass Business School in London have concluded the instrument is suitable for wider use.

Cass said the Kortis extreme longevity risk bond, issued by Swiss Re in 2010, was built around the reinsurer's experience with mortality and natural catastrophe risk. Swiss Re also brought experience in the U.K. pensions and annuities sector, Cass said.

"The research demonstrates that the underlying bond design is very flexible," Cass said in a statement.

The performance of the bond was studied in detail by Cass faculty members Andrew Hunt and David Blake. Cass is part of City University London.

"The Kortis bond provides a new method of transferring extreme longevity risk from insurers and reinsurers to investors in the capital markets," Blake said in a statement. "As the prototype of a new breed of longevity-linked securities, it is important to be able to model and analyze it."

The ability to shift these longevity exposures into the capital markets, Blake added, offers the opportunity to de-risk pension funds.

"We are the first to model and analyze the bond since it was issued," Hunt said. "Our study discusses its design features, models its payoff and analyzes the different risk

factors present using a number of recently developed techniques that allow for the correlations in mortality rates between different countries."

Hunt cited a report from consultants Towers Watson that the U.K. pensions buy-in, buy-out and longevity swap market was worth almost £35 billion (US$54.5 billion) in 2014. "The reinsurance market has started to investigate novel methods for managing this risk," he said.

The research, Cass said, suggests "that issuing further Kortis-type bonds is essential to maintaining the current high rate of growth the longevity risk transfer market."

OECD warns pension funds over 'excessive search for yield', Chris Flood, FTfm, July 6, 2015

Pension fund managers and life insurance companies are increasing their chances of going bust if they undertake aggressive shifts into alternative assets to meet their promises to savers, warns the OECD.

The rising share of pension and life insurance assets invested in hedge funds, private equity, high-yield corporate bonds and commodities "warrants vigilance" by regulators and policy makers, says the Paris-based body in its latest report.

It believes the move into riskier investments could result in the solvency position of pension funds being "seriously compromised" in the event of a market shock where there is a freeze on liquidity.

"The concern is whether pension funds and life insurance companies have, or might become involved, in an excessive search for yield to match the level of returns previously promised when financial markets were delivering higher returns," says Pablo Antolin, head of the OECD's private pensions unit.

Indeed, according to a report by PwC, the professional services firm, global alternative assets could almost double to more than $15tn in the next five years.

David Blake, director of the pensions institute at Cass Business School in London, is not convinced this is a bad thing. He disputes whether the OECD is right to be concerned about the shift.

"Is it not more sensible for pension funds to develop a mix of investment strategies, given the choice of new asset classes that are now available?" he says.

The OECD says a lack of data has hindered an exact assessment of the extent of the portfolio changes by pension funds and life insurers, but Mr Antolin says a move into riskier assets is definitely taking place.

Forecasts from PwC support that. It expects pension fund assets will increase from $37tn in 2013 to $57bn by the end of 2020, with alternatives making up a far bigger share of total assets.

Japan's Government Pension Investment Fund, the worlds largest, recently added a 5 per cent allocation to alternatives for the first time, and a number of other large Japanese public pension funds are expected to follow suit.

In the US, the 96 largest public pension plans that manage $2.9tn in total assets, have increased their exposure to alternatives (excluding property) from around 3 per cent in 2001 to 15.1 per cent in 2013, according to the National Association of State Retirement Administrators.

Keith Brainard, director of research for Nasra, says he does not believe the solvency of public pension funds could be threatened by this shift towards alternative assets.

"I do not accept that alternatives are by definition more risky than other assets, and, in fact, in some cases they can be less risky," he says.

Amlan Roy, head of global demographics and pensions research at Credit Suisse, agrees. He says that the current financial models used by many pension funds to guide asset allocation choices are inadequate.

He believes it is unrealistic to expect a repeat of the returns on equities and bonds seen in the 1980s and 1990s, the two best decades for performance for 200 years.

"Pension funds need to look carefully at alternative asset classes, which are no more risky than equities at current valuations," says Mr Roy.

Within fixed income, pension funds' and insurers' need for long-dated bonds to match their liabilities has led to huge growth in demand relative to supply, meaning the outlook for returns has deteriorated.

This has left investors with little choice but to consider alternatives.

Euan MacLaren, head of Natixis Global Asset Management's UK and Ireland institutional business, says the increased volatility of fixed income markets is another factor encouraging pension funds to reconsider their strategic choices.

"Our pension fund clients have a good understanding of their liabilities but more are re-examining how their assets are structured," he says.

He adds that there has not been a big change in the risk appetite of pension funds but instead a willingness to consider a wider range of investment options that could boost returns.

The OECD is unconvinced. "Regulators and policy makers need to remain vigilant to prevent an excessive search for yield," says Mr Antolin.

More asset managers become shadow banks: 120% rise in number of fund houses operating direct lending strategies, Madison Marriage, FTfm, June 21, 2015

The number of asset managers lending directly to companies in the US and Europe has more than doubled in the past two years, underlining fears about the rapid development of financial intermediaries known as shadow banks.

The 120 per cent rise in the number of fund managers operating direct lending strategies has come as banks have been forced to scale back their lending activities due to regulatory pressure to shrink their balance sheets.

Asset managers have been quick to fill the lending void, particularly in the US, where the number of direct lending managers has jumped from 44 to 110 in two years. The number in Europe has nearly doubled to 85.Assets in the industry have more than tripled since 2006 as a result, to $441bn by the end of last year, according to figures from Brown Brothers Harriman, the financial services group, and Preqin, the data provider.

Some of the biggest non-bank lenders to small and medium-sized enterprises include Oaktree, the US asset manager, Centerbridge, the US private equity firm, and Intermediate Capital Group, the UK asset manager. Collectively they have raised nearly $90bn for private debt in the past decade.

The rapid development of the private debt market — seen as part of the shadow banking industry, in which an array of institutions perform bank-like activities — has prompted concern among regulators and some industry figures.The US Financial Stability Oversight Council, a grand committee of regulators set up after the 2008 financial crisis, said last month that the migration of leveraged lending away from banks could lead to sloppy underwriting, resulting in “larger losses in stressed conditions”.

David Pitt-Watson, executive fellow at the London Business School and former director of Hermes Fund Managers, said it was a “good idea” for fund managers to finance the real economy, but raised concerns about their expertise and liquidity issues.He said: “Do fund managers know the companies they are lending to? Or are they buying packaged debt, and do they understand what lies behind it? [Should] this not be the job of recapitalised banks, who have the expertise and money to lend?

“What happens if there is a run on the fund? How do [investors] get their money back? Banks can borrow from the central bank, fund managers cannot. Right now, well-run funds, where illiquid SME debt is only a small part of their assets, might be a helpful development. But those conditions are not easy to police.”

Alternative lending in Europe accounts for around 20 per cent of the market, according to the BBH/Preqin figures. In the US, non-bank lenders accounted for 85 per cent of leveraged loan activity in 2013, up from 37 per cent in 1998.The industry is expected to continue expanding rapidly in both regions as investors intensify their search for yield in the low-rate environment. Two-thirds of the 1,500 institutional investors tracked by Preqin said they would raise allocations to direct lending strategies in the expectation of annual returns of 8-14 per cent.

David Blake, director of the pensions institute at Cass Business School in London, also expressed doubts about the role of fund managers in private lending.

"In principle this is a good idea, since SMEs are now very badly served by the official banking system in terms of high interest rates, onerous collateral conditions and the risk of withdrawal of funds at short notice," he said.

"However, for it to work well, there needs to be strong trust [between borrowers and lenders]. The question is do fund managers, with their utterly short-termist attitudes, have the temperament to do this well?"

Chris McChesney, head of alternative investor services at BBH, rejected these concerns. "The term shadow banking implies an unregulated environment. We are talking about non-bank lending rather than shadow banking, and a capital base that in some ways is more stable than loans backed up by bank deposits," he said.

"There is a fundamental change underway in [how] asset managers see themselves [in relation to] companies and borrowers. Companies are now borrowing from Blackstone [the private equity group] instead of HSBC [the bank]. It's a redefinition of the role of asset managers and banks."

Longevity risk: 'it's the demographics stupid', Natasha Browne, Professional Pensions, 18 June 2015

The development of a capital market for longevity risk would ease the debt burden on future generations, Natasha Browne hears

At a glance

- Leading academic professor David Blake says insurers face "severe" concentration of longevity risk
- Experts say the reinsurance market uses this risk as a natural hedge against its life insurance business
- A quarter of the UK population is made up of retirees, but this is expected to rise to 38% by 2050

Ageing populations driven by lower birth rates and improved life expectancy is a serious fiscal problem for advanced economies. It increases the burden on working populations to sustain the older generation.

Figures show there are 25 retirees for every 100 people of working age in the UK. But the proportion of retirees is projected to rise to 38% by 2050.

Current national debt, including state and public sector pension promises, is over three times higher than GDP, according to the director of the Pensions Institute (PI), professor David Blake. Separate figures from Hymans Robertson show private sector defined benefit (DB) liabilities have exceeded GDP for the first time too, by £200bn.

Insurance companies have stepped in to soak up DB liabilities through buyouts, buy-ins and longevity swaps. LCP has predicted the total value of annual bulk annuity

deals will soon reach a "new normal" of over £10bn. Indeed, 20% of FTSE 100 businesses with UK pension plans have already agreed some form of transaction.

But speaking at Squire Patton Boggs Pensions Conference 2015, Blake warned there was a "severe" concentration of longevity risk in the insurance industry. This could drive the sector into insolvency if it gets its projections on longevity risk wrong, he said.

Blake is keen to develop a capital market for longevity risk. He has spent ten years campaigning for the government to issue longevity bonds to support the market. These would act as an additional hedging instrument. Fundamentally however, the bonds would establish a yield curve and the market price for longevity risk.

He said the major barrier was a lack of political will. "The government is not interested in this problem. It's only concerned with short term problems. It's only concerned with winning the next election.

"It says 'if we introduce these bonds, the beneficiaries will be in ten years' time and that will probably be the opposition party, why should we do that?' I think that the next 50 years it's going to be 'it's the demographics stupid' that we should be thinking about rather than 'it's the economy stupid'."

Longevity bonds would provide the government with a new form of long term funding, Blake said. The government (or taxpayer) is already the insurer of last resort, especially in respect of the Pension Protection Fund (PPF). But Blake pointed out it was currently missing out on the risk premium for propping up the market.

Blake said: "In other words, the next generation is providing insurance but not earning a risk premium for providing that insurance. So longevity bonds can act as a catalyst for the development of the capital market solution.

"It would help with the construction of national longevity indices and it would aid with price discovery - the price of risk at different ages."

Another advantage of longevity bonds is that they would ease the burden of capital requirements on insurers. "If you can't hedge a systematic risk, your Solvency II capital goes up and that makes your annuities more expensive," Blake said.

The insurer view

Pension Insurance Corporation (PIC) is one of the leading players in the bulk annuity market. It has been involved in some of the biggest transactions on record so far, including the £1.5bn buyout of the EMI Group Pension Fund in 2013.

Its head of business origination Jay Shah is enthusiastic about the development of a capital market for longevity risk. But he is confident the insurance market is coping well, especially as it can offload a lot of the risk onto reinsurers. These, he says, are better placed to deal with the risk because it acts as a natural hedge against their life insurance business.

Shah explains: "Insurance companies, certainly in more recent years, have tended to hedge out that longevity risk to reinsurers. For example, Pension Insurance Corporation has hedged out somewhere between 60% and 70% of our longevity risk.

"But are we just transferring the risk? Is the concentration of risk just going from the pension scheme to us to the reinsurers? Well actually it's not because over the last several decades the reinsurers have been taking on mortality risk.

"They've been writing life insurance business and reinsuring life insurance business. They already have an exposure to people dying too early so taking on exposure that people live too long is actually a good balance for them."

Shah says the worst place longevity risk can sit is with the pension scheme. The risk is spread more efficiently when it is transferred to an insurer. This is because there is a larger proportion of average-sized policies able to absorb the shocks created by a small number of expensive policies.

He explains: "Take someone with a £100,000 pension that was inflation-proofed. If they lived for five years longer than was expected, allowing for inflation, you're probably looking at that costing the scheme something like £1m more than they were expecting.

"When that comes through to an insurer through a bulk annuity policy, the insurance company has less concentration than the pension scheme because it's got a larger number of people."

In other words, a handful of large pension pots among 100,000 pensioners averages out much more than a handful among 100 pensioners.

Shah adds: "Yes the risk remains with the insurance company, but it's pooled and averaged out among a much larger population."

A significant barrier to the development of a capital market for longevity risk is its potential to attract investors. The time horizon is too long for most. Shah says: "It would be great if the capital markets were able to provide some way of hedging longevity risk.

"But people who want to buy these interesting investments which have exposure to longevity tend to want to have an exposure for five years, or a maximum of ten years. Whereas longevity risk persists for decades.

"To date, there hasn't really been that tide of investors who are prepared to take a view on longevity risk into the very long term. That's been one practical constraint."

Blake warns of dangerous concentration of longevity risk among insurers, by Natasha Browne, Professional Pensions, 17 Jun 2015

The insurance industry faces a “severe” concentration of systematic longevity risk through the market for buy-ins, buyouts and longevity swaps, according to professor David Blake.

He warned the industry could run into serious trouble if it got pricing wrong and called for the development of a capital market to create a more robust solution for longevity risk transfers.

This would require the government to begin issuing longevity bonds to act as a hedging instrument, but the director of the Pensions Institute (PI) said he has been campaigning unsuccessfully for ten years to achieve this.

Figures have shown Pension Insurance Corporation (PIC) reinsured the longevity risk relating to £2bn of liabilities with Hannover Re and Reinsurance Group of America in 2014 alone.

Legal and General also completed £3.1bn in new bulk annuity transactions in the half year to June 2014, while Rothesay Life agreed deals worth a total of £2.8bn last year.

Speaking at the Squire Patton Boggs pensions conference yesterday, Blake said: "Risks are being transferred from all over the country, from small corporations into a small number of large insurance companies.

"That's leading to a concentration of risk within the insurance industry and if they get their projections on longevity wrong, that means the insurance industry is going to be in trouble.

"We need to turn longevity into an asset class that is held not only by natural long-term investors like sovereign wealth funds, insurance linked securities investors, and endowments. This needs to become an asset class of the young because we've got to get fair intergenerational transfers of these risks.

"If [insurers] get the trend risk wrong, it's underestimated life expectancy that is going to drive the private sector into insolvency and that's what it's concerned about. And so we need a hedging instrument provided by the government to hedge that risk.

"The government is not interested in this problem. It's only concerned with short term problems. It's only concerned with winning the next election.

"It says ‘if we introduce these bonds, the beneficiaries will be in ten years' time and that will probably be the opposition party, why should we do that?' So I think that the next 50 years it's going to be ‘it's the demographics stupid' that we should be thinking about rather than ‘it's the economy stupid'."

How can schemes tackle the headache of transaction costs?, by Stephanie Baxter, *Professional Pensions*, 11 May 2015

Stephanie Baxter looks at responses to the FCA’s consultation on the murky area of transaction costs

At a glance

- Schemes will have to report on and analyse transaction costs when they assess value for money

- The FCA's call for evidence asked the industry how these costs should be disclosed
- While transparency is welcomed, trade bodies warn it may cost schemes a lot of time and resources

Asset management fees have come down in defined contribution (DC) thanks to the 0.75% charge cap but costs that fall outside the cap are still a huge issue for schemes.

These hidden charges such as transaction costs can have a material impact on returns, particularly where a portfolio is actively managed. Disclosing these costs to trustees is paramount to enabling them to assess whether the scheme provides value for money to members.

The industry has applauded the Financial Conduct Authority (FCA) and Department for Work and Pensions (DWP) for taking the lead on this in their call for evidence on *Transaction Costs Disclosure: Improving Transparency in Workplace Pensions*, which ended on 5 May.

The True and Fair Campaign said in its response that shaking up the system will "significantly change behaviour" which is "clearly dysfunctional at present". "At the moment it is completely ignored by managers and various agents along the investment chain as the costs may be small individually but significant when added to other layers of costs," it added.

While everyone – even the asset management trade body the Investment Association – agrees there must be more transparency on these opaque costs, the big question is how to get there.

The first hurdle is gathering all the data, which the National Association of Pension Funds (NAPF) believes would be an arduous task.

Getting the data

Iain Cowell, a consultant at the trade body, says: "Schemes would have to go through an extensive exercise of gathering data, going to every manager and then filtering and cleaning up the data."

A number of schemes already collect this data via two or three people in their fund accounting teams. It is very challenging to get consistency across the data that is not calculated or reported in a standardised way. Cowell says it has taken schemes as much as five years to get to a point where they can understand their cost base.

"That's why we want the asset management industry to drive that process to be much cleaner and more consistent so the asset owners aren't struggling to receive the information," he adds.

The Investment Association chief executive Daniel Godfrey himself has admitted his industry misled the public during the last 20 years over charges, "with disclosure that nobody understands at best and which can be misleading at worst".

While schemes have much to gain from greater disclosure, they could face higher costs through rushing the use of an advanced template before inconsistencies in data are addressed.

The NAPF estimates that for a large scheme the cost of hiring a consultant to collate the data needed to complete the existing template could be around £20,000 a year.

There have been concerns in some quarters that it would be difficult and costly for asset managers to step up their game on transaction costs.

The Pensions Institute director **David Blake** is not convinced by these arguments, however. He says managers "should be doing this anyway" and does not believe it would require a lot of investment in IT resources.

The True and Fair Campaign rejects this claim, particularly the notion that it is difficult to identify bid/ask spreads: "It is actually surprisingly easy to capture the bid-ask spreads, particularly within the equities market."

It cites a "simple" tool on Bloomberg that captures the average bid/ask spread for most securities over customisable periods of time. While more challenging to do this for bonds, any major financial organisation with a dealing desk will have "intimate knowledge" of this, it added.

While transparency is welcome, it is crucial to avoid punitive costs for collecting data that is of limited value. "We shouldn't be looking at data that investors and asset managers have limited ability to change," says Cowell. "We should collect data that is meaningful, worth collecting, and that as informed buyers helps them do the job."

In February the pensions industry applauded the Investment Association's paper proposal of a methodology for consistently calculating portfolio turnover rate (PTR) and a framework for the disclosure of transaction costs. While Blake welcomes the trade body's endeavours, he says having these kinds of industry consultations that every couple of years throw up different approaches to the methodology "can be very complicated" and "takes time".

He says "let's not waste time" trying to agree suitable risk and return measures before starting to report transaction costs and "let's just get on with it".

"The DWP and FCA need to sit down with the relevant parties to understand these things better and have a plan for starting with something simple but then build this up over time into what we really want through planned timetables. I would just get it started with a timetable to trial things bearing in mind the costs."

What could go wrong?

Some respondents warned of the potential unintended consequences where increased transparency results in more rigid transaction cost budgets. The Society of Pension Professionals (SPP) said it was vital that attention to costs does not direct attention away from key concerns such as risk/return, contribution levels, and decumulation strategies, in securing good member outcomes.

"So the approach to transparency must avoid creating an environment in which there is implicit pressure to avoid investment strategies or transactions, due to concern that they might be perceived as too expensive," it cautioned.

One worry is that it could cause herding to passive investment strategies without any protective overlays such as currency hedging. Active strategies could be pressured to effectively become passive to produce lower costs.

Many schemes have already had to adopt passive strategies in the default fund to keep charges within the 75 basis points cap. Blake argues that the "average Joe" in an auto-enrolment default fund should not be engaged in active management anyway and should be in low-cost passive funds.

He believes turnover costs and other charges should be capped to discourage active trading. The existing charge cap could be extended to include some or all transaction costs or they could be put into a separate cap.

However, Blake acknowledges there are problems with having a DC cap that includes turnover costs because schemes don't know what they are until the end of the year.

"It's almost impossible to impose a strict year-by-year cap because you'd be in a position where in September you'd hit the cap and then you can't do any more active management until January."

This could unduly influence asset manager behaviour. The SPP said: "For example, if a manager was close to the limit of its transaction cost budget, it might feel under pressure not to sell an underperforming asset because to do so might breach its budget."

It would have to be done on a rolling basis such as over a three-year period to avoid this issue, says Blake. "You would put charges into components whereby certain charges would have to meet the cap every year but other charges wouldn't." For example, if one-year costs were 85bps then the next year they would need to be lowered to 65bps.

Other respondents were keen to avoid imposing a cap, notably the NAPF, which believes this is not the healthiest approach to drive future improvements.

Cowell says: "What we don't want is the creation of hard rules that allow people to game the system. This is why the whole thing has to be about openness and transparency where we all philosophically agree to do the same thing."

How should schemes measure costs?

There is much debate over how the impact of transaction costs on a portfolio should be measured.

The True and Fair Campaign said there must be a “simple, common analysis of transaction costs and other costs presented in a mandated uniformed format” so that scheme members are able to easily understand it.

It would put the key elements of transaction costs – broker commissions, taxes and spreads – into one comprehensive number and multiply it by the average portfolio turnover rate to give the actual impact of transaction costs as a percentage of the fund/portfolio each year.

What can we learn from the Dutch?

The Dutch pensions market is far ahead of UK in transparency and benchmarking of transaction costs, which it has been working on for the past five years. It was originally driven by the regulator, but to curtail that the industry decided to work together.

Yet five years on it is “still not at a perfect place”, says Cowell. While they have a much better grip on 75% of the tangible costs, they still don’t have a consistent picture on others such as market impact costs that are linked to the trading process.

“People aren’t hiding this information but it’s about developing consistent frameworks so people can engage on the topic in a meaningful way without spending excessive costs on consultants. It’s an incremental process because they are learning and understanding what costs they have.”

He says this is one of the key lessons the UK can learn from the Netherlands. “So there has to be incremental staged approach, which means getting meaningful information that we can do something with.”

Do trackers beat active funds? Our new analysis has the answer, By Kyle Caldwell, Daily Telegraph, 04 Apr 2015

A look back over 10 years reveals the markets where human fund managers are most likely to earn their keep

British savers had a 50:50 chance of picking an “active” fund that managed to beat simple automated rivals over the past decade, research for Money Telegraph has established.

The study, by Morningstar, the data firm, worked out how many funds run by a human stock-picker beat the best performing “tracker” funds in six regions over various time frames.

The data, summarised in the graphic, makes interesting reading at a time when investors are increasingly turning their backs on City stock-pickers and turning instead to tracker funds, which offer low-cost exposure to a particular stock market. Three years ago tracker funds held £60bn of British savings, but this figure has now leapt to just shy of £100bn.

Some of the results are surprising and conflict with previous academic studies which concluded that a monkey with a pin could do a better job picking shares than a highly paid fund manager.

The graphic outlines the chances of an active fund manager beating the best-performing tracker of the relevant index over the past three, five and 10 years. The six markets picked – the UK, US, Europe, Asia, Japan and global markets – are among the most popular with British investors. Our analysis looked at "growth" funds, those that aim simply to increase in value over time, and did not include income funds.

Active funds fared better relative to trackers over the longer time frames in the study.

This was especially true of funds that buy European shares, with 70pc of actively managed European funds beating the best European tracker over 10 years. Among Asia funds, 55pc of active portfolios beat the best tracker over a decade, while the figure for the UK was 52pc.

Forty-eight per cent of global funds with human managers outperformed the best passive fund over 10 years, compared with 38pc of Japanese funds. In last place were active US funds, only a third of which managed to beat the top tracker.

Overall, 50pc of active funds beat tracker funds over the past decade. The figures are net of fund charges.

What the experts say

Financial advisers such as Philippa Gee, of Philippa Gee Wealth Management firm, said the data showed savers should not favour one strategy over the other and should instead hold a mixture of the two.

"It [belief in either active funds or trackers] has become a religion to some investors, to the extent that they are not prepared to weigh up the other side of the argument and will only talk up the merits of one strategy and criticise the other," she said.

"When I invest personally and for my clients, I use both. Tracker funds are better in some markets and much cheaper, but there are certain fund managers who deliver superior returns and are worth paying a premium for."

Our findings, which found a one in two chance of picking an active fund that outperforms, paints fund manager as more skilled than other research has done in the past.

Last summer the **Pensions Institute** at Cass Business School, the respected academic body, issued a damning study into active funds. It found that 99pc failed to beat the stock market between 1998 and 2008, returning an average of 1.4 percentage points less than the market each year.

Professor David Blake, the author of the research, said at the time: "Based on the findings, just 1pc of fund managers are 'stars' who are able to generate superior performance."

Commenting on our research, Prof Blake said: "Over the longer 10-year horizon, the results in most markets tend to converge to the 50pc level – that is, an equal chance of outperforming and underperforming the market. This is what you would expect.

"Ultimately investors need to decide whether they want to flip a coin. The three and five-year numbers flatter the active funds due to the bull market equities have enjoyed since the financial crisis and are not an indication of fund manager skill."

Why do fund managers perform better in certain markets?

As the chart shows, the chances of an active fund beating a tracker vary from one region to another.

Experts say there are reasons why fund managers are able to gain an edge in certain markets and not in others.

Jeremy Beckwith, an analyst at Morningstar, said shares in smaller companies, which have more scope to grow quickly than their larger peers, were poorly represented in tracker funds because the funds' stakes are proportional in size to the companies' representation in the index.

In the UK, for instance, the FTSE All Share Index, which most tracker funds aim to replicate, is dominated by the 10 biggest companies. These heavyweight shares, which include BP and Vodafone, make up more than a third of the index.

A fund that can take significant stakes in small companies has the scope to outperform a tracker, whose fortunes are strongly influenced by this small group of huge companies. (It also has more scope to underperform, of course.)

In the case of Europe and Asia, successful fund management is all about buying the "right countries".

Mr Beckwith said: "Both economic and political factors can change quickly and either negatively or positively impact on how that country's stock market performs. The fund managers are paid to switch the money around when they see fit to either take advantage or protect capital, whereas the tracker funds do not have this freedom."

The fact that active funds in America struggled to beat trackers will come as little surprise to the more experienced investor.

The majority of US funds, over both short and long time periods, fail to beat the S&P 500 index.

Fund analysts this was because so much attention was lavished on American companies, with analysts poring over their accounts, making it tough for US find managers to find mispriced shares.

Mike Deverell of Equilibrium, the wealth manager, said: "The US is seen as a very efficient market with every stock followed by hundreds of professional analysts. This makes it very difficult to spot a bargain. We only use tracker funds for clients who want exposure to America."

But the analysts could not put their figure on why Japan funds fared so badly. Mr Beckwith suggested: “Perhaps it is just because there are not many decent fund managers who invest in the region.”

Is our data reliable?

Yes, but as Prof Blake said, the bull market since 2009 may have helped active funds.

There is, however, another factor that could have given active funds a boost relative to trackers over the past 10 years. At the start of that period tracker funds were much more expensive than they are today. This will have put their average cost over the period up and reduced their returns after fees were taken into account.

Ms Gee said: “It has only been in the past five years or so that tracker fund costs have come down. Some had fees similar to active funds, but some are now 10 times cheaper.

“It will be a different story over the next 10 years. Active funds now have a much bigger hurdle to beat, given that today the cheapest trackers cost as little as 0.09pc and active funds tend to charge 1pc.

“There is now a bigger gap for fund managers to bridge and only the most skilled investors will be able to do it.”

Local UK pension schemes waste millions on high fees, by Madison Marriage and Chris Newlands, *FTfm*, March 29, 2015

A vast discrepancy in fees paid by the 89 pension funds that form the UK’s Local Government Pension Scheme has prompted calls for a complete overhaul of the £220bn framework.

Comprehensive data given to FTfm has shown that a large number of LGPS pension funds may be squandering millions of pounds of taxpayers’ money on excessive fees

The data, which examine investment costs as a percentage of assets under management, highlighted the £656m Waltham Forest pension fund as the worst offender. It spent £7.5m (1.14 per cent of its assets) on investment costs last year.

The £1.38bn Swansea pension fund spent £11.6m (0.84 per cent of assets), while the £1.34bn Shropshire pension fund spent £10.6m (0.79 per cent of assets).

John Clancy, the Birmingham City councillor who compiled the data, said any spend above 0.4 per cent of assets was “absolutely dreadful”. “I really cannot speculate as to how they could possibly defend [these costs],” he said.

David Blake, professor of pension economics at London’s Cass Business School, described the figures as “shocking”.

He said: “The average local authority pension fund size is £2.3bn and one would expect that funds of this size could negotiate much lower fees. Even more disturbing

is the range of fees, from 1.14 per cent to virtually nothing. Council taxpayers who underwrite these costs are getting a very bad deal, indirectly paying extortionate fees to the fund managers of those schemes."

FTfm analysis of the pension funds' annual reports showed that the high level of fees often did not translate into better performance. Many funds with a similar size and asset class mix paid very different fees for near identical performance.

The £765m Hammersmith and Fulham pension fund, for example, spent £4.9m on investment costs last year and achieved a 6.4 per cent return. The £775m Enfield pension fund spent just £1.3m on investment costs for an identical return.

Similarly the £4.9bn London Pension Funds Authority spent £32m on investment costs and returned 6.1 per cent. The £5.7bn Tyne and Wear pension fund by comparison spent £8.8m on investment costs for a 5.2 per cent return.

Michael Johnson, research fellow at the Centre for Policy Studies, the think-tank, questioned the aptitude of the trustees and investment consultants who oversee the funds.

He said: "The whole governance framework is laughable. Many of the individuals involved lack the ability to ask penetrating questions and demand useful answers. The LGPS is in a bloody mess [given] the complete breakdown in governance and the deeply entrenched vested interests."

John Ralfe, an independent pension consultant, agreed that the funds are poorly managed, largely because many are overinvested in expensive active fund managers.

He said: "It is all part of the LGPS being dysfunctional."

Edmund Truell, chairman of the LPFA, said in response that "the costs of investment are far too high across the [local government funds]". He added that since he became chairman of the LPFA in 2013, it has stopped working with the consultants and most of the senior executive team that presided over the previous investment arrangements.

Kieran Quinn, chairman of the £13.2bn Greater Manchester pension fund, which spent just under 0.1 per cent (£12.9m) of its assets on fees last year, admitted there are serious governance concerns at many local authority funds.

He said: "[There are] enough examples of schemes that have not challenged their asset managers sufficiently to get the fee levels that are relevant. The issue is about basic governance. "If somebody is paying excessive money for failure then it is absolutely right that both the people receiving the cheques and the people paying the cheques need to be challenged."

Large pension salaries confuse Dr Jekyll with Mr Hyde, by Chris Newlands, *FTfm*, February 15, 2015

Chris Newlands finds that those in charge of some big pension schemes are not so poor after all

Every story needs a hero and a villain. For each Dr Jekyll there must be a Mr Hyde.

In the investment market those roles have long been defined. On one side the protagonists are the poor, vulnerable pension funds and on the other a populous gang of well-heeled asset managers make for worthy foils.

However, FTfm research that reveals multimillion-dollar salaries at some of the world's largest pension funds muddies the water somewhat.

It seems those in charge of some of the biggest pension schemes are not so poor after all. Indeed, analysis of 14 funds shows that the former chief executive of the Ontario Teachers' Pension Plan, Jim Leech, was paid $7.4m in 2013, the year he retired, while Mark Wiseman, chief executive of the Canada Pension Plan Investment Board, was paid $3.1m.

Elsewhere, the highest-paid executive at the Australian Super fund received $1.04m and the chief executive of Denmark's ATP, Carsten Stendevad, was paid $903,000.

Our heroes are out-earning many of our villains and, aside from confusing the plotline of our story, it raises questions as to whether the large salaries awarded to pension fund bosses stops them from opposing excessive pay at the companies in which they invest — a criticism that has also long been levied at asset managers.

Pension CEO pay

Pension fund	CEO	2013 Total pay ($)	2013 Investment returns (%)
OTPP (Canada)	Jim Leech	7,360,000	10.90
CPPIB (Canada)	Mark Wiseman	3,120,000	16.50
OTPP (Canada)	Ron Mock	2,500,000	10.90
Super Fund (Australia)	Highest paid executive	1,040,000	14.30
NBIM (Norway)	Yngve Slyngstad	936,321	15.90
ATP (Denmark)	Carsten Stendevad	903,000	14.50
APG (Netherlands)	Dick Sluimers	794,721	6.20
Railpen (UK)	Chris Hitchen	786,000	n/a
AP2 (Sweden)	Eva Halvarsson	735,618	12.70
PGGM (Netherlands)	Else Bos	587,000	n/a
Calstrs (US)	Jack Ehnes	454,036	18.66*
AP3 (Sweden)	Kerstin Hessius	472,097	14.10
Calpers (US)	Anne Stausboll	414,416	16.20
PPF (UK)	Alan Rubenstein	359,525	11.10

Sources: Annual reports; FTfm research * 2013/14 figure

Deborah Hargreaves, founding director of the High Pay Centre, a think-tank, believes it does. For her, the findings show precisely why we "cannot rely on pension funds" to hold companies to account over pay.

"These pension chief executives are benefiting from the high-pay culture themselves and often see nothing wrong with multimillion-dollar awards for top bosses," she says.

At the lower end of the pay scale, Anne Stausboll, chief executive of Calpers, earned $414,416 in 2013; Sweden's AP3 paid chief executive Kerstin Hessius $472,097; and the UK's Pension Protection Fund paid its chief executive, Alan Rubenstein, $359,525. All generated better returns than Ontario Teachers in 2013.

David Blake, director of the Pensions Institute at Cass Business School in London, says: "I am all for performance-related pay but there has to be a clear and well-defined relationship between the value that is added and the pay."

He suggests the performance-related pay formula should be symmetrical: if a scheme makes losses, the chief executive should too.

"If not, the fund faces a major moral hazard since the chief executive has an incentive to take on more risk," he says.

"If the fund performs well he or she will get a big bonus. If it performs badly there is no financial penalty."

So what does the influential academic think of Mr Leech's $7.4m pay deal, which Ontario Teachers is at pains to point out includes long-term incentive payments?

He says: "It is unlikely such a CEO has the symmetrical performance-related pay contract [I referred to]. I therefore conclude that pension CEO pay contracts that generate incomes of more than $7m cannot be in the best interests of either plan sponsors or scheme members."

Without becoming something of a villain myself, it is hard to disagree.

Liquidity premium escapes UK investors, by Amanda White, top1000funds.com, January 23, 2015

http://www.top1000funds.com/analysis/2015/01/23/liquidity-premium-escapes-uk-investors/?utm_medium=Email&utm_source=ExactTarget&utm_campaign=

UK pension funds have not taking advantage of their comparative advantage as long-term investors and have not earned a positive long-run liquidity premium on their investments, according to a paper from the Cass Business School that examines UK pension funds' monthly allocations to major asset classes over the period 1987-2012.

The authors – David Blake, Lucio Sarno and Gabriele Zinna – identify that the combination of herding behaviour of these investors and short-term automatic rebalancing towards a long-term optimal asset allocation, driven by their liabilities

rather than by expected returns, can be obstacles to asset prices reaching their equilibrium values.

Published by the **Pensions Institute** at the Cass Business School at the City University London, the paper, The market for Lemmings:Is the Investment Behavior of Pension Funds Stabilizing or Destabilizing, finds that although UK pension funds are long-term investors they have not earned a positive long-run liquidity premium on their investments because their investment behavior is driven by different incentives.

"Pension fund managers fear relative underperformance against their peer-group, which encourages them in the very short term to herd around the average fund manager who turns out to be a closet index matcher," the paper says.

"Further, their short-term objective is to rebalance their portfolios when valuation changes across different asset classes cause portfolio weights to violate investment mandate restrictions, while their long-term objective is to systematically switch from equities to bonds as their liabilities mature. Overall, our results show that pension fund investment behavior might be less stabilizing than previously believed."

Analysis of the data by the authors finds that pension funds herd and, in particular, they herd in subgroups defined by size and sector type, consistent with reputational herding.

Pension funds also rebalance their portfolios in a way that is consistent with meeting their mandate restrictions in the short term and with maintaining a long-term strategic asset allocation that matches the development (in particular the maturity) of their liabilities.

This mechanical rebalancing could also be destabilizing if it has the effect of driving prices away rather than towards equilibrium values.

The paper, ***The market for Lemmings: Is the Investment Behavior of Pension Funds Stabilizing or Destabilizing***, can be found here

http://www.pensions-institute.org/workingpapers/wp1408.pdf

Tesco ditches generous pension scheme to shore up finances, By Simon Jessop, *Reuters*, 8 January 2015

LONDON, Jan 8 (Reuters) - One of the last defined benefit pension schemes run by a FTSE 100 company and open to new members is set to close in plans announced by Britain's biggest retailer Tesco as it looks to shore up its balance sheet.

The scheme, which pays out an income for life to retirees based on average career earnings, has 350,000 members, including 203,000 active members of staff, and has a 3.4 billion pound shortfall in funds to pay forecast liabilities.

That has forced Tesco to pump in cash to close the gap - 542 million pounds in the last financial year alone, its accounts show - with more needed in the coming years to meet obligations of 11 billion pounds.

The company said on Thursday its pension scheme would be revalued in May and that it would consult on the planned changes in June, before implementing the changes in February, 2016. It would also have to put more money in, but gave no details.

A combination of people living longer lives and the need to reflect pension liabilities on corporate balance sheets has prompted most firms to shut their schemes in recent years, although many have done it in stages to soften the blow.

"Tesco was very unusual amongst FTSE 100 companies in keeping open its DB scheme. Most others started the closure process years ago," said **David Blake**, director of the Pensions Institute at Cass Business School in London.

"The scheme was therefore relatively very generous, but it was running (a) big deficit."

The plan to cut the scheme, announced in a much-awaited strategy update on Thursday alongside its Christmas trading statement, came as little surprise to many in the market.

"The pension scheme, as is, is almost unheard of these days. It seems anomalous that they offer it when others don't," said Nick Kirrage, fund manager at Tesco's eighth-biggest investor, Schroders.

"I don't think it's the defining factor in whether Tesco fixes itself, but it's one of the reasonably obvious things to do over time."

As part of the strategic overhaul, chief executive Dave Lewis announced cost cuts, asset sales and the appointment of Matt Davis to head up its UK and Ireland business.

The need to woo investors follows a halving in the High Street stalwart's share price in 2014 following a series of profit warnings and an accounting scandal.

A 12 percent jump in the share price on Thursday suggested the update had gone down well with stock investors, leaving it on course for its biggest daily gain since December 2008.

Bond investors, meanwhile, were less impressed, and sold off the firm's debt on fears the turnaround plan would not be enough to halt a downgrade in its credit rating.

(Additional reporting by James Davey and Neil Maidment, editing by David Evans)