European Pensions

October 2021

Ireland: A re-awakening?

The ramifications of the IORP II Directive for the Irish pensions sector

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See page 39 to hear from PensionsEurope's Pekka Eskola


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It's about time

Time is such a precious commodity. We all value time; sometimes we wish it would slow down and sometimes that it would speed up.

It is also hugely important for pensions; for example, how long someone saves for a pension has a huge impact on their retirement outcome. How much to save into a pension would also be much simpler if we knew how much time we had in retirement at the outset – although being aware of one's mortality might not appeal to some.

Then there is the development of pensions policy and products, which notoriously takes a long time. But, it would appear, the industry is crying out for more. In a recent response to a consultation on due diligence from the European Financial Reporting Advisory Group (EFRAG), PensionsEurope stressed the importance of leaving stakeholders sufficient time to respond to public consultations.

The consultation in connection to the European Union's sustainability reporting standards was launched on 16 June with a deadline of 15 September. In its reasoning, the association noted that time was needed for discussions, as they first take place between national associations and that conversation is then brought to a European Union level.

"HOW LONG SOMEONE SAVES FOR A PENSION HAS A HUGE IMPACT ON THEIR RETIREMENT OUTCOME"

PensionsEurope is not the only one; in Ireland, where the Pensions Authority's draft code of practice on the IORP II Directive has recently closed for consultation, Irish Association of Pension Funds (IAPF) CEO, Jerry Moriarty, made comments on the short turnaround time of the consultation (22 July – 16 September), which being over summer made it even more challenging to compile responses.

He also raised concerns about the length of time the authority has given itself to read through the responses and make revisions, before publishing the final code of practice in November. So, while there's an inside joke in the industry about how long it takes to ever get anything done in pensions, maybe that's not always a bad thing.

I'm reminded of a comment I heard recently, in that it is better for things to be done slowly and got right, than to rush things through and make a mistake. Consultation responses are hugely important for pension policy development, allowing for collaboration between industry and regulators – so if the industry wants more time to answer, give it!

Natalie Tuck, Editor

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EIOPA launches dashboards and pension tracking service consultations

PUBLISHED IN RESPONSE TO EC REQUEST FOR TECHNICAL ADVICE

Written by: Sophie Smith, Duncan Ferris and Jack Gray

The European Insurance and Occupational Pensions Authority (EIOPA) has launched two consultations seeking views on the development of pension tracking services (PTS), and on pensions dashboards and pensions data.

The consultations were launched in response to the European Commission's (EC) request for technical advice on these two services and are part of the implementation of the Capital Markets Union action plan.

As the two services have different purposes, EIOPA split its technical advice into two separate consultations.

The first is seeking views on the development of best practices for establishing a national PTS, an online tool that would provide savers with an overview of their future retirement income, based on the benefits from all pension schemes in which they participate.

In particular, EIOPA outlined recommendations on the role and scope of the pension tracking system, such as providing an aggregated overview of accrued entitlements and projected retirement income in a "simple and understandable manner".

It has also addressed how information should be presented to savers, considering people's cognitive and behavioural traits, and the technical requirements for creating the pension tracking system, such as live access and digital ID.

Alongside this, EIOPA has outlined a set of principles, good practices and examples that authorities can use to facilitate savers' access to personal pension information.

The EIOPA consultation noted, however, that PTS practitioners "overwhelmingly agree that a PTS is a long and challenging project", therefore suggesting that a progressive implementation on how to roll out and scale up the service is "crucial".

"Building a PTS takes time, several years at least," it stated. "In such a timespan, ideas evolve, new insights develop and new technologies emerge. It is also not possible to wait until the very last detail is known, hence requiring flexibility at all levels to handle uncertainties."

Despite this, EIOPA also highlighted making pensions more digestible for users as the "first step towards sensible decision-making and sound financial planning", stressing that correct and understandable information is "a necessity for a comprehensive pension system in which consumers make sensible financial choices".

Alongside this, EIOPA has also published a consultation on technical advice on pension dashboards, which are expected to support the EU and member states in monitoring the adequacy and sustainability of pension systems.

The paper has recommended the development of a live pension dashboard, which will serve as a visual online tool that enables users to view and interact with different indicators through the same platform.

It also suggested that pension dashboards should provide a "comparable, transparent and up-to-date view" of the adequacy and sustainability of national pension systems.

In particular, it recommended that the existing adequacy and sustainability indicators proposed by the European Commission, such as demographic and macroeconomic assumptions, be complemented by indicators relating to private pension providers, like insurance undertakings and institutions for occupational retirement provision (IORPs).

The paper also considered issues around the collection of pensions data in relation to dashboards, suggesting that whilst some data gaps "will take some time" to fill, the already available pensions data could be used to start developing and publishing dashboards in the short term.

In other news, EIOPA also launched a public consultation on the methodological framework for stress-testing IORPs. The methodological framework for stress-testing IORPs sets out rules, guidance and possible approaches to support future stress test exercises.

The discussion paper aims to create an "active dialogue" between supervisors, industry, consumer associations and academics.

EIOPA has proposed a 'toolbox approach', consisting of relevant analytical tools and approaches designed to capture the characteristics of both defined benefit (DB) and defined contribution (DC) IORPs.

It stated that, given the blurring line between DB and DC IORPs, having a toolbox of common methodological principles and guidelines that was agreed upon beforehand could "greatly facilitate" the stress test process and guide "effective deployment" of instruments. The tools can be divided into three categories: balance sheet tools, projection tools and surveys.

"Building a PTS takes time, several years at least. It is not possible to wait until the very last detail is known, hence requiring flexibility at all levels to handle uncertainties"

European Economic Area (EEA) IORPs hold a total €2.5trn in assets, according to EIOPA. Its Financial Stability Report, which used quarterly data from EEA nations, found that €1.7trn of the total assets are held by IORPs in the Netherlands, with the area's second largest IORP sector being Germany with €238bn. Meanwhile, Sweden accounted for €166bn and Italy for €161bn.

The report also noted IORP value as a percentage of nations' gross domestic product, which it dubbed as 'penetration rates', noting that the Netherlands' rate was more than 200 per cent, while Germany's rate was 7 per cent. Sweden and Italy had respective penetration rates of 35 per cent and 10 per cent.

The asset value of a sample of EEA IORPs from the third and fourth quarters of 2020 exceeded their value in the fourth quarter of 2019, indicating recovery from the initial shock waves of the pandemic.

Debt instruments accounted for around 50 per cent of EEA IORP's assets, mostly consisting of sovereign bonds, while the second most prevalent asset type was equities, which accounted for 2 per cent of the average portfolio. This led EIOPA to comment that IORPs were "potentially most affected by the pertaining low yields in sovereign exposures, but will also be affected should corporate failures materialise and risk premia significantly increase".

News in brief

■ **Danish** pension investments in alternative asset classes have passed DKK 500bn and now make up 14 per cent of the sector's overall assets, according to Danmarks Nationalbank. Its analysis of the pension industry's investments in alternatives stated that the increased allocation had provided diversification and stable returns, but also altered companies' solvency and liquidity. The sector has committed to reaching green investments of DKK 250bn by 2030.

■ The total assets of the six largest **Finnish** earnings-related pension providers totalled €230.5bn at the end of June 2021, according to the Finnish Pension Alliance (Tela). The group includes four pension insurance companies (Elo, Ilmarinen, Varma and Veritas) and two public-sector pension insurers (Keva and Ver). The average equity exposures were 49.6 per cent for pension insurance firms and 55.05 per cent for public-sector providers.

■ The average funding ratio of **Dutch** pension funds climbed to 109 per cent in August, up from 108 per cent in July. Aon Netherlands' latest Pension Thermometer also found that the policy funding ratio remained at 103 per cent.

■ **Sweden's** AP2 made a return of 10.2 per cent in the first half of 2021, after expenses, its best half-year result ever. At the end of the first half, the fund's profit amounted to SEK 39.2bn and the fund's assets stood at SEK 421.2bn. AP2's private equity portfolio returned 39.7 per cent. Its return relative to the benchmark index was 0.4 per cent, excluding alternative investments and costs.

German pension dashboard prepares for operational phase by end of 2022

PENSION SCHEMES THAT PROVIDE ANNUAL REPORTS WILL BE REQUIRED TO CONNECT TO THE DASHBOARD IN 2024

Written by: Natalie Tuck

The German pension dashboard is preparing for its first operational phase by the end of 2022.

In an article written for the Actuarial Association of Europe (AEE) Aon partner, André Geilenkothen, and Mercer partner, Stefan Oecking, detailed the progress of the dashboard so far.

The German government asked a team of actuaries to develop a conceptual basis for a pension dashboard in 2020, with draft legislation passed in the summer of 2020, coming into effect in February 2021 known as the 'RentÜG', the 'Act on the Development and Introduction of a Pension Dashboard'.

Geilenkothen and Oecking said that in the first 12-month test and evaluation phase, pension schemes can initially connect voluntarily to the dashboard, before it becomes mandatory in 2024 for schemes that are currently legally obliged to provide annual status reports.

The preparations of the Central Office for the Pension Dashboard (ZfDR) are supported by various expert advisory boards, which contribute a wide range of expertise on all aspects of old-age provision. The German actuaries of the German Association of Actuaries (DAV) and the German Institute of Pension Actuaries (IVS) are significantly involved in these advisory boards.

"The pension dashboard is overdue. Digital tools already provide us with a quick overview in many areas of our daily lives – but for pensions, many different status reports on paper still prevail. Moreover, experience shows that the expectations of German citizens regarding their standard of living in retirement unfortunately often deviates from reality," they wrote.

"Therefore, an early, comprehensible and realistic presentation of the expected retirement income is beneficial for the individuals to take any necessary savings decisions in a timely manner. Experience from other countries that have already established a pension dashboard solution (e.g. in the Nordic or the Benelux) shows that such an easily accessible source is highly appreciated by individuals and helps to promote financial literacy."

In other news, new regulations on crypto assets in Germany will "open the gates" for pension funds to invest in the asset class, it has been suggested.

On 2 August, a German law came into effect that allows Spezialfonds, known as special funds, to hold up to 20 per cent of their assets in cryptocurrencies.

Global Digital Finance (GDF) director of regulatory affairs EMEA, Lavan Thasarathakumar, believes this will pave the way for increased investment by pension funds and insurers in Germany.

GDF is an industry membership body that promotes the adoption of best practices for crypto assets and digital finance technologies. It expects other regulators to follow suit, and believes a consultation paper from the Bank for International Settlements is already providing confidence for financial institutions to invest in crypto and has set out a potential framework.

Analysts are predicting the move could mean up to USD 400bn of crypto investment by Spezialfonds, which currently hold more than USD 2.1trn of assets.

GDF expects others to follow the approach of German regulators and highlighted the decision by the Securities and Exchange Commission in the US to allow special purpose broker-dealers to invest in crypto assets as a great start.

Ireland's Pensions Authority publishes draft code for IORP II regulations

THE DRAFT CODE SETS OUT THE AUTHORITY'S EXPECTATIONS OF OCCUPATIONAL PENSION SCHEME TRUSTEES

Written by: Natalie Tuck

The Pensions Authority in Ireland has published a draft code of practice in relation to the newly introduced regulations since the transposition of the European Union's IORP II Directive.

The draft code sets out the authority's expectations of trustees of occupational pension schemes and trust RACs to meet their obligations under the European Union (Occupational Pension Schemes) Regulations 2021.

The code outlines in detail a wide range of expectations from governance and general scheme management to conflicts of interest, outsourcing and administration, among other areas.

"This code sets out the authority's minimum expectations for all schemes in the areas covered by the code. Depending on the size, nature, scale, and complexity of a scheme, trustees may consider it appropriate to implement additional measures above and beyond what is specified in this code. Trustees should always remain mindful of their fundamental duty to act in the members' best interests," the draft states.

The guidance comes following the transposition of the directive in April this year, two years after the original deadline set by the European Union.

A final code of practice on what the authority expects from regulated entities to meet their obligations under the Pensions Act, 1990, as amended, will be published in the week commencing 15 November 2021.

Guidance for the public and employers about the minimum standards they should expect from master trust vehicles will be published in the week commencing 13 December 2021.

The regulator also published information for trustees on the annual compliance statement (ACS) that is provided for under the Pensions Act 1990, as amended.

The authority said the form of the 2021 ACS will be published the week of 15 November 2021 and trustees are expected to prepare the 2021 ACS before 31 January 2022. Trustees will not be required to submit the 2021 ACS to the authority in 2022, although the authority may request sight of the 2021 ACS from trustees.

Meanwhile, consolidation of the 150,000 Irish pension schemes is "fundamental" to improving the Irish pension system, according to the Pensions Regulator, Brendan Kennedy.

Publishing a statement alongside the Pensions Authority's *Annual Report and Accounts*, Kennedy said that compared to the rest of Europe, Ireland is an "outlier" as there are over 150,000 pension schemes, most of which are very small.

"Proper supervision and value for money will not be achieved unless there is a much smaller number of larger, more efficient schemes. Consolidation of the number of defined contribution schemes is fundamental to improving the Irish pension system and is a goal of the authority," he said.

Despite this, he said the immediate priority for all pension schemes and the authority is putting in place additional structures and processes required by the IORP II Directive. He stated that few schemes would have been compliant on the day the directive was transposed.

"Compliance with the amended legislation is not an end in itself. The purpose is to make pension schemes more efficient and accountable, and to ensure that there are trustees in place who are able and willing to address the significant responsibilities involved in overseeing and investing pension assets for up to 50 years," he noted.

Higher Danish pension investment charges found to not lead to higher returns

THE COUNTRY'S CONSUMER WATCHDOG'S REPORT FOUND LARGE DIFFERENCES IN ASSET MANAGEMENT

Written by: Natalie Tuck

Higher pension asset management charges do not result in higher returns in the Danish pension system, the country's Competition and Consumer Authority has found.

In a comprehensive report published on its website, the watchdog said that there are "large price differences in asset management between pension companies". However, savers should not expect higher returns from those providers that charge more for investment, it said.

The analysis by the Competition and Consumer Authority is based on data from a 2019 report, *Competition in the market for pensions*, which contained a number of recommendations to improve competition in the Danish pensions market.

The price that Danish pension savers paid to have their savings invested amounted to approximately 0.6 per cent of a pension companies' assets in 2017, corresponding to approximately DKK 14bn, it found. It said this is around 60 per cent of the average total cost for administering and managing pensions.

Its report also noted that historical returns are not a good indicator for future performance. Therefore, it is hard to choose a pension company that will have a high risk-adjusted return going forward.

The watchdog recommended that PensionsInfo, the website pension savers can use to see an overview of their pension savings, be expanded. It said savers should be able to use the website to compare how their company/companies perform in relation to other companies.

Currently, PensionsInfo uses standard rates for investment costs for a number of assets, which the watchdog believes makes it more difficult to compare investment costs across different companies. Therefore, it is recommended that savers should be able to view pension forecasts on PensionsInfo on the basis of the actual investment costs, as this will highlight the possible significance of asset management prices in pension forecasts.

However, Insurance and Pension Denmark has blasted the report and believes that competition in the pensions market is "extremely effective", including the management of pension assets. It said that pension companies invest in different assets with different strategies, and therefore have different costs. However, it argued that data shows that the return on costs does not vary systemically between companies.

In other news, the Danish Financial Supervisory Authority (FSA) has ordered six life insurance and pension companies to revise their risk assessment on money laundering.

It follows a review undertaken by the FSA on 10 life insurance and pension companies' risk assessments in the area of money laundering to make sure they comply with section 7 (1).1 of the Money Laundering Act.

This provision requires individual companies to prepare a risk assessment, which identifies and assesses the risk that the company may be used for money laundering and terrorist financing.

The Danish FSA generally assesses that life insurance and pension companies in Denmark as a whole have a relatively low risk of being used for money laundering or terrorist financing. However, it said companies still need to make sure that the risks that do exist are covered.

The FSA highlighted the § 53 product, which is a particularly non-tax-favoured pension scheme, as being medium risk.

Icelandic pension fund assets increase by 7.3% in H1 2021

THE RISE IN ASSETS WAS 1 PERCENTAGE POINT GREATER THAN THE 6.3 PER CENT INCREASE SEEN IN THE FIRST HALF OF 2020

Written by: Natalie Tuck

Icelandic pension fund assets increased by 7.3 per cent in nominal terms over the first half of 2021, the Icelandic Pension Funds Association has revealed.

This compares to a return of 6.3 per cent in the first half of 2020. Over the period, assets rose to ISK 6,150bn at the end of June.

During the period, foreign assets accounted for just over a third of all the funds' assets, a proportion that has been "fairly stable" this year, according to the association. Private assets held by pension funds accounted for approximately 10 per cent of the funds' total assets; this asset class has grown by 8.6 per cent so far this year.

Prepayments for new lending by pension funds in the first six months of the year amounted to ISK 24bn. Net prepayments of indexed loans amounted to ISK 32bn, while new non-indexed loans in excess of prepayments amounted to almost ISK 8bn.

The association said that recently, there has been a rapid change in household mortgages, from indexed to non-indexed loans, and when looking at all lenders, about half of household mortgages are now non-indexed. Total lending by pension funds to households amounted to ISK 486bn at the end of June, which is almost a quarter of all household housing loans.

Spain presses ahead with planned pension reforms

DESPITE THE PLANNED REFORMS, SOME HAVE WARNED THAT THEY MAY NOT GO FAR ENOUGH IN ADDRESSING THE PENSION SECTOR'S DEFICITS

Written by: Natalie Tuck

Spain is pushing ahead with planned pension reforms, which includes paying workers to postpone their retirement, according to reports.

However, French press agency, *AFP*, wrote that analysts have warned the reforms do not go far enough to help reduce the deficits in the pension system.

The country revealed earlier this month that it plans to get more people to work longer by giving cheques worth up to €12,000 per year to retirement-age workers who postpone their retirement. Retiring early on the other hand would lead to a reduction in monthly payments.

According to *AFP*, Spain's Budget Minister, Maria Jesus Montero, told a news conference: "Pensioners will no longer have to worry about the evolution of their pension."

The reform, which has been approved by the Spanish cabinet, will restore the indexation of pensions to inflation. A conservative government eliminated indexation in 2013, although in 2018 it hiked pensions in line with inflation following protests by pensioners against their loss of purchasing power.

The 2013 reform gradually increased the legal retirement age to 67 in 2027 from around 65 currently.

IE Business School head of the economics department, Rafael Pampillon, believed raising pensions in line with inflation was "outrageous".

News in brief

■ **Ontario Teachers' Pension Plan Board** has announced 2025 and 2030 interim targets to reduce greenhouse gas emissions as part of its journey to achieve net zero on its investment activities by 2050. Ontario Teachers' has set targets to reduce portfolio carbon emissions intensity by 45 per cent by 2025 and 67 per cent by 2030, compared to its 2019 baseline. These emission reduction targets cover all the fund's real assets, private natural resources, equity and corporate credit holdings.

■ The **South Korean** Prime Minister has been warned against building new coal power plants by APG Asset Management, a subsidiary of pension administrator, APG. A letter to Prime Minister, Kim Bu-gyeom, from APG Asset Management head of APAC responsible investment and governance, Yoo-kyung Park, raised concerns about South Korea's plan to build new coal-fired power plants. It relates to three plants with a combined power capacity of 6.3 gigawatts under construction in Gangwon Province. He warned that failure to phase out coal will incur a substantial cost.

■ Aviva Investors, the global asset management business of Aviva, and the Public Sector Pension (PSP) Investment Board, one of **Canada's** largest pension investment managers, have announced the acquisition of the Hoxton Campus. The acquisition consists of four offices located around Hoxton Square in the Shoreditch area of London. The deal represents the fifth investment that Aviva Investors and PSP Investments have made together since 2015, originally investing in a portfolio of commercial properties in central London.

Aon and Willis Towers Watson terminate proposed merger

THE DEAL COLLAPSED AFTER THE US DEPARTMENT OF JUSTICE FILED A CIVIL ANTITRUST LAWSUIT TO BLOCK THE MERGER

Written by: Natalie Tuck

Aon and Willis Towers Watson (WTW) have agreed to terminate their proposed USD 30bn merger following an "impasse" with the US Department of Justice (DoJ).

This will end litigation with the US DoJ. The proposed combination was first announced on 9 March 2020 and was approved by the European Commission in July 2021. As a result of the termination of the business combination agreement, Aon will pay the USD 1bn termination fee to WTW.

Aon CEO, Greg Case, said: "Despite regulatory momentum around the world, including the recent approval of our combination by the European Commission, we reached an impasse with the US Department of Justice."

The proposed deal was agreed between Aon and WTW in March 2020 and would have created a combined equity value of around USD 80bn.

In its lawsuit, the US DoJ warned that the merger of two of the 'big three' insurance brokers would create a broking "behemoth", threaten to eliminate competition, raise prices and reduce innovation for American businesses, employers and unions that rely on these services.

Aon and WTW had previously taken steps to reduce competition concerns in the US and Europe by agreeing to certain divestures.

Index shows global retirement issues

RETIREMENT SECURITY WAS ESPECIALLY LOW IN ASIA PACIFIC

Written by: Sophie Smith

New Zealand is the highest ranked non-European country in terms of retirement security, according to the Natixis Investment Management *2021 Global Retirement Index*, ranking sixth.

The nation was followed by Australia in seventh place, with both countries ranking in the same spot as last year.

North America was found to have the highest regional score with 72 per cent, followed by Western Europe with an overall score of 69 per cent.

Eastern Europe and Central Asia, meanwhile, ranked third as a region at 50 per cent, with four of the bottom 10 countries for finances included in this region: Turkey, Hungary, Slovak Republic and Latvia.

Asia Pacific, however, was found to have the lowest overall regional score of 32 per cent, with this region receiving the last or second-to-last score in three out of the four sub-indices.

More broadly, Natixis Investment Management's report emphasised that the risks presented by inflation, interest rates, and public debt, and the financial challenges of employment and healthcare have been exacerbated by the Covid-19 pandemic, warning that retirees are particularly vulnerable to low interest rates and rising inflation.

Diary dates 2021

The latest events occurring across the European pensions market

PLSA ANNUAL CONFERENCE 2021
12-14 October 2021
Online
This year's PLSA Annual Conference will examine what the road to economic recovery from Covid-19 looks like, analysing the hurdles for pensions and revealing the opportunities to lead the race.
The three-day online conference of industry keynotes, educational sessions, topic deep-dives and digital networking will feature speakers such as UK Pensions Minister, Guy Opperman, and economist Professor Mariana Mazzucato.
plsa.co.uk/events/conferences/

EUROPEAN PENSION AWARDS 2021
20 October 2021
London Marriott Hotel, Grosvenor Sq.
Now celebrating their 14th successful year, the European Pensions Awards were launched to give recognition to and honour the investment firms, consultancies and pension providers across Europe that have set the professional standards in order to best serve European pension funds over the past year. The shortlist for the awards has now been announced and bookings for tables at the gala dinner awards ceremony are now open.
europeanpensions.net/awards/

IRISH PENSION AWARDS 2021
18 November 2021
Shelbourne Hotel, Dublin
Now in their 10th successful year, the Irish Pensions Awards continue to go from strength to strength, giving well-deserved recognition to those pension funds, pension providers, advisers and pension professionals who have strived to maintain the highest standards of excellence and professionalism in everything they do, despite the challenging economic and political landscape they have found themselves operating in over the last year.
europeanpensions.net/irishawards/

Not to miss...

WORLDPENSIONSUMMIT 2021
12-14 October 2021
The Hague
conferences.pionline.com/conference/WPS/2021

IAPF BENEFITS CONFERENCE WEEK
19-21 October 2021
Online
iapf.ie/events

INSURANCE ASSET MANAGEMENT AWARDS
25 November 2021
Hilton London Tower Bridge
insuranceassetmanagement.net/awards/

PENSIONS AGE AWARDS 2022
23 February 2022
Grosvenor House, Park Lane, London
pensionsage.com/awards/

People on the move...

The latest news and moves from people within the European pensions industry

If you have any appointments to announce please contact natalie.tuck@europeanpensions.net

CARL HAGLUND

Veritas Pensionsförsäkring's Board of Directors has appointed Carl Haglund as the new CEO of the company. Haglund had been serving as director of the consulting company Accenture and will start at Veritas no later than January 2022. He has previously worked as deputy CEO of the bioenergy operator Sunshine Kaidi New Energy Group, as Finland's Minister of Defence and as a member of the European Parliament.

EMMA DOUGLAS

The Pensions and Lifetime Savings Association (PLSA) has appointed Emma Douglas as its new chair, effective from 14 October. Douglas was selected by a sub-committee, and will succeed outgoing chair, Richard Butcher, following the end of his four-year term. Douglas, who has chaired the PLSA Policy Board since 2018, will serve as chair for three years, with the option to extend for a further three years.

ALLAN PALDANIUS

The Finnish Centre for Pensions has appointed Allan Paldanius as director of research, statistics and planning, and as a member of its management group. He has extensive experience of earnings-related pensions, having previously been director of finance at Finland's public sector pension provider, Keva, with expertise in actuarial affairs and earnings-related pension financing and implementation.

CARL HESS

Willis Towers Watson has announced the appointment of Carl Hess as its new president and next CEO. He will assume the role of president immediately, following his "unanimous" selection by the board, and will succeed current CEO, John Haley, upon his retirement on January 1 2022. Hess, who currently acts as head of investment, risk and reinsurance business, started his career in the company in 1989 and has since held a number of leadership roles.

JESSIE WILSON

Dalriada Trustees has appointed Jessie Wilson as a professional trustee. Wilson joins from Baillie Gifford, where she was a director in the firm's US financial intermediaries team and previously held the role of client services manager. She began her career at HSBC Actuaries & Consultants as an actuarial analyst, and brings 15 years' experience to the role. Dalriada said the hire would strengthen its UK staff network.

DAVID TILLER

Quilter has announced the appointment of David Tiller as commercial and propositions director. Tiller will oversee Quilter's portfolio management technology, client-driven investment solutions, adviser tooling and platform, and will report to Quilter Investor's CEO, Stevin Levin. Prior to this, he was Standard Life Aberdeen head of client technology solutions, and is also an Origo Services non-executive director.

HARALD RIEGER

Union Investment has hired Harald Rieger as head of institutional clients, from August 2022 at the latest. He will succeed André Haagmann, who will move to the board of managing directors of Union Asset Management Holding AG in March 2022. Subject to approval by the German Federal Financial Supervisory Authority, Rieger will join the board of managing directors of Union Investment Institutional GmbH at the same time.

CORINNE LAMESCH

The Association of the Luxembourg Fund Industry (Alfi) has confirmed the re-election of Fidelity International country head, Luxembourg, Corinne Lamesch, as chairperson. Capital International Management Company conducting officer, senior counsel and board member, Jean-Marc Goy, and Union Investment managing director and board member, Maria Löwenbrück, have also been appointed as vice-chairpersons.

ROMAN BONER

Robeco has appointed Roman Boner as lead portfolio manager of the RobecoSAM Smart Energy strategy. Boner, who is based in Zurich, is an experienced thematic investment manager. He joins Robeco from Woodman Asset Management, where he built up its impact offering, and has previously held various roles at Swisscanto and UBS Global Asset Management.

VICTORIA SHARPE

HSBC Asset Management has announced the appointment of a new direct real estate team as part of its strategy to build out its alternatives business. The team will be headed by the firm's new managing principal and head of real estate, Asia Pacific, Victoria Sharpe, who joined the company on 1 September. Sharpe brings nearly 40 years' investment experience in real estate, investing on behalf of institutional investors globally.

MONIQUE MATHYS-GRAAFF

Willis Towers Watson has announced the appointment of Monique Mathys-Graaff as senior director, in the newly-established role of senior sustainable investment strategist. The role will see her working to further integrate sustainability into investment processes and embed sustainable investment thinking into client portfolios. She will report to head of investments, EMEA, Mark Calnan.

COUNTRY SPOTLIGHT IRELAND

A re-awakening?

After a delay of over two years, the IORP II Directive has finally been transposed into Irish law. Whilst all member states are governed by the regulations, it's about to shake up the Irish pensions sector like never before.

Natalie Tuck **reports**

The Irish pensions sector, according to the country's Pensions Regulator, Brendan Kennedy, is an "outlier" of Europe. He means by this, that Ireland is unique in the vast number of small pension schemes it has compared to the frequently seen industry-wide schemes of countries on the continent.

The European Union's updated pension legislation, the IORP II Directive, which all member states are governed by, therefore creates a unique challenge for Ireland's pensions sector. For the Pensions Authority, however, it could be an opportunity to shake up the industry and serve as a catalyst for the consolidation of the country's pension schemes.

The IORP II directive

Ireland was the last member state to transpose the directive over two years past the original deadline in April 2021. The directive itself builds on the original IORP Directive of 2003.

Europe's pension markets are heterogeneous in nature, which is why the directive allows for a degree of flexibility in its implementation; for its part, the Irish government has chosen to mirror the directive in its transposition. The regulations are now in the hands of the Pensions Authority, which is tasked with overseeing compliance of IORP II.

Its draft code of practice was published for consultation in July, with stakeholders given until mid-September to submit their responses. It is expected that a finalised code will be published for schemes in November. However, there will be a grace period to become fully compliant.

William Fry senior associate, Ciara McLoughlin, explains that the authority recognises the major regulatory change to the pensions landscape: "The Pensions Authority has consistently recognised these challenges in its communications with industry, and this is reflected in the compliance grace period in place up to the end of 2022. This will allow schemes and employers time to assess what the implications of IORP II are for them and decide how best to approach the regulatory challenges it brings".

The draft code of practice

At first glance, the draft code appears to be very detailed in its instructions, with the huge amount of documentation required standing out. Those that have delved deeper into the code, however, have noted a lack of detail in some areas.

Irish Association of Pension Funds (IAPF) CEO, Jerry Moriarty, says: "On the one hand it is very prescriptive; I have counted over 50 different documents that trustees must keep and update at different intervals but then there are other areas where it is a little bit vague and unclear. One of the big concerns we have is that it states that this is the minimum code that applies to all schemes and there are some schemes that will need to do more but it doesn't give any detail of what that more might be."

This links to a key theme highlighted by those in the industry, which is the lack of proportionality seen in the draft code. The IORP II Directive frequently mentions that the requirements should be proportionate to the size, nature and scale, and the complexity of the activities of the IORP.

LCP Ireland partner, Roma Burke, says: "The detail can be a double-edged sword. On the one hand, it is very helpful in the context of a new legislative environment to have a clear set of instructions. On the other hand, it doesn't allow schemes much leeway."

This is echoed by Law Debenture director, Paul Torsney, who says that there isn't a mechanism within the draft code that, subject to a reasonable minimum level, gives trustees a certain amount of discretion to decide what suits their scheme best given the circumstances of the scheme and the resources available. "If you look at each of the prescriptive requirements in isolation they generally appear quite reasonable. In a world with infinite resource and time you can do everything," he notes.

On the flip side, Torsney too, cites a "vagueness" in terms of talking about risk and the assessment of risk. "There is some wording [*in the draft code*] that needs to be fleshed out more and hopefully that will be in the final code.

Another issue that highlights the differences between large and small schemes is how much of the regulations will be completely new for schemes. McLoughlin says there will be a divide between schemes of different sizes.

"We've got some large pension schemes as clients, that are very well-run schemes and a lot of what they are doing is in the code and already in their system of governance. What they're doing [*to prepare for the regulations*] is looking at all their current practices and undertaking a gap analysis to see where there is a gap in their governance requirements," she says.

"We would anticipate that, for smaller schemes, a lot of the requirements will be new, and often those schemes would not be accustomed to this level of governance. For example, small schemes would have almost none of the policies in place that are envisaged under the code."

With the huge amount of documentation required, Moriarty says a lot of the work will be around documenting what is already being done. For example, the rationale behind all decisions made by trustees must be documented. However, Moriarty raises the point that this goes against what legal practice would recommend.

In some instances, the code brings in new processes for all schemes, such as the internal audit function. Torsney says that for most schemes this requirement will be completely new. This is an area that awaits more clarity, he says, as it is not yet clear what exactly this role will entail.

Another big concern for schemes is the cost of complying with the new regulations, and Moriarty says the cost benefit of some of the policies is debatable. When the IORP II Directive was implemented in the UK a full cost benefit analysis was undertaken, he states, something that has not been done in Ireland.

"[*The draft code*] implies that you do a tender for new administrators every three years but if you've got a good relationship with your current provider it can be quite a costly exercise to then do a full tender."

Time is also a big factor and, initially, McLoughlin predicts the set-up of becoming compliant is going to take up a lot of time and input from trustees, but once that set-up is complete, it may not be that much work on an ongoing basis.

Some are concerned though that becoming compliant by the end of the authority's grace period at the end of 2022 will be "very challenging". Torsney expects that trustees will need to have a significant number of meetings next year to work through everything. "Next year there might need to be a lot of extra more focused and shorter meetings just to get it over the line… It does feel like a challenge to become compliant by 2023."

Broadly, the feeling from the industry, Moriarty says, is that there is apprehension around how practical it is. "There is a lot of concern around how much additional work is required and that leads to a general concern of whether it will improve member outcomes or whether it is going to lead to additional work and additional costs, which ultimately will come back to members and employers anyway."

Impact on trusteeship

"The bar for trusteeship is obviously being raised significantly," Torsney says of the draft code. This, he explains, includes increases in areas such as the time commitment, the level of scrutiny, and the sense of liability and risk on an individual trustee.

Those in the industry are aligned on their view that such a change will see a decrease in the number of lay trustees because of the extra responsibilities and liabilities set out by the code, and the need for at least one trustee to have a qualification. "We have a really big concern that this is going to be the end of lay trustees, particularly," Moriarty says.

"If you only have professional trustees then you only have professionals in the room for conversations, you've lost the people who understand the employees, understand the company and understand the backgrounds… if you can't get lay trustees anymore then that just changes the whole landscape, and not necessarily in a good way."

On the other hand, the use of professional trustees is expected to become more popular. "We think there is going to be a trend towards professional trustees and we've heard of new providers from the UK as well entering into the Irish market," McLoughlin says.

Law Debenture is one of those firms that has recently entered the Irish market and Torsney says part of the reason for the expansion across the Irish Sea is due to "looking at what's coming down the track" and the need for more professional trustees.

Consolidation

It is no secret that the Pensions Authority would like to see significant consolidation in the Irish pensions market.

The Pensions Regulator, Brendan Kennedy, writes in his guest column for *European Pensions* [*page 19*] that the "obligations of IORP II are almost certainly too onerous and costly for small pension schemes", which is why consolidation is a priority for the authority.

Moriarty, who questions whether it is right for the regulator to set such a policy, says a lot of the draft code of practice is "really driven at making it so difficult that you will only have that small number of schemes".

The problem with pushing for consolidation, the experts agree, is the lack of viable options for schemes to consolidate in to. One option could be for DC schemes to join master trusts but last year the authority ruled that none of these schemes were "fit for purpose".

"That puts schemes and employers in a very difficult position because on the one hand they are being told they have to consolidate, but on the other hand they're being told the things you need to consolidate into are not fit for purpose, so what do you do in the meantime?… I think a lot of schemes are in a very difficult position in terms of how to move forward with this," Moriarty says.

Further guidance on master trusts is due from the authority in December, McLoughlin says. "What we are seeing is a 'wait and see' approach and that is what we are advising a lot of our clients to do who are looking at consolidation or appointing a professional trustee."

Another issue is the wind-up process for schemes, Lockton Companies partner, Niall O'Callaghan, says: "At the moment there is quite a significant process involved in winding up a trust and moving it to a different trust." He believes that if the authority wants to consolidate schemes, then it also needs to look at the regulation around wind up to make it easier for schemes, whilst also protecting the rights and benefits of members.

How can schemes prepare?

Whatever the impact, the regulations are here to stay and many are interested in whether the authority will take on board the key points made by the industry. Regardless of the outcome, schemes are advised to begin work immediately and then review the final code in November to identify any areas that may need addressing.

The first deadline for schemes is the Remuneration Policy on 31 December, Burke says, so if that is to be met, the work must start now. "Complying with IORP II is a big job, but possibly the hardest part is actually starting," she concludes. ■

GUEST COMMENT

Consolidation is key

Ireland's Pensions Regulator, Brendan Kennedy**, explains why the consolidation of Ireland's 150,000 pension schemes is a priority for the Pensions Authority**

Irish occupational pensions are going through a period of unprecedented change, triggered by the transposition of the IORP II Directive and the Irish government's 2018 *Roadmap for Pensions Reform*. The objective of these changes is to improve significantly the consumer protection for pensions savers and beneficiaries.

In April 2021, the Minister for Social Protection signed the regulations that transposed the IORP II Directive into Irish law. These changes imposed significant additional obligations on Irish occupational pension schemes and committed the Pensions Authority, which is responsible for the supervision of Irish pensions, to implementing forward-looking, risk-based supervision.

The particular challenge for the Irish pensions sector is the number of pension schemes: there are over 150,000 pension schemes. Almost all of these are single employer schemes and the great majority are single member arrangements. Although the transposition provisions allowed a five-year derogation for pre-existing single member arrangements, there are obviously enormous challenges ahead for the Irish pensions sector. These challenges can be summarised as follows:

The obligations of IORP II are almost certainly too onerous and costly for small pension schemes; there are not enough trustees with the required experience and qualifications to manage the existing number of pension schemes, such a large number of pension schemes results in duplication of administration and governance and is an obstacle to achieving efficiency and value for money, and, applying forward-looking, risk-based supervision to such a large number of schemes would be extremely difficult.

Consolidation of Irish pension schemes is therefore a priority for the Pensions Authority. Multi-employer master trusts are expected to be an important part of future pension provision in Ireland. The authority's immediate focus is on ensuring that master trusts are compliant with all of their obligations.

Few if any existing occupational pension schemes were wholly compliant at the transposition date. The trustees of these schemes and their sponsoring employers must decide as quickly as possible whether to take the necessary steps to achieve compliance or whether consolidation into a larger scheme is a more appropriate response.

It is important that the implementation of these reforms happens as soon as possible. The long-term, multi-generational investment of retirement savings has always been a profound and often underestimated challenge, and the environment for those managing pensions savings is as complex as it has ever been. The ongoing transfer of risk from schemes or employers to individual savers, the investment dilemmas presented by climate change, the need to ensure value for money, the role of advice and information for savers: these are all issues that need to be addressed as quickly as possible.

The objective of our reforms is that those running pension schemes will have the necessary qualifications, experience, processes and advice to take the appropriate steps and make the best decisions on behalf of members and beneficiaries. ■

GEOPOLITICS

Risk and reward

Geopolitics, or the point at which geography and politics meet, is an important topic for investors to understand and be aware of when formulating investment policy. Duncan Ferris **examines how investors deal with geopolitical change and what challenges they have faced in recent times**

WRITTEN BY DUNCAN FERRIS

Change can be scary. The risks associated with making major life decisions can leave many people feeling paralysed and scared to make a mistake in their attempts to move forward with their lives. Moving to a new city might carry the risk of loneliness or starting a new job might mean meeting unpleasant new co-workers.

But geopolitical change, such as shifts in climate or aggressive land-grabs from sovereign nations or militant groups, carry risks that are on a completely different level.

While many people might not be affected first-hand by these changes, the money in their savings and retirement accounts can be impacted by changes happening on the other side of the globe. So how can institutional investors ensure that they are geared up to deal with the influence of geopolitical change?

Frameworks

One obvious question to ask is: what steps can be taken to prepare for rapid geopolitical changes so that, when the time comes, you are ready to react as quickly and sensibly as possible?

Mercer Ireland senior investment consultant, Maebh O'Connor, says Mercer has a strong focus on its global investment capabilities across investment strategy, manager research, governance and risk management. "Expertise in these areas provides a solid foundation to address the challenges posed by geopolitical changes.

"As an example, our global dynamic asset allocation committee meets regularly to assess market conditions and establish relative asset allocation views both globally and regionally, publishing reports on a quarterly basis for global, Australian, US and European markets. It will meet and revise its views intra-quarter should circumstances require.

"The latest examples of this were in November 2020 when markets were reacting to the US election, amid the escalation of Covid-19 cases and again when the news that vaccine approval was on the horizon."

She also stresses that Mercer Ireland's client base, similar to pension investors generally, are medium- to long-term investors and so it is unlikely that "knee jerk reactions to specific market trends" could be recommended as a regular course of action.

APG Asset Management economics and strategic asset allocation team members, Thijs Knaap and Charles Kalshoven, add: "We prepare for volatility by constructing portfolios with different assets, the combination of which tends to be robust against shocks; and by regularly executing a rebalancing strategy that often has us buying risky assets after a geopolitical shock, and selling them again when the worst has passed.

"Because we expect volatility, not every event is a reason to change the outlook. Geopolitical risks tend to be temporary and markets tend to recover from their anxiety. Therefore, it pays to keep calm.

"As an investor, one is in the business of harvesting risk premiums. Apart from rebalancing, diversification is key: not all countries or assets will be affected similarly."

Additionally, Knaap and Kalshoven say that more predictable geopolitical events are factored into their outlook, while developments which "may occur with some probability" are explored in "deterministic scenarios" in which their likely effect on markets is assessed and the robustness of their investment policies is evaluated.

Now that we have a grounding in how frameworks for evaluating geopolitical change are put in place, it is perhaps a good idea to delve into specific examples of events and trends which have required evaluation.

"EVEN FOR ARMS-LENGTH INVESTORS, DEALING WITH CHINA IS MORE COMPLICATED THAN OPERATING ON WESTERN CAPITAL MARKETS. LESS LEGAL, MORE POLITICAL."

Flashpoints

As a general rule, investors like certainty. It is when incidents with major unknown consequences occur that uncertainty creeps in and investors get nervous. For example, the recent rapid takeover of Afghanistan by the Taliban, following the withdrawal of US troops and other allies of the incumbent Afghan government.

While this is terrible for the Afghan people and a major humanitarian crisis, it might at first seem like an event with limited economic consequences. After all, Afghanistan is not a major player in global trade or production and is far away in the Middle East. However, the truth is quite different.

For example, the chaos caused by a militant group overtaking Afghanistan could have major implications for the nation's neighbours and other regional powers. In this case, many nations in the region are, of course, major oil producers, and so there could be medium- or long-term implications for oil prices and therefore the price of equities in linked industries.

Criticisms of the US military's abrupt exit from Afghanistan could spur Washington to hike military spending, potentially leading to more lucrative deals for defence firms and diminishing investment into areas such as education or healthcare.

The immediate reaction to many crises is for investors to seek out assets that are perceived as a safe haven. For example, data released by Schroders in 2019 showed that in the short months following the onset of the Gulf War, the 9/11 terrorist attacks and the Iraq War, returns from US and global shares dropped by at least 9 per cent on each occasion, while demand for gold and US government bonds climbed.

However, this is a fairly broad strokes examination of three events that presented a litany of risks. When it comes to specific examples of how institutional investors deal with geopolitical shifts, O'Connor cites Covid-19 and Brexit as two great examples of recent inciting incidents of major change.

Speaking about dealing with the former, she says: "We generally advised clients to stay their course. We encouraged clients to take advantage of attractive valuations to rebalance portfolios back to their target asset allocation (buy equities/ sell government bonds) or add to existing exposures in asset classes such as high yield debt, where risk tolerance allowed.

"Some clients had appetite to act tactically to capture opportunities in the distress of credit markets in Q2 2020. Those clients would have added or introduced investment grade or sub-investment grade credit to their strategies, some veering more to the private credit space where they had tolerance for a degree of illiquidity."

Meanwhile, in the case of Brexit, she comments: "Although there were intermittent bouts of market volatility associated with Brexit, the diversification of client portfolios meant that the investment impact was limited. Brexit presented largely as an implementation issue for clients as access to UK fund structures became difficult.

"We liaised with managers about their procedures for accommodating Irish/EU clients, checked legalities of fund structures and quantified exposure to UK assets. In some cases (not many), asset transfers were required because existing fund structures became inaccessible or updates were required to legal documents to facilitate continued access to funds post-Brexit."

This paints a picture of two very different forms of problems for investors, with Covid-19 appearing to have been dealt with in terms of rebalancing certain assets, while Brexit presented more of a logistical challenge.

When it comes to specific trends in geopolitics that are worth keeping an eye on, Knaap and Kalshoven cite a breakup of the euro area and climate emergencies leading to refugee flows as situations that may occur. They also emphasise the importance of the opening of Chinese markets and China's increasing influence on world affairs.

They explain: "Even for arms-length investors, dealing with China is more complicated than trading on Western capital markets. Less legal, more political. You find that you need different information, and a different approach more generally, in this new environment. It's more complicated, but that also favours the relatively large parties that have the resources to adapt."

Opportunities

While the risks associated with geopolitical change are perhaps the most important aspect of the issue, it is also worth considering whether changes might create opportunities for institutional investors.

Business strategy group Boston Consulting Group (BCG) in March released advice regarding how risk managers can turn geopolitical risks to their advantage. As an example, BCG noted that a fossil fuel company might consider monitoring public support for mitigation of greenhouse gas emissions in order to determine the right time to develop alternative energy technologies and beat competition to the pinch. In turn, institutional investors can monitor trends like these to determine whether investing in this kind of innovation will offer favourable and stable returns.

In fact, investment opportunities tied to the issue of climate change extend far beyond the realm of green energy. Analysis published by Morgan Stanley in April highlighted a number of other sectors which could see business booming amid changes in climate. For example, one area cited was construction companies and resilient building materials, as many places around the globe might need to commence projects to build structures that are better equipped to withstand being battered by the strong winds and flooding that come with extreme weather events.

However, O'Connor says the possibility of using geopolitical events as opportunities is heavily dependent on investors' ability to "react appropriately". She notes that "a solid investment strategy foundation, strong governance structures, flexibility and the ability to react swiftly to change as appropriate are key criteria in facing challenges and capturing opportunities".

O'Connor explains: "As an example of investment opportunities, large dislocations in credit markets during the Covid-19 crisis in March 2020 created opportunities to add corporate bonds and sub investment grade debt at attractive yields to the benefit of clients who were well positioned to capture those opportunities. Our delegated clients also benefited from swift action on their behalf in this regard."

So, while it is clearly possible for investors to make opportunities out of geopolitical change, it is important for them not to get ahead of themselves. Sensible implementation of frameworks that can evaluate the risks posed by emerging events and realistic developments are clearly key in preparing for dealing with change. Once those foundations are in place, investors can then start to examine how they can turn situations to their advantage. ■

INTERVIEW

Hoping for reform

Duncan Ferris **speaks with The Association of Pension Companies of the Czech Republic (APS) president,** Aleš Poklop**, about calming nerves in the pandemic, encouraging savers to put more away for retirement and the possibility of reform in the nation's pension system**

Could you give me an overview of the main work and objectives of the APS?

The APS unites eight out of nine pension companies in the Czech market, with the ninth only having been established a few months ago. The mission of the APS is, in particular, to coordinate, represent, defend and promote the common interests of pension companies, vis-à-vis the legislature and its bodies, ministries and other state administration bodies, or other institutions and authorities. Furthermore, the APS also comments on legislative proposals and other measures concerning supplementary pension savings or supplementary pension insurance, to act as an advisory and information centre in the field of private capital savings for retirement, and to promote the idea of private capital savings for retirement to the general public.

> "THE APS UNITES EIGHT OUT OF NINE PENSION COMPANIES IN THE CZECH MARKET, WITH THE NINTH ONLY HAVING BEEN ESTABLISHED A FEW MONTHS AGO"

It appears that the amount of people with a pension in the Czech Republic is increasing. Has the APS worked to encourage more people to save for retirement?

Currently, 4.5 million Czechs save for their retirement privately. These people are obviously aware that their retirement prospects are not very optimistic, given the current situation of the unreformed state pension system. The fact that they also save privately is good news, but in order to secure enough money as well as their low pension from the state, to prevent against a 'financial cold shower' when they retire, they should save more money than they do already.

The APS motivates them to do so, for instance, by regularly giving examples, such as calculations, graphs, and articles, showing how much, and in which funds, it is possible to increase the value of their monthly deposits. We also regularly publish the results of fund management, so that people have information on how well individual types of investments, such as shares, bonds or a mix of both, and the specific funds that implement them are doing.

Czech pension funds seemed to perform well during the

Covid-19 pandemic, with the value of the new pensions increasing by an average of 4 per cent. How did the APS work to support the funds during this period?

The Covid-19 pandemic has impacted stock markets around the world, and this has, of course, affected Czech pension funds too. Subsequently, however, the funds were able to return relatively quickly to normal and so the losses were quickly erased. We, as an association, acted to calm the market and possible future panic by explaining to people not to interrupt their saving plans in the event of a loss of income during the lockdown, because there is no risk of any debt or fine in the month when no money is sent.

Interrupting payments on a pension is not a problem, but people often do not know this information and unnecessarily cancelling a pension prematurely would be disadvantageous for them, as cashing out their savings before the age of 60 years effectively results in a fine. Of course, it is also important to inform your pension company about the suspension of payments.

It appears that there are strong calls for reform in the Czech pension system. What kind of ideas are being put forward?

The Czech state pension system has been running at a loss for a long time; every year a third of the state budget goes to it and it is the largest cost for the state. The deficit is growing and it is not possible to maintain it in the long run. However, pension reform is not a popular topic for politicians, so only cosmetic adjustments are taking place. This includes money being distributed but the income side remains unresolved.

Thus, there is a danger that the collapsing system will be saved in the future by an unpopular increase of taxes, or a sharp reduction in already low pensions. We are pushing to change the system, for example, to provide people with higher contributions from the state when their deposits are higher, so to encourage higher rates of saving.

We are also considering the possibility of promoting entry into the system automatically as soon as you start your first job through automatic enrolment. And, of course, we want employers to have a duty to contribute to employees' private pension saving plans by law.

How important is the imbalance between men and women's pensions in the Czech Republic? Might the issue change in the future?

This disparity is very unfair and stems from the fact that women do not pay social insurance when they are caring for newborns. In addition, they are paid less than men for the same work (about 15 per cent in CZ), which means that they also have lower state pensions, on average. In the private sector of pension savings, of course, both men and women have exactly the same conditions and rights, yet when women earn less, it is possible that they also put less aside for pension savings.

Are there any issues with pension saving in the Czech Republic, or in Europe generally, that you would like to mention?

In the Czech Republic, the general problem is that people do not contribute enough money into pension saving funds. And so, even after interest in a good fund, they do not earn enough for their retirement. At the same time, we assume that in the future, pension savings will no longer be just a 'pleasant bonus' in the form of extra money, but a necessity, because the financial decline after retirement will be huge, as we already have a compensation ratio below 50 per cent in the Czech Republic.

"PENSION REFORM IS NOT A POPULAR TOPIC FOR POLITICIANS, SO ONLY COSMETIC ADJUSTMENTS ARE TAKING PLACE"

Another problem is that the old pension savings system still exists in the Czech Republic, with three million Czechs still belonging to it, even though it is closed to new members. It guarantees that people can never receive less than 0 per cent interest. If they were on track to receive a loss, a pension company pays for the loss so people are never below zero.

This means that many funds only value money in very conservative government bonds, and don't even beat inflation. Unfortunately, people cling to this guarantee and do not want to switch to new, many times more advantageous funds, which can achieve returns of as much as 10-20 per cent per year when the situation with the stock markets is good. ■

THE RISE OF DC ASSETS

DC asset allocations: A seismic shift or tentative beginnings?

As DC schemes become more popular, the allocation approaches funds are taking are indicative of the opportunities and challenges facing the market

WRITTEN BY TOM HIGGINS, A FREELANCE JOURNALIST

Defined contribution (DC) schemes are on an unrelenting rise in Europe. As the bricks and mortar of the European pensions sphere undergo significant change, investment strategies are coming to the fore that remain largely untested in many parts of Europe.

The European DC space is yet to reach the level of maturity seen in some individual markets, such as the UK, but the shift is already pronounced. More governments and corporations are exploring the cost benefits of DC schemes as a long-term replacement for increasingly expensive defined benefit (DB) guarantees.

European DC pension assets are expected to exceed the €10 trillion mark by 2030, up from €4 trillion at the beginning of 2020, according to research by Indefi, marking a significant change to the makeup of pensions across the continent.

Within the world's seven largest pensions markets, known within the *2021 Global Pension Assets Study* from the Thinking Ahead Institute as the P7, leading European DC-dominant nations are driving global trends.

The Netherlands, Switzerland and the UK have all contributed to a remarkable shift in the European pensions landscape, with DC assets accounting for over 53 per cent of the assets held among the P7. In 2000, DC assets represented only 35 per cent of total pension assets among the seven largest markets.

Spurring this rise, the European front runners are all at different stages in their shift to DC. The Netherlands still holds 94 per cent of its pension assets in DB schemes, while in the UK, 81 per cent of assets are still in DB schemes. But the inevitable growth in DC across European markets is forcing pension schemes to reconsider the makeup of their allocations, and review both where they put their money and how they utilise various approaches to achieve desired objectives.

Illiquidity issues

It is not simply a case of looking for opportunities and asset classes that provide good returns, says Mercer Ireland partner and DC & master trust market leader, Caitriona MacGuinness.

She says that one fundamental issue that dictates much of the asset allocation decision making is that it is more difficult for DC investors to hold illiquid asset classes, as individual members need the "ability to access their savings in certain circumstances".

In practice, this means that DC schemes lean towards asset classes that can be liquidated quickly, "generally those offering daily liquidity," says MacGuinness.

But LCP Ireland investment consultant, Odhrán Mulrooney, says that the habit of investing in daily dealing funds for DC schemes needs to be addressed as it "limits the investable universe and puts DC members at a relative disadvantage," in comparison to the opportunities available to DB clients.

Meanwhile in the Netherlands, Kempen Capital Management fiduciary manager, Frank van der Ploeg, says that a similar pattern can be seen in his domestic market, although DC pension funds will still make "significant allocations" to illiquid assets – often around a fifth of total assets.

Yet there is a case to be made for a greater allocation of illiquid assets, Mulrooney says. Between 80-90 per cent of DC members are invested in the default option in Ireland, and with investment horizons often being over 30 years, Mulrooney believes that schemes of a certain size should be more willing to utilise illiquid opportunities in the default offering.

"This is something we have worked on with some larger DC schemes in the UK and is something we'd like to see adopted in the Irish market."

Likewise, MacGuinness says that while there has been some evolution in this area, there are not yet solutions in Ireland that meet the reality of the fee constraints facing DC funds.

"Some more developed DC markets, such as Australia and New

Zealand, have the scale to incorporate illiquid elements, but this is not yet a feature of most Irish DC funds and could improve outcomes for members," she says.

But the wave of greater consolidation coming to the Irish pensions market may bring the need to facilitate more illiquid assets to the fore. In August, the Irish Pensions Regulator, Brendan Kennedy, said the consolidation of pension schemes was "fundamental".

Technicalities take precedent

To say that the European pensions space is nuanced would be an understatement, and various intricacies from across the continent are set to dictate future allocations, resulting in myriad approaches.

In the Netherlands, hedging against inflation risks is not a "hard requirement" for DB schemes, van der Ploeg says, while many schemes consider the cost of inflationary hedging for the whole population to be too high. Yet this attitude may undergo a significant shift as the DC transition continues in the Netherlands.

"For DC schemes, the more relaxed regulatory framework such as the absence of liabilities, allows pension investors to re-evaluate inflation hedging. Specifically for older participants, it might be reasonable to pay 1-2 per cent, per year to avoid the risk of high inflation affecting real pensions," he says.

Broadening equity horizons

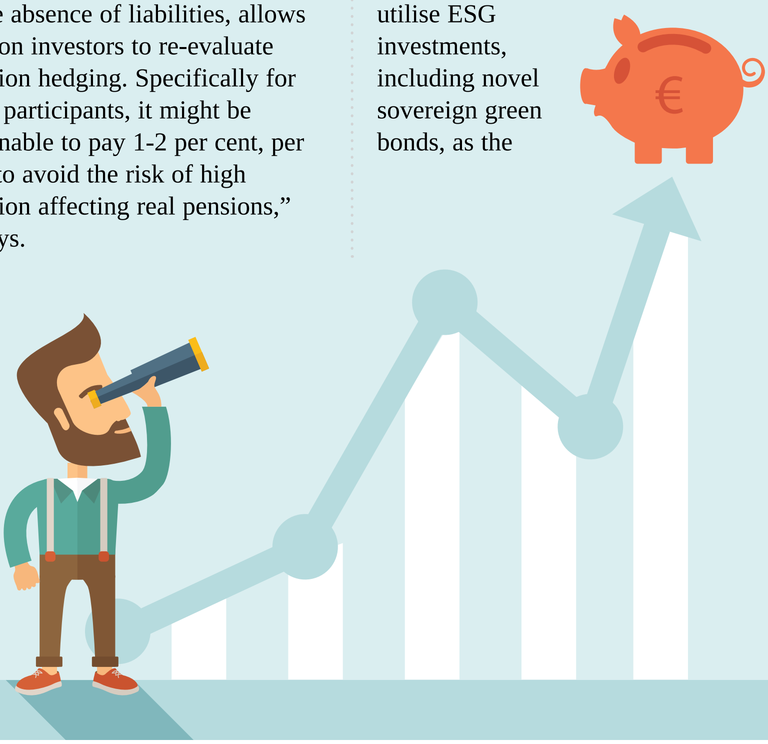
Equities continue to be at the core of a DC growth portfolio, helping to achieve the growth required to support retirement goals as well as providing the liquidity needed for individual members.

But Irish Association of Pension Funds (IAPF) CEO, Jerry Moriarty, says that in recent years, there has been a growth in allocation to alternatives, with equity allocation dipping to below 50 per cent for the first time, according to the latest *IAPF Annual Investment Survey*.

Of this allocation, 3.5 per cent of DC assets are in absolute return funds, 5.1 per cent in diversified growth funds, 0.1 per cent in hedge funds and 5.3 per cent is invested in "other alternatives".

But one inescapable trend that is influencing DC asset allocations across Europe is the shift towards sustainability and the rise of environmental, social and governance (ESG) investing.

As an element of the equity universe, approaches to ESG investing are nuanced and varied across the pensions landscape. Whereas some DC providers will utilise ESG investments, including novel sovereign green bonds, as the backbone to a portfolio for sustainably-conscious members through the default offering, others may utilise the performance and momentum of ESG opportunities within a broader range of equities through self-selection or a niche fund.



Legislative drivers

On the continent, the introduction of the IORP II Directive has further accelerated the integration of ESG into asset allocations. Under the ruling, pension providers in EU member states must invest prudently in the best long-term interest of members and beneficiaries and operate an effective governance system that includes consideration of ESG factors.

And while this has predominantly resulted in an increase in allocation to sustainably-focused equity products, there is an emergent demand for other asset classes, such as corporate bonds and emerging market debt. Mulrooney believes that this area is set to develop significantly over the coming years, with new products set to come to market.

But the bigger picture still remains uncertain and untested. The transition to DC schemes is set to intensify, with ever great flows of capital set to facilitate the ever-increasing number of DC scheme members, intensified by the prevalence of auto-enrolment practices.

Yet many issues remain unaddressed, particularly in how the composition of the default offering can best serve both the financial needs of savers alongside the growing necessity to incorporate sustainability alongside effective corporate governance.

So far, the shift in allocations may not be hugely pronounced, but the momentum looks unlikely to dissipate. ■

Insurance Sweden

Anti-money laundering: No one-size-fits-all approach

THE POTENTIAL IMPACT OF PROPOSED ANTI-MONEY LAUNDERING LEGISLATION ON THE PENSIONS INDUSTRY

"WITH THE PENSION SECTOR, PRODUCTS ARE OFTEN LOW RISK AND ROOTED IN A SPECIFIC NATIONAL CONTEXT"

In July, the European Commission presented an important legislative package to strengthen the European Union's (EU) anti-money laundering (AML) framework and counter the financing of terrorism. The proposals came in the wake of several high-profile cases in the banking sector in recent years. There is no doubt that we cannot afford to lose the fight against money laundering. It is equally true that we all need to contribute, including the insurance and pensions industry.

This does not necessarily mean that we should all be doing the same things. Risks differ. Financial Action Task Force (FATF), the global standard setter on combating money laundering, has pointed out that, generally, the money-laundering risk associated to the life-insurance sector is lower than that associated with other financial products or other sectors. Many insurance products are simply not flexible enough to be an attractive choice for money launderers. For instance, insurance pension products are designed for the long term and will often only pay out after retirement.

A risk-based approach to counter money laundering and terrorism financing has been the backbone of AML regulation, and should continue to be so for a simple reason – resources should be focused on real risk. Applying a risk-based approach helps increase effectiveness and reduce compliance burdens.

The AML package means further harmonisation, including the creation of an EU supervisor and a single rulebook. A new EU Anti-Money Laundering Authority (AMLA) will be at the centre of a more centralised EU supervisory system. In the financial sector, it will directly supervise a number of the riskiest cross-border financial sector entities. Fully staffed, the AMLA is expected to have 250 staff members.

The substantive AML law that applies to insurers and other obliged entities will be transformed to a directly applicable regulation. In other words, these AML rules will no longer be implemented in national law. More detail is added, for instance, on the customer due diligence, and further detail is still to come. The AMLA will be given a mandate to develop lower level rules on key aspects such as simplified due diligence measures.

The commission expects the full rulebook to apply by the end of 2025 and the AMLA to begin direct supervision thereafter. Large banks are often at the centre of the discussions about AML rules. However, we must not lose sight of the fact the these rules apply to a range of different sectors. With the pension sector, products are often low risk and rooted in a specific national context. It is therefore essential that AML regulation is guided by a risk-based approach.

Against this backdrop, we are not convinced that regulation is the best way forward. Regulations assume the same type of situation across all member states. In the pension sector, there is clearly a need to adapt to local conditions. The level of detail on customer due diligence also makes it more difficult to apply a risk-based approach in relation to pension products where the risk is low due to the product features.

Simplified due diligence should be the rule for low-risk pension products. Furthermore, occupational pension should be left out altogether. Institutions for occupational retirement provision (IORPs) are quite rightly not covered by the AML rules under EU law because of the low risk. To be consistent with the risk-based approach, life insurers should also be excluded when they perform the same activities.

We also value the role of national supervisors. There are clear risks with a development that involves the transfer of direct supervision to the EU level. National supervisors generally know their home markets better. ■

Written by Insurance Sweden senior legal adviser, Rickard Sobocki

INTERVIEW

Mapping the route to net-zero

Sophie Smith **chats with Norwegian pension fund KLP director of corporate social responsibility,** Heidi Finskas, **about the scheme's roadmap to net zero and how it is using engagement to create change**

WRITTEN BY SOPHIE SMITH

Can you tell us about what prompted KLP to commit to reaching net zero by 2050?

We all know that this transition is important. Climate change will have a catastrophic impact on the planet and on our living conditions across the world. Institutional investors have an important role to play in limiting global warming and supporting the transition to a low-carbon society – in their allocation and investment decisions, as well as in being clear about the financial risk that climate change brings to the economy and their investment portfolios.

Our chance to do something about it is in everyone committing to doing their part in order to reach the 1.5˚C Paris Agreement target. We have to acknowledge that a drastic transition is needed and link our individual targets to science-based emission pathways.

To succeed in securing the best possible return on the pension funds we manage, we must take the issue of climate change seriously. For KLP, climate change represents a financial risk. Helping to limit global warming to no more than 1.5˚C is therefore both right and financially prudent.

Can you tell me more about the fund's recently approved roadmap to net zero?

There is no single, incontrovertible method by which a financial institution should operationalise the 1.5˚C target. KLP has therefore developed a roadmap based on established standards and best practices. The roadmap is intended to describe how KLP will measure its degree of alignment with the Paris Agreement, or the proportion of our investments whose emissions trend is compatible with the 1.5˚C global warming target.

KLP has a net-zero ambition that covers our entire investment portfolio. By doing this, we will continuously measure how our investees are performing in the transition, and identify appropriate measures to influence emission reduction in the real economy.

The roadmap shows how KLP will assess each and every investment to ensure its emission path is aligned with the Paris Agreement ambitions.

How has the fund been working to meet its net-zero commitment so far, both in terms of its investments and operations? And what further plans does it have in future?

Key actions taken towards net zero so far are:

1. A strong commitment to renewable energy. KLP already has 5 per cent of assets under management in renewables, and we continue to invest more. We have a clear focus on financing new projects in order to increase the capacity of renewable energy, and this has prompted new partnerships, which have made it possible for us to invest all over the world, even in developing countries where we know the need for both capital and energy is especially urgent.

2. Seeking to influence companies in target setting and emissions reduction. We do this through direct engagement with companies, through collaboration with international investor groups, and we support many climate-related resolutions at annual general meetings.

3. Divested from coal and tar sands. These are the most carbon intensive fossil fuels and must be replaced by renewables as quickly as possible. As a result of this, we have been part of the construction of 25 renewable energy facilities that have come into operation. Our investments are free from coal and tar sands, and the carbon intensity for our portfolio of listed securities has decreased by 50 per cent from 2010 to 2019.

Exactly how KLP will reach net-zero emissions is as yet uncertain, as the uncertainty is significant when it comes to the development and decarbonisation trend in the market. Solutions and choices will have to be made on the way to 2030 and 2050.

The immediate need is to ensure that the transition to a low-emission society happens faster. KLP's most important task will therefore be to focus on short-term results relating to the decarbonisation of the

economy and our investment portfolios, as well as to help the emergence and expansion of green solutions like renewable energy.

To sum up, going forward, we think that the most important actions we can take are:

- To increase climate-friendly investments. Currently our annual target is an increase of at least NOK 6 billion per year. (We are pleased that the result last year was NOK 8.8 billion.)
- To encourage companies to set climate goals, cut emissions and become more transparent about their own climate impact.
- To take steps with regard to high-emission sectors and companies that fail to follow the required emissions mitigation pathway.
- To help accelerate the transition to a low-emission society by bringing our influence to bear on markets and political policies.

Can you also tell us a bit more about the fund's stewardship work and how this is used alongside divestment policies?

Supporting and pushing companies in their transition efforts is the first step for an investor. At KLP, we engage directly with companies, especially Norwegian companies, on their climate targets. We also collaborate with international investor groups, such as for instance Climate Action 100+, which focuses the engagement on the largest emitters, 167 companies that are critical to the net-zero emissions transition. Another example of collaboration is deforestation in the Amazon, where an investor group is engaging with companies exposed to the challenging deforestation situation in Brazil and with Brazilian authorities.

I would also like to highlight voting at annual general meetings and climate-related proposals as an important way of influencing. There are several cases from the past couple of years where climate-related resolutions got the majority vote. Two examples this AGM season: electing board members to Exxon mobile, and the resolution for HSBC to phase out from coal and set targets aligned with 1.5˚C. Another example, that didn't get a majority vote, but still got strong support (30 per cent), was a resolution at Shell's annual general meeting to set, publish and report on GHG emissions targets that are consistent with the goal of the Paris Agreement.

There is a case for divestments or exclusions. The fact that we put action behind our words – whether that is in allocating more to renewables, divesting from coal or voting at a resolution suggesting more ambitious climate targets – creates a strong synergy between our tools as investors.

Furthermore, there are also cases where we see that engagement is not worthwhile as we are unlikely to get the result we are hoping for because companies are simply not willing or able to transform. Divestment is also about sending a strong signal to the market about what direction we would like to see companies move, for instance, like when we decided to divest from coal and tar sand.

How have clients' and members' views been incorporated into the fund's responsible investment strategy?

KLP is created by and for the Norwegian municipalities and health enterprises. Their agenda is our agenda, and we have set our target so that they can be confident that their pension savings is managed in a way that will support the Paris Agreement, which the Norwegian government is also a part of. KLP's responsible investments strategy, including the net zero target, is approved by the board, where our owners and clients are represented. We also have a close dialogue with clients through more informal channels. Our impression is that Norwegian municipalities and health enterprises are clear in their views that KLP must have high climate ambitions while creating a competitive return on their pension assets. ■

PODCAST

‘The power of three’:

Using Common Contractual Funds to improve tax outcomes for investors

Large asset owners are still investing in equities in a way where they are taxed on their income. The implication is that they get a poorer return. They need to, and can, improve this, but how?


AMX Head of Platform Solutions, Aaron Overy**, and AMX Product Tax Specialist,** Kevin Duggan**, discuss with European Pensions Editor,** Natalie Tuck**, about the options to help ensure good withholding tax outcomes for institutional investors**

Large asset owners are still investing in equities in a way where they are taxed on their income. The implication of this is that they get a poorer return. They need to, and can, improve this, but how? Aaron, to begin, how can this need be fulfilled for investors?

Aaron Overy (AO): At AMX we are very tax aware, and we work with large investors on how they can set up pooled funds. Pension funds are tax exempt, and as the beneficial investor of these pooled funds, there’s always the potential that they’re not set up in a way that is withholding tax efficient, and this is the first of this ‘power of three’.

Last year we did a study where we looked at how much UK defined benefit plans were losing by investing in the wrong type of fund structure. That came out to about £250 million a year potentially lost because of these fund choices, which was about 40 basis points of withholding tax drag on global equity dividends. By making a choice of a fund type that is tax transparent, where you can ‘look through’ to the underlying beneficial investor, you can ensure that this withholding tax is not lost. You can therefore improve performance and return for the investor but also performance for the manager.

People often use Open Ended Investment Companies (OEICs), Société d’investissement à Capital Variables (SICAVs), Irish Collective Asset-management Vehicles (ICAVs), Undertakings for the Collective Investment in Transferable Securities (UCITS) and Alternative Investment Funds (AIFs) as pooled funds, which are perfectly good funds but, because they’re not tax transparent, you do get this withholding tax drag. Funds such as the Irish Common Contractual Fund (CCF) enable pension funds to get to where they should be as per the treaties between them as the investor and the investment markets. We’ve seen this work in the UK, South Africa, Germany, Canada, The Netherlands, and Switzerland. There are plenty of places for investors to use these fund structures – these tax transparent funds – in underlying global investor markets.

And so that works for investors but what about the actual funds?

Kevin Duggan (KD): Number two in the ‘power of three’ covers fund level relief; in certain countries domestic investment funds meet qualification conditions for reductions or exemptions from local withholding tax on dividends received. The conditions, for example, could be based on the legal form of the investment fund or the European Union (EU) regulatory status. Following several EU court decisions, the principle of EU fund equivalency continues to grow, to effectively ensure EU funds achieve the same treatment as domestic funds.

For example, there’s been precedents in Spain, but we have also seen this in Sweden, Norway, France, and Greece – the number of countries is continuing to grow. As we explored in a recent AMX article on EU equivalence rulings and how they are changing and how dividend withholding tax applies to institutional funds, post-Brexit we’ve seen many UK funds impacted in these countries because the EU/EEA establishment condition is no longer valid. This will likely add some basis points of withholding tax drag to performance.

And are there any other options other than look through and fund level relief?

KD: Yes, number three in our power of three applies to sovereign wealth funds and supranational entities, whereby you look to relevant domestic tax codes in each investment jurisdiction. This is best illustrated by way of an example. Section 892 of the US Federal Tax Code provides certain tax benefits to foreign sovereigns that invest in US assets. It effectively exempts from US Federal Income Tax the income of a foreign government derived from investments in stocks, bonds or other domestic securities owned by such foreign government. This third method achieves exemption from US dividend withholding tax for qualifying sovereign entities investing through CCFs simply by applying section 892 to their holdings.

AO: We spoke about investors being tax aware and these supranational entities and sovereign wealth funds are often able to claim immunity from taxation; they are very large organisations with lots of money in equities. Yet, I've seen examples of sovereign wealth funds using Cayman corporates in a way that results in withholding tax drag. And, with the size of their investments, this is millions of dollars every year. Again, this is simply because they've not chosen the correct fund structure and instead have only thought about how they are investing. Perhaps the investment managers haven't thought about how their clients may get to this better outcome using a better fund structure.

That's three great outcomes for investors – how does this work in real life? Do you have any examples of how using tax efficient structures can open up opportunities?

AO: Absolutely, we've spoken about the power of three; looking through to beneficial investors, the use of fund level relief and the use of section 892 exemption. We're talking to investment managers and investors all the time and we've helped them. With one of our managers, we obtained a Canadian opinion from our tax adviser for the fund structure, for the CCF for Canadian investors. They were then able to compete against domestic funds as a global equity manager.

On the investment side we've worked with the Japanese Tax Agency to confirm transparency of the CCF for UK investors in Japanese equities. Japanese equities in a world mandate is very often the second largest market. They would have potentially been paying 15.315 per cent withholding tax. The treaty between the UK and Japan can get back down to zero and so, in large markets with sizeable potential withholding tax drag, the confirmation of the transparency of the CCF means that they don't have to pay that, nor should they, and they can get down to zero withholding tax in Japan.

Are there any final points you'd like to make about the value of using CCFs?

KD: One final point I would like to make is the benefit of risk management. CCFs are complex structures, which require considerable operational expertise to run efficiently. There are high volumes of data, there are requirements for timely fast and accurate calculations. Different jurisdictions will have their own specific withholding tax rules and tailoring will be required to the jurisdictions of the different investors. Operational oversight of the tax services provided by the administrator is very important. Schemes and investment funds need to work with a partner who has the necessary knowledge and expertise. The robust accounting systems and technology to make this work smoothly and manage those inherent risks so we see the benefits of good risk management through the use of the CCF.

AO: I think it's about good governance; regulators are looking closely at the moment at whether funds are being run well and if the different actors are truly being transparent and providing good governance. That includes the management company, the trustees, the managers and ensuring the best possible outcome for investors. If the fund is being run in a way that does impact those investors, because of withholding tax for example, then perhaps that's not good governance. We've got these three options, the 'power of three': looking through to the beneficial owners, having that tax transparent fund and using the fund level equivalence across the EU and the EEA, or the sovereign exemption. There are these options available for those that are tax aware to implement and therefore to give the best possible outcomes to investors to provide good governance. ■

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RISING LONGEVITY

How to solve a problem like longevity

Jack Gray investigates how pension systems across Europe are attempting to solve issues with ageing populations and what new trends are emerging

WRITTEN BY JACK GRAY

Last year was a challenging and shocking experience for people around the world as the Covid-19 pandemic swept across the globe. The tragedy of widespread loss of life affected all areas of society, including the pensions sector. Following years of increasing life expectancy across Europe, the only three countries that saw a rise in 2020 were Denmark, Finland and Norway.

Although the pandemic is not over, vaccines and a greater understanding of the virus have led to many believing that last year was a statistical anomaly and life expectancy will continue to increase from this year. "Due to the coronavirus pandemic, mortality in 2020 was higher than expected," explains a Federation of Dutch Pension Funds spokesperson. "The pandemic is not expected to adversely affect the upward trend in life expectancy."

This brings the issue of longevity back into the limelight, with governments and pension organisations across Europe looking for solutions to an ageing population and analysing emerging trends.

Variable concerns

Looking at European Union (EU) member states together gives an idea of the challenges countries are facing. Between 2019 and 2070, the life expectancy at birth is expected to grow by 7.4 years for men and by 6.1 years for women, the working-age population will decrease by 8 percentage points as a percentage of the total population, and the EU's old-age dependency ratio is projected to rise from 35.3 per cent to 58.9 per cent.

"These alarming figures urge governments to assess the adequacy and sustainability of the pension system and to place pensions at the heart of social and economic policies at all levels," says PensionsEurope senior policy adviser, Simone Miotto. "In certain countries, governments should be very concerned about the impact of the demographic challenge on their pension systems and act promptly to ensure good pensions to all."

The scale of the issue varies from country to country, with Insurance and Pension Denmark senior consultant, pension and welfare, Lotte Katrine Ravn, noting, "as in most European countries", there are concerns regarding the increasing life expectancy of the population in Denmark.

"This increase, coupled with the extreme low-interest environment, has put increased pressure on long-term life insurance products," adds ATP head of pensions, Liselotte Milting.

However, this is not the case for all nations, with Tela manager, public advocacy, Janne Pelkonen, stating that there is "not much concern anymore" in Finland due to reforms in 2005 and 2017.

Solutions and strategies

"We now have two automatic stabilisers integrated in the statutory pension system in Finland," explains Pelkonen. "The life expectancy co-efficient was introduced in 2005 and implemented in 2010, and means that everyone born after 1947 has their pension levels adapted to their rising life expectancy.

"In 2017 we linked our retirement age to life expectancy. This also has a long implementation period and, starting from 2030, the lowest boundary of retirement age is going to be linked to life expectancy."

Indexation of life expectancy and retirement age is a common solution to the problem and is also used in the Netherlands and Denmark, among others. It aims to address affordability and labour issues by ensuring that there are enough people working to support those in retirement.

Ravn notes that the indexation in Denmark, introduced 15 years ago, has proven "very successful" and has had a "massive impact on the actual retirement age and thereby the long-term public economy".

"It was clear in the early 2000s that the Norwegian pension system was not sustainable," says KLP head of analysis, Lisa Marie Dickson. "Life expectancy was increasing, and birthrates were declining.

"Since 2011 a pension reform has been gradually implemented. Its key goal is to meet the challenges the demographic development represents to the financial sustainability of the pension system and to encourage people to postpone retirement and work longer.

"The actuarial life expectancy adjustment of pensions and new rules for pension indexation ensures sustainability, flexible retirement encourages people to retire later and thereby contribute to the workforce longer."

Flexible retirement can allow those who want to continue working, or to have more money in retirement, to do so, but it can also put risk on the shoulders of members. Dickson explains that if the member withdraws their pension too early and lives longer than expected, they will not have maximised their pension. However, if they wait too long they might die before they have profited on the higher annual payments that come with a late withdrawal.

Changes have also been taking place at a company level, Milting notes, with many pension firms in Denmark redesigning products to only provide guaranteed mortality in retirement, for example annuity pricing based on prevailing mortality at the point of retirement, aiming to limit longevity risk for younger pensioners.

"The solutions and strategies adopted have been very different," summarises Miotto. "They range from structural pension reforms, such as the one ongoing in the Netherlands that is transforming the occupational pension schemes from DB to DC with solidarity elements, to more spotted technical changes to the current existing structures."

"THIS INCREASE, COUPLED WITH THE EXTREME LOW-INTEREST ENVIRONMENT, HAS PUT INCREASED PRESSURE ON LONG-TERM LIFE INSURANCE PRODUCTS"

However, Miotto warns that the solutions and strategies adopted by national governments are not always long term, consistent or timely, as pension reforms are a very delicate issue from a societal, political, and budgetary perspective.

Emerging trends

Governments, associations and pension companies continue to try and stay one step ahead of demographic changes that shape pension policy. As the situation evolves, longevity trends that need to be addressed are emerging.

One key example is the polarisation of life expectancy between socio-economic groups. This brings questions of fairness, as if one group has a notably lower life expectancy than the other it may be unfair to have a one-size-fits-all retirement age.

"Even in Finland where we like to think of ourselves as a Northern European welfare state, there is polarisation of life expectancy between different socio-economic groups," states Pelkonen. "Those with lower education levels or work status have seen at best rather modest increases in their life expectancies. I think this is probably the case in most European countries."

Ravn notes that, in Denmark, parties in parliament are beginning to think that an official pension age of 72 by 2050 is presenting a "downside" for some employment groups, such as blue-collar workers.

"A newly established pension commission has been given the task to investigate a shift in the timeline of a life expectancy indexation and ways to simplify the pension system in general," she adds.

Meanwhile, in Norway, Dickson explains that people having to work longer is "putting increased focus on private savings in tier three".

Changes to working patterns and labour markets are also pushing pension reforms, as Miotto explains: "All forms of employment other than full time have considerably increased over the past few decades and their use has become more widespread across economic sectors and occupations. Still today, these workers are not always adequately covered by their pension system. Pension systems will need to be modernised to reflect the continuous changes in the labour markets to maintain and/or improve their income maintenance capacity and inclusiveness." ■

CLIMATE CHANGE

Climate impact vs risk

Europe's pension schemes are all now aware of the financial risks of ignoring climate change but, morally, should schemes also be considering the climate impact of their investee companies too?

WRITTEN BY DAVID ADAMS, A FREELANCE JOURNALIST

Just a few years ago, this magazine was running articles about "growing interest" in environmental, social and governance (ESG) investment strategies. Today, in many European markets ESG is a primary factor in pension funds' long-term strategies. Research from PwC in 2020 suggested that ESG assets will account for between 41 and 57 per cent of all mutual fund assets in Europe by 2025.

In part this is because ESG funds have done well in recent years: PwC's analysis suggests that ESG-aligned funds outperformed non-ESG counterparts by a cumulative average of 9 per cent between 2010 and 2019.

The shift is also pragmatic: there are clear risks for funds, and many of the companies in which they are invested, in a world where policymakers and public opinion are pushing businesses towards a world of net-zero carbon emissions and encouraging investors to divest from carbon intensive businesses.

Pressure to minimise environmentally damaging activity is coming from legislation, regulation, campaigners and the court of public opinion, guided by the increased frequency and severity of extreme weather events, and urgent warnings from scientists about the pace of climate change.

Reducing exposure to risks related to climate change and the transition to a net-zero world makes sense. But should funds also be basing investment strategies on assessments of the environmental impacts of their investments? After all, what is good for the environment is ultimately good for the economy, investment returns, and society – and would also help to mitigate climate risks. Would such a strategy be compatible with a fund's fiduciary duties to pension fund members or savers?

The importance of impacts

Growing numbers of people now believe investors should assess climate impacts as well as risks. In August 2021, 34 economists and academics publicly urged the Norwegian government and parliament to commit the country's Government Pension Fund Global (GPFG) to a net-zero goal. They also criticised Norges Bank Investment Management (NBIM), which runs the GPFG, for focusing on climate risks, instead of climate impact.

NBIM spokesperson, Line Aaltvedt, says it expects companies in which it invests to "integrate relevant climate change risks and opportunities into their corporate strategy, risk management and reporting".

"We expect … a business plan for managing climate risk… targets to reduce greenhouse gas emissions, and… [*consideration of*] the sensitivity of their long-term business strategy and profitability to different future regulatory and physical climate scenarios."

Aaltvedt says that an expert group appointed by the Ministry of Finance to assess climate risk for the fund presented its report in August, and a political process of reviewing that report is now underway, so it cannot comment further at this stage. That report's recommendations include a suggestion that NBIM seeks "to influence companies' behaviour and strengthen the market's functioning through better climate risk reporting".

Growing numbers of investment professionals now see the case for investment strategies evolving beyond climate risk assessment. Willis Towers Watson's Thinking

"TOO MANY INVESTORS HAVE APPROACHED ESG FROM A DEFENSIVE STRATEGY WHEN YOU ARE LOOKING AT RISK, RETURN AND IMPACT"

Ahead Institute co-head, Marisa Hall, thinks climate risk strategies tend to focus on too narrow a range of factors.

"Too many investors have approached ESG from a defensive strategy where you are looking at risk, return and impact."

Hall acknowledges that making these changes can be difficult. Larger funds may find it difficult to reduce climate risks or to focus on creating positive climate impacts because of their sheer size and the range of their investments.

However, Hall believes this will lead some to conclude that they need to do more than climate risk identification and mitigation. Instead, they must try to tackle systemic issues by analysing and seeking to reduce climate impacts. "They view it as within their fiduciary duty to work on climate impact," says Hall. "They believe that working on that will help their portfolio [*in risk and return terms*]."

She says some smaller investors delegate some of these tasks to investment managers. "When they're assessing managers they ask for disclosures around how they are dealing with climate impacts." Both approaches are the product of "enlightened self-interest" on the part of funds and their members, she suggests.

Europe leads the way

Regulators and policymakers will determine whether asset owners and investors are permitted or encouraged to use climate impact within their fiduciary duties. But the direction of travel seems clear. In the European Union, the European Commission published a new *Sustainable Finance Strategy* in July 2021, containing proposals for further development of reporting obligations under the Sustainable Finance Disclosure Regulation (SFDR), including introduction of reporting requirements on Principal Adverse Impact (PAI). It suggested that it could become mandatory for pension schemes and funds to consider the non-financial impact of investment decisions based on ESG factors. Financial regulators in non-EU European jurisdictions have tended to follow the EU's lead on ESG.

European pensions industry body PensionsEurope is currently consulting members and working groups to define a position on these proposals. But it has already stressed the need for proportionality in the way regulations are enforced; and a need for consistency and an integrated approach to changes in reporting regulations affecting corporates and institutional investors.

In particular, PensionsEurope secretary general, Matti Leppälä, asks for proportionality to be taken into account when revising the IORP II Directive – Europe's key legislation for pension funds. The proposals imply that pension funds would be required to report some information that some of the companies in which they are invested are not yet required to report. This would mean funds would have to obtain information from specialised data providers, at significant cost.

"Many big pension funds already do impact investing and are committed to net zero, so for them this is a natural development," says Leppälä. "The concern would be for smaller pension funds: how are they able to comply with these requirements? Our members are long-term investors, who have taken ESG issues very seriously for a long time, so this development is very welcome. But it's about the speed and practicality of how this is done."

Hall draws attention to a report published recently by the law firm Freshfields, commissioned by the Generation Foundation, the UN's Principles for Responsible Investment (PRI) and the UN Environment Programme Finance Initiative (UNEP FI).

The report considers how far laws require or permit investors to invest for sustainability impact. It concludes that where investing for climate impact can be effective in achieving financial goals, investors are likely to be required to consider using them.

"In effect," says Hall, "investors need to be able to set those impact goals and to measure progress towards them. We need to change the rules so that investors have more of a free hand to pursue sustainability goals that strengthen the overall economy, and therefore provide a more secure environment for their own investors."

"MANY BIG PENSION FUNDS ALREADY DO IMPACT INVESTING AND ARE COMMITTED TO NET ZERO, SO FOR THEM THIS IS A NATURAL DEVELOPMENT"

In 2019, the Varma Pension Insurance Company in Finland reviewed its climate policies, introducing a new strategy based on assessing transitional risks related to its portfolio. Its aim is to have a carbon-neutral investment portfolio by 2035.

Varma director of responsible investments, Hanna Kaskela, notes the difficulty involved in analysing data to identify climate risks and impacts. "There is a lot of opinion regarding climate change-related impacts, both negative and positive," she says. "You need to assess those thoroughly and have good data." She expects that in future investors are likely to be asked to report on other environmental impacts, such as the impact of business activities on biodiversity.

Hall is sure pension funds and other institutional investors will soon be asked to do more to improve the climate impacts of their investments. "The integration of ESG is almost yesterday's news," she says. "The difference now is what is being called for is pension funds to act as agents of change, to address systemic problems. For a fiduciary to be able to get to that position, they need to be able to say that working on those system challenges matters for my portfolio, because the world is so interconnected."

So pension funds across Europe will be investing to help save us all from the climate emergency – making it even more important that we all keep saving for retirement. ■

PensionsEurope

Keeping track of savings

PENSIONSEUROPE CHIEF ECONOMIST, PEKKA ESKOLA, ON SEEKING THE OPTIMAL ROUTE TO INTRODUCING PENSION DASHBOARDS AND PENSION TRACKING SYSTEMS IN THE EU

European public pension systems are facing the dual challenge of remaining financially sustainable and being able to provide Europeans with an adequate income in retirement. Governments across Europe are considering different ways to help close the pension gap that is emerging – for economic and demographic reasons – between state pensions and citizens' income needs in retirement. At an individual level, promoting better understanding and wider engagement in occupational and personal pensions is needed.

In December 2020, the European Commission sent a Call for Advice to the European Insurance and Occupational Pensions Authority (EIOPA), requesting technical advice on the development of best practices on pension tracking systems (PTS) and a pension dashboard. The roots of this request originate from the June 2020 report of the High-Level Forum on the Capital Markets Union.

The commission seeks to develop best practices for the set-up of national PTS that facilitate access to individualised pension information. Related to the PTS, the commission is also considering whether any additional measures would have to be envisaged at national level to ensure interconnectivity with the European Tracking Service (ETS), which is currently under development. Secondly, the commission seeks to fill a gap in the current monitoring of pension adequacy in the EU countries by establishing pension dashboards that cover indicators about future pension entitlements at the aggregate level of the country and for all sources of retirement income.

The initiatives to develop PTS and dashboards are good and welcome. Considering the design of the national pension system and the individual savings needs, people should be encouraged to supplement public pensions with life-long saving and investment, including through more active participation in occupational and personal pension schemes. A simple overview of all retirement sources in one place could be a powerful tool to engage people in an otherwise complex topic.

The information on PTS should be kept to the minimum, as people should be able to make some decisions based on them, and additional information not linked to the goal of the PTS could be made accessible via signposting to the pension providers or could be placed in the third or further layer of the PTS. Information on environmental, social and governance (ESG) factors (or costs, investment strategy etc.) could be signposted to existing information provided by pension providers under the European Union (EU) Sustainable Finance Disclosure Regulation, where applicable, and the Statement of Investment Policy Principles.

As the PTS should be independent, objective, and free of charge, public funding from the national budgets may be the best option (and the EU budget for the ETS) at least in the construction phase of PTS. Although the creation of a PTS by private initiative and cooperation between pension providers is not entirely impossible (see for instance the example of Denmark), it nevertheless could be very complicated. Some form of compulsion both to provide and share the necessary data, as well as to achieve an equitable distribution of costs, is necessary. This can best be realised by public action.

The EU countries have been projecting age-related public expenditures jointly with the commission since 2006 and future pension adequacy since 2012. Complementing the economic and budgetary projections in the ageing reports and adequacy projections in the pension adequacy reports with non-public pensions would allow obtaining a comprehensive picture of future pension developments. Pension dashboards could provide an up-to-date view of the progress made towards adequate and sustainable pensions across Europe.

As populations are ageing, comparable information about the role of occupational and personal pension schemes across Europe would also be valuable for benchmarking, identification of best practices and possibly the formulation of policy recommendations in the EU semester. ■

"THE INITIATIVES TO DEVELOP PENSION TRACKING SYSTEMS AND DASHBOARDS ARE GOOD AND WELCOME"

Written by PensionsEurope chief economist, Pekka Eskola

Inflation:
KEEPING PENSION FUNDS UP AT NIGHT

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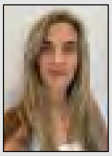
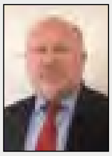
Our panel of experts considers the medium- and long-term prospects for inflation, what it could all mean for pension fund investing, and discusses the tools that are available for pension funds to prepare for whatever the future may hold

Chair:

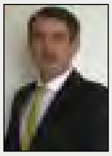


CLAIRE LINCOLN
Head of Institutional Sales, World Gold Council
Claire joined the World Gold Council in 2020 to head up distribution relationships across Europe. She has spent more than 13 years working in front office sales roles within financial services firms including Bloomberg, Credit Suisse and most recently The Bank of New York Mellon in London.

Panel:



ANDREW COLE
Trustee Executive, BESTrustees
Andrew has more than 15 years' pension experience of both defined benefit and defined contribution schemes, managing one scheme through five valuation cycles. For the past seven years, he has also chaired the investment sub-committee of a £650 million portfolio. Andrew joined BESTrustees in April 2019. Prior to joining BESTrustees, he spent over 35 years working in global financial markets. Andrew is a regular contributor to the pensions press.



MARTIN COLLINS
Trustee Director, 20-20 Trustees
Martin works for 20-20 Trustees as a trustee director. His particular strengths are investment and funding strategy and financial risk management. Martin has worked in pensions for 30 years as a scheme actuary, a derivative structurer, a chief investment officer and as the employer for a £40 billion pension scheme. This experience gives Martin empathy and understanding of the issues an employer faces as well as the technical skills to be a first-class trustee.

RAJ MODY

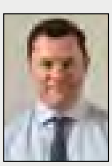
Global Head of Pensions Consulting, PwC

Raj is global head of pensions consulting at PwC. His clients include companies, trustees and governmental organisations. He advises trustee boards and company management on developing strategy and implementing change to their pension arrangements. Raj's areas of expertise include financing and security, risk management, asset and liability strategy including insurance transactions, benefit design and governance.

JOHN O'BRIEN

Partner, Europe Zone Leader, Mercer

John is a Dublin-based partner in Mercer and leads its European strategic risk management group, a network of colleagues specialising in assisting Mercer's larger clients to navigate areas such as capital allocation, risk management, efficient financing of long-dated liabilities, risk transfer, balance sheet management and risks relating to ESG. Prior to Mercer, he worked in a niche investment firm and also Irish Life Investment Managers.



JOHAN PALMBERG

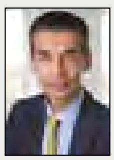
Senior Quantitative Analyst, World Gold Council

Johan is a senior quantitative analyst at the World Gold Council. He has spent 10 years researching the precious metals markets, both within the World Gold Council, as an independent consultant, and with the World Platinum Investment Council. Prior to this, Johan worked in fund management and investment research. He has an MSc in Finance from the Swedish School of Economics in Helsinki.

DERRY PICKFORD

Principal, Aon

Derry has over 21 years' experience in financial services including four years as principal in Aon's asset allocation team. Previously he was co-head of asset allocation at South-African fund manager Ashburton-FirstRand and chief economist at hedge fund manager Sloane Robinson. Derry did his undergraduate degree in economics MA Hons and his postgraduate degree in financial economics MSc Distinction (London). He is both a CFA and CAIA charterholder.



PHILIP ROSE

Chief Investment Officer Strategy & Risk, Redington

Philip boasts a 27-year career at Redington and in sell-side capital markets, helping clients to achieve their objectives, including many with directly inflation-linked liabilities. In his role as CIO, previous roles at Redington and in a 14-year career in capital markets, he has played an instrumental part in envisioning and designing many of the approaches that the firm uses to help its clients achieve their objectives, however complex.

Please note this event took place in June 2021, so some of the data will be retrospective.

Inflation fears and pension funds

» **Chair:** Inflation is sitting at the top of investors' agendas and the topic is dividing the crowd into various camps. Are you an inflation hawk, sharing the table with the likes of Larry Summers, urging the White House to scale back its stimulus program, otherwise the US may find itself in an inflationary episode not seen in a generation? Former chief economist at the Bank of England (BoE), Andy Haldane, holds a similar dreary outlook. He recently said that he believes once the so-called inflation genie is let out, it may prove difficult to get back into the bottle.

Or perhaps you are an inflation dove, sitting amongst Christine Lagarde and Jerome Powell, who insist that higher inflation will prove nothing but transitory. The common thread amongst this group is that they believe the risk of removing stimulus too soon outweighs the risk of igniting a little inflation.

Or finally, you may find yourself in a third camp which almost has a pandemic tone about it. It's all about the data, dates, or both.

Whichever camp you fall in, how worried are, or should, pension funds be about the prospects for inflation and are they doing enough to deal with this potential risk?

» **Rose:** By pure nature of UK defined benefit (DB) schemes, inflation has always been one of the clear risks they have had to deal with, and one they've actively managed. It's probably a case where macro views have been something you delegate down, because trying to determine asset returns from macro views is difficult. Even people who spend a lot of time and effort on it, and have a good track record, find it difficult to do as we've seen in the positioning of any number of hedge funds and macro funds – they very easily go wrong.

Most of our clients are well hedged against the inflation exposure that comes with DB liabilities – they have large exposures to long-dated inflation expectations, and hedge those, and have ongoing hedging programs as their liabilities change and as inflation expectations change.

So, from a DB point of view, the inflation linkage is fairly well contained and well hedged.

From a defined contribution (DC) point of view, the difficulty with putting risk management in place is, if you look at what DC members actually do, very few take up index-linked pensions, or they take up even fixed-rate pensions. The demand there is much more for a nominal sum, rather than for an inflation-linked cashflow of some type.

Thinking about what might happen in the future, you need to look at the combination of both inflation and growth, because central banks over last 10/20 years succeeded on inflation, but they failed on growth, so a more balanced approach between the two is probably a good thing. That said, there are a lot of risks in the European approach of trying to keep inflation very low, but also by keeping growth low as well.

» **Pickford:** Most of our DB clients also have their direct inflation risks well hedged. My concern lies more around the indirect risks of an inflation spike on the real value of growth assets. We don't think inflation is going to be high indefinitely. Some of the shock to inflation is transitory, and driven by supply bottlenecks, which will eventually ease. However, we suspect some is driven by strong growth too, so tighter monetary policy might be needed. Central banks have plenty of room to tighten policy if necessary, but are growth asset prices necessarily pricing that risk in?

So, whilst direct risks are well managed by most DB schemes, that doesn't mean we can be totally relaxed about inflation risks.

» **O'Brien:** Across our client base, on the DB side, we see high hedge ratios too and a good understanding of where there is basis risk, and where there is exposure beyond what market instruments can deliver.

"It is right that pension funds and the sponsors behind them think about inflation because their time horizon now is more immediate"

Inflation hedging gets more complicated when you look at the continent because, first of all, where there is inflation linkage among pension funds, it often has an element of discretion associated with it, certainly on the post-retirement side. Often there are caps and collars that are cumulative by nature, and that is difficult to assess, difficult to model, but also changes people's perceptions. They may say, for example, "I only have a max of 10 per cent exposure to inflation here, so why should I worry about bringing something potentially expensive on board?"

To pick up on Philip [*Rose's*] comments on DC, the loss of purchasing power among DC members approaching maturity has never really been tested because we've lived in a low inflation environment for the entire history of the DC market. As we see the IORP risk function and other governance enhancements starting to take shape around the continent, a lot of thinking will need to be done about how to protect DC benefits.

» **Mody:** To pick up on the point about inflation definition, in the context at least of DB schemes, we are not talking about unlimited retail price inflation; we are talking about a capped and collared version of that – limited price inflation.

Another force that is moderating the underlying inflation exposure which DB funds have is, at least in the UK, the movements happening from 2030 to redefine RPI to a CPI basis of calculation. All of that serves to contain the exposure that pension funds have, although it is still there of course.

It is right that pension funds and the sponsors behind them think about inflation because their time horizon now is more immediate. If you look at how pension funds were investing in the '80s and '90s, you could afford to have a long-term time horizon in order to get inflation-beating returns, but now, when you look at the £1.8 trillion worth of assets that are sitting in UK DB schemes, about £50 billion of those are being paid out every year in pensions. That's a much more clear and present exposure to inflation. It's not some conceptual risk that you have to manage over the next decade or two – you have to manage it this year, next year, and the year after. That's a new feature of managing inflation in the 2020s that was different from decades ago.

Also, there are more options for pension funds today, and for their members, when it comes to reshaping benefits and that is a relative novelty when you look at the multi-decade lifetime of pension schemes. That didn't happen historically, but from the turn of this century many pension schemes have given members options to reshape the inflation around their benefits.

So, in a situation when inflation might be high, and because of the fair value exchanges that go on when members take these options, they'll be paid good value when there's a concern about future inflation risk. Just at the time when inflation exposure might be increasing for pension funds, it might be a good platform and a time for when members are prepared to take that trade and trade out inflation risk for a flat pension.

Finally, we need to think about retirement and an individual's income needs in a more modern way than used to be the case. I think an inflation-linked pension for the rest of life, say from the age of 70 onwards, is not a very good fit for a typical person's likely income needs.

Putting long-term care aside, generally speaking, because of health, mobility, lifestyle and so on, if you think about older people's lifestyles, you will have a certain spending pattern for your 60s. It probably does then reduce for a decade into your 70s, and then it reduces again into your 80s. You're not doing in your 80s what you might have been doing in your 60s. So I'm not sure you need an inflation-linked pension in your retirement. You might do very well to have a flat pension which maintains its purchasing power in respect of the actual expenditure and outgoing that you might need to have as an individual over time.

» **Chair:** There's been a lot in the press lately on this point and trying to almost present value what you're going to need in 20, 30 years' time. That's a really interesting point.

» **Cole:** Most DB schemes I'm involved in are reasonably hedged – anything between 75-100 per cent. There is, however, a lot of basis risk with respect to the inflation pay out profiles. Schemes have different inflation, which means it is difficult to hedge precisely. Therefore, it doesn't seem to me too much of an issue today but, because of the basis risk, we will be having to re-hedge schemes on a fairly regular basis, which could be every two to three years. The bigger issue is the lack of hedging instruments that are out there. In the UK, for example, I'm not aware of a very liquid market in terms of CPI-linked products.

I also agree there is an issue with DC going forward. The point about lifestyle changes as people get older has already been made.

» **Collins:** I have been more concerned about inflation since the start of the pandemic, because of the nature of government deficits opening up. But generally, where I've been managing schemes for a long time, it's a risk we've hedged out because predicting future inflation is too big a risk to run.

You can never hedge precisely, you always have some imprecisions, but most schemes are on a journey somewhere towards taking it down radically. It's more challenging for schemes that are less advanced on that journey because you've also got to think where you are relative to your interest rate hedging position. Actually going too far, one ahead of the other, is a bigger risk than having both unhedged. But, most people are on a journey to reduce the risk, because it is too hard to call.

On Raj [*Mody's*] point on exchanges by members of increases for higher flat pensions – that's an interesting development and it's great to give members choice. It's really good as trustees though to hedge that risk up until those exchanges happen and then you can release the hedges, because you're still running that risk until the exchange happens.

Short-term versus long-term

» **Chair:** If we think about the short-term versus beyond 2021, are we moving into a transitory period, or into a new inflation era?

» **Mody:** It's an interesting time to be asking whether there is a likelihood of certain short-term disruption to inflation. Not necessarily because of underlying factors, but because of how the mathematics of inflation plays out. When you're comparing what's happened during a period of disruption – and you've had macro issues like oil price and huge disruptions to supply chain all feeding through and that has served to make the cost of goods at all parts of the supply chain wobble – you're going to see mathematical quirks coming through when you compare annual inflation from one year to another.

There have already been massive disruptions to the demand side of things as well. Consumer and business behaviours have changed radically. All of that is going to create a short-term disruption, probably over the next year or two, as we return to a more normal pattern of working behaviour/consumer lifestyle, and in relation to the global supply/demand chain as well. That's the short-term view.

Long-term – particularly in the UK given the BoE's central bank focus on managing inflation, and given the fact that, from a pension fund perspective, there are limits to your inflation exposure and in many cases substantial hedging – I don't think it's a huge long-term risk. The question I would pose is: what is creating this fundamental dislocation around the way that markets are measuring inflation risk, which in turn is creating problems for pension scheme holdings, including particularly index-linked gilts?

For example, if you look at what happened through most of 2020 and the inference you can make from index-linked and fixed-interest gilt markets, broadly speaking, as an investor or a holder of index-linked gilts, you were paying about £160 for £100 worth of index-linked maturity value.

Over a 20-year period to maturity, that does feel high in terms of what is happening there in respect of the risk of inflation the investors think they are protecting themselves against.

That has sustained throughout 2020, but interestingly it's sustained through to 2021, even after the announcement about changing RPI to CPIH last November. So, effectively, instead of say £100 on maturity, if you follow through the CPIH wedge impact, it's like you're getting the equivalent of an index-linked £92 say on maturity, because you've taken out some of the formula effect of what will happen to RPI.

Investors are now paying, if you went into the market now, roughly £160 for £92 in today's money – £92 of future maturity value over a 20-year time horizon. That does feel, relative to other opportunities, like a relatively expensive way of hedging inflation.

That then raises a whole raft of questions about what's happening in that market, what the right strategy for pension schemes might be if, as is classically the case, actuaries are using that market inferred approach as information to create their inflation forecasts. If they are doing that, there's likely to be a distortion in that inflation forecast.

» **Palmberg:** In the near-term, it does feel like the inflation story is something that's created in the press, and also perhaps in Andy Haldane's office! Thinking, for example, about the recent prints that we have seen – CPI in the US up 5 per cent for the second time in 30 years, and more importantly the core PCE number from the US that came out two weeks before – we sort of knew these things were going to happen. As the oil price hit almost zero last year, we knew that there were going to be transitory effects on commodities and, as you recover from a crisis, that nominal GDP would be high. We, as did other people, flagged this but nevertheless once these prints come in everyone gets very excited and it does feel like it's something that's been egged on by the media.

That's not to say that it cannot be damaging even if it is created in the press because a lot of this is about

expectations, and we know how much central banks fear expectations. If they become elevated and people start acting on them, then that could be dangerous.

The case for inflation being short-lived is strong. Some of the fundamentals in terms of economic slack, unemployment and labour force supply are still not inflationary.

We also had China's update, but that was PPI – China's 'factory gate' prices are rising at 9 per cent a year, but if you look at some of the other things that drive inflation in China, like the credit impulse, as it's very much a debt led economy, that tends to lead PPI by six to nine months and that's gone negative. Even there it doesn't look like these pressures will be long lived.

In the UK, Bloomberg is expecting something like 1.8 per cent so hardly a problem. We wrote a note on inflation a couple of months ago and we said that inflation will be quite high, and it could be high for two or three months, but now I would say the case for it dying down by H2 is pretty strong.

In the long term, demographics is clearly an issue. If we look at demographics in China, where everyone's getting a lot older, the danger there is that the workforce is reduced, and this whole thing that we've seen in the last 20/30 years of making things cheaply in China might be over. That might be something that structurally pushes up prices.

Then, on the flipside, we're also getting older in the West and once we get to 60 or 65 or over, our spending drops.

The other factor to consider is debt. A lot of people think debt is inflationary in the long term, but it's probably deflationary. A lot of debt means that there's a lot more saving in the economy, and it tends to be inhibiting to growth. All this debt that is sitting on people's balance sheets means that they are more likely to pay down debts than go spending.

The final point worth raising in the long term is this move towards net zero and climate change. That's a very interesting story because it could be quite inflationary. Supply chains having higher standards and the regulatory costs of moving things around the world might be different to what we've had before. Even equality is potentially inflationary – if you take money from the rich and give to the poor, it's more likely to be spent than saved, or even invested in something that increases productivity.

So we've come to a point where, in the long term, inflation could be structurally higher. If it makes it more volatile then that's a risk that we have to face and deal with, and that's where the choice of assets is very important. In the short-term this definitely feels like a blip and not one to be too concerned with.

» **Rose:** We've had lots of big shocks to the economy in terms of supply and demand, so having relative price levels adjust is a good thing. We should see big changes in prices – in the US, for example, you're seeing big demand for used cars etc. That will drive inflation up or down. Even in the 2008 crisis, it was more deflationary, and you did see spikes in inflation and then it coming back down quite quickly.

One thing to bear in mind in terms of long-term inflation is that central bank control is a political choice – and the choice will depend on what voters want, what politicians think they want, and what they think will get them re-elected. It's also the case that, even if you make the choice to try and reflate, you can fail as Japan has done. Japan printed large sums of money, spent a lot of debt but it hasn't succeeded in producing inflation. It has probably succeeded in sustaining its economy in a relatively benign way, but it hasn't actually produced inflation.

The interaction with environmental, social and governance (ESG) and climate change is interesting because there you have two effects – one is that potentially the traditional inflation hedging assets outside the inflationary bond market don't score that well from a climate perspective. So that's arguably people moving out of the commodity complex.

Correspondingly, one of the aims of climate action is to drive oil prices up. So, you want to basically stop people investing in oil production, and that moves oil prices up. It means demand for oil goes down. Then you've got two effects – the oil price goes up, and that's going to be very inflationary, and then also you've got an economy that's a lot less dependent on oil prices. It is probably fair to say also that the developed economy as a whole is probably a lot less dependent on commodity prices than they were. Any sort of commodity shock is not going to necessarily have the same inflation shock that it would have done 20 years ago.

There is actually also a big political risk in inflation being much too low as well – can developed markets really stand another 10 or 20 years of below par growth? If that continues, you could have things that make 4-5 per cent in inflation look pretty benign.

» **Cole:** Western economies have massive amounts of global debt, and the easiest way to decrease that debt is to inflate your way out of it. So, from a government policy perspective, it would be okay to have moderate inflation because, provided we still have low rates, it helps the exchequers.

As a short-term issue, there are global shortages – some of those Covid-19 related. Shipping prices have gone up and, in commodity markets, prices have increased substantially. Year to date, energy prices are up roughly 40 per cent. Copper and aluminium prices are up roughly 25 per cent year to date. Agricultural goods have risen in the order of 20 per cent on average. There's clearly inflation around, so what you're seeing in the US is hardly surprising. I believe that it will be a relatively short-term blip; perhaps it will go on for the next year and a half to two years, until the global environment normalises.

The race to net zero could be inflationary in the short term. When you look at metal prices which are used in battery production, they have increased significantly, and this is going to be increasingly important. There are likely to be some real inflationary pressures given the race to net zero.

» **O'Brien:** Ultimately, inflation is the level of prices today versus 12 months ago. We did have a major collapse in demand globally last year and there's a huge unwinding of base effects, which is influencing the levels of inflation that we currently see. This will continue because that demand shock played out for months and, as we slowly recover from that, those base effects are going to have quite a tail associated with them.

Looking at the European markets, the forward curves are quite interesting at the moment. There is an expectation of around 1.8 per cent which is very much in line with the European Central Bank's targets over one year; but it collapses quickly afterwards down to 1.2/1.3 per cent, and is persistent at that level for the next five years or so, before rising again to more robust pricing at the longer end. Certainly, the tail could push into this middle period of depressed expectations.

We do need to look at this as a risk though, ultimately. There is that 'genie out of the bottle' effect, and when inflation has taken off, typically the regimes that we've seen have lasted 20 and even 30 years, if you consider 1990 to today as a low inflation regime. Once the genie does get out of the bottle, there is a potential long-term risk there.

In Europe though, there are many factors that are going to act as headwinds against a higher inflation regime. Demographics is a major aspect of that. We have high unemployment rates in many European countries. Again, that's going to keep levels down, and very high savings rates. We haven't really seen a good test as to whether the high savings rates that are prevalent around Europe could possibly unwind. However, the protectionism that we're seeing a little bit more of very recently, versus previously, that may have an interesting impact.

So it's a risk. It's very hard to call. There are good reasons to think that it is a temporary phenomenon, and I'd lean in that direction, but as an institutional investor you have to look at this as a risk, and then think about how your portfolio could evolve in all sorts of scenarios.

"As an institutional investor, you have to look at this as a risk, and then think about how your portfolio could evolve in all sorts of scenarios"

» **Pickford:** The last UK CPI figures [*for April*] were in line with expectations so there's nothing too concerning about the current set of UK data. As far as the shorter-term outlook is concerned, we've never turned the economy on and off before and that's bound to create some volatility. Given the strong base effects, UK year-on-year inflation is going to get a lot higher but it will likely fall back again next year. I don't see a strong appetite for either higher inflation targets or deliberately overshooting targets, as this will create economic pain. It will not only lead to higher nominal rates but possibly real rates, if they decide to reduce inflation back towards optimal levels.

The US is a bit different. We know the fiscal stimulus has been much bigger, and that US household balance sheets are looking phenomenally healthy from the increase in equity and house prices; they're also flush with liquidity too, thanks to last year's excess savings.

The danger is that US inflation continues to accelerate for longer than the Fed is expecting. Whilst the Fed does have a deliberate strategy to overshoot the longer-term target, in order to compensate for past low-inflation, it may be that the inflation shortfall is made up much sooner than anticipated.

We think it is possible that markets may be slightly complacent about some of those risks. It's intriguing that the 30 year US Treasury is now below 2.2 per cent. When Greenspan spoke back in 1994 about the "somnambulance" of bond markets, that they were sleep-walking into dangers of higher inflation, yields were at 6.5 per cent, with inflation at 2.5 per cent. It is extraordinary how much has changed. So there is the potential for a shock there.

Raj [*Mody*] mentioned some interesting points on the UK linker market and what's priced into RPI expectations after RPI reform is due. I think the dislocation is mainly supply side driven, rather than people suddenly getting concerned about long-term inflation expectations. In its first Fiscal Risk Report, the Office for Budget Responsibility (OBR) argued that index-linked gilts (ILG) were risky because the inflation accrual feeds directly through to the deficit. Ever since then, the Treasury has directed the Debt Management Office to reduce their issuance of linkers and that has meant that we've had a very tight linker supply coming through. I think the OBR overstated the fiscal risks from ILG; it might make year-to-year forecasting of the deficit tricky, but lower than expected inflation can be bad for the public finances, so issuing linkers is a good hedge for the government, as well as being a good hedging asset for schemes. It would be great if linkers made up a bigger share of issuance.

Building debt resilient portfolios

» **Chair:** How do we go about building resilient portfolios to be prepared for the different scenarios we have mentioned?

» **Mody:** There are four primary factors to my mind when it comes to the decision-making framework for how you would construct a portfolio. One is around income versus capital. That income versus capital return shape is more important nowadays given the maturity profile of pension funds compared to historically.

I would then look at the risk/value equation – what you think is good value even when you've defined an asset class. Is it the right time to go into it? Risk needs more analysis than perhaps people are used to. People talk about index-linked gilts as being a risk-free benchmark or asset class, for example. Well, it's not, when the definition and the formula can be redefined in terms of the return that you're getting on that asset class. That doesn't sound risk-free to me when you're looking holistically at the definition of risk. People might mean default risk or credit risk, but risk needs to be looked at holistically.

Third, I would look at cost; not the value of the asset class, but the cost of getting into it – the transaction costs, holding costs and so on.

Fourth, I would look at governance, and the overhead for the trustees as the ultimate fiduciaries responsible for that asset class. What's involved in overseeing, managing and having that particular asset class in their portfolio? What are the other wider governance considerations around the expertise they need, to know that they're doing the right thing in relation to that asset class?

I would include ESG in that final governance category. Some might say that needs to be separated out now given the increasing focus on it, but for me that's just a subset point of governance.

» **Chair:** So what might a basket of inflation protection assets look like?

» **Cole:** Most DB portfolios have already been hedged with a combination of inflation derivatives and linkers. If you're looking wider than that on the DC side one could consider offering commodity-linked products. You need to be a little bit careful in terms of offering those products as some are not necessarily good hedges for inflation.

» **Pickford:** I think there is potentially a role for gold and possibly other commodities. In our fiduciary portfolios we have a strategic allocation to gold, not so much as a hedge on inflation but as a diversifier for all sorts of potential shocks. Commodities though have performed poorly ever since they became a popular diversification strategy. A lot of the arguments around there being a roll yield from the future price trading at a discount to the spot price, have been proven to be overly optimistic.

But that doesn't mean there aren't tactical opportunities in commodities. I tend to think of these things as being more trades, rather than strategic holdings. CTAs and specialist hedge funds have the ability to make money from commodities, but we're less keen on strategic passive exposure.

» **Collins:** Gold has traditionally done well as a tail risk hedge in bleak scenarios. It probably makes most sense where you've got a lot of growth assets as a hedging complement.

Going back to the original question about inflation and deflation, a trend for UK pension schemes is to move increasingly from growth assets towards credit and part of that is about maturing of schemes. Also, I'm worrying about inflation at the moment, but I don't know what's going to happen, so I also think about deflation, and moving on from growth assets to credit actually helps mitigate deflation risk as well. Generally, proxy hedging is not something I'm brave enough to have a go at, and I am thinking about deflation risks through increased use of credit.

» **O'Brien:** When we're thinking about this, we'd normally distinguish between inflationary growth versus stagflation, and if you look at a portfolio that looks reasonably well positioned in a stagflationary

scenario, it has probably got inflation linked bonds, gold and commodities in there.

But if you look at what is likely to do well in an inflationary growth scenario, it probably looks quite different. It has got equities, real estate, infrastructure equity and so on in there as well.

Also, if you look at this from a risk management perspective, as a Eurozone investor, investing in government linkers or in swaps is the way to go, but one of the complications in Europe is that you cannot invest in inflation-linked bonds without taking credit risk on either France, Germany, Italy or Spain who are the only issuers that are out there at the moment. This is certainly something that we have seen quite a lot of investors grapple with when they have been looking historically at increasing their inflation hedging. Concerns about France, concerns about Italy, concerns about Spain and the steep pricing of the safer option, being German linkers.

Going back to the point about caps and discretionary increases, it is probably opportune now for investors to take a look at the zone in which they have inflation exposure in their benefits and the point beyond which maybe there is limited exposure. Are there substitutes that are less expensive than direct inflation hedges, or that don't come with the credit risk implications of putting on inflation hedges? In particular, we have several investors thinking quite a lot about the illiquidity premium at the moment and essentially harvesting that for the journey.

The other thing we're seeing our clients interested in is whether a higher inflation scenario will impact correlations between asset classes. Historically, and certainly for the last 10-20 years, we've enjoyed low and negative correlations between fixed income and equities, but if things were to change and we were to jump to a different regime, potentially some of those correlation structures that we've enjoyed could break down and that could lead to more overall volatility in portfolios and put more emphasis on risk management. So, it's important to look at all scenarios and diversify as much as possible.

» **Rose:** I agree with the point about maintaining a diversified portfolio – however that's often easier said than done. The tolerance for governance structures, whether it's a consultant level or investor level, always does limit what level of diversity you can have.

Also, a lot of inflation hedges aren't easily available outside the government bond market to non DB investors, be it DC, be it private wealth investors, where there are limits in terms of UCITs and so on, and even getting commodity exposure is quite complicated.

It has to be said, also, that there's not much demand for direct and indirect inflation hedging.

We had some clients who asked "can I hedge spot realised inflation over the last year or so?" and it turns out there's not very much that is that correlated with realised inflation. Paradoxically, even inflation break-evens are not that correlated with realised inflation over the short to medium term.

So, it does come down to a question of whether I can generate a return across a wide range of economic scenarios? Can I do that without lagging too much behind my peers and my expectations of one or two particular scenarios? It has to be a portfolio someone can hold over the long term, not a portfolio which they have and then where there's 10 per cent drawdown, they immediately look to come out of it.

Gold as an inflation hedge

» **Chair:** Perhaps this is a good time for us to share some of our findings from our recent paper, *Beyond CPI: Gold as a strategic inflation hedge?*

» **Palmberg:** Of course. What we look at generally in terms of gold is how it performs in conjunction with other assets. It's not a panacea. It's not the most acutely brilliant asset in hedging anything – it does a bit of tail risk hedging, it does a bit of inflation hedging, and it does all things well, but it does it best as a complement to a basket.

In our paper, we looked at gold, infrastructure, real estate, even a relative value growth equity strategy, and Treasury Inflation Protected Securities (TIPS). This was during a benign market, from 1998 onwards, when TIPS were introduced. We haven't seen a lot of high inflation during that period, and we've had comfort from the mid '90s – since the central bank started implicitly and explicitly targeting inflation – that inflation was not going to get out of hand. We have had some

periods when it's been above that target for more than eight to 12 months and there have also been periods when it's been rising, and maybe concerning people.

What we did was divide the data into those phases, and then we looked at how well our assets performed in those phases, and how often they performed well. You also need to look at the cost of holding one of these assets on your books, so when it's not an inflationary scenario, what are you then losing?

From my experience in a hedge fund, we ran an option book to protect ourselves from tail risk, which cost us 3.5-4 per cent a year. That's a lot of cost for a fund that's expected to return about 8-9 per cent. Those are acutely good at what they do, but timing them is very difficult, as is probably the case when inflation strikes, or tail risk deflationary crashes strike. That's where gold is particularly helpful in that it returns pretty nicely over time. Even when the economy's growing, even when you've got growth in the economy, gold tends to do well. Then it does well when there's a sharp downturn. This is notwithstanding the fall from 1980 to 1999.

The other thing to look at is how well it performs as a diversifier. If you compare just gold and commodities, they tend to be quite cyclical in nature. If you look at Sharpe ratios, they might have slightly better Sharpe ratios because of strong returns, but if you look at something like a Treynor ratio, i.e. what's the contribution to the overall portfolio, they are far worse. That's where gold shines again, in that its contribution tends to be very good to that portfolio.

The final point to consider is liquidity. If you do have to sell these things, what is the potential slippage? That's where gold tends to perform well, as we saw last March when everything sold off. Initially gold tends to sell off, because it's used as a means to acquire liquidity, and then after a while it catches up. We've seen that in 2008 and we saw it last year again.

If you use all those metrics and then rank the various assets, then gold tends to score quite highly. On any individual metric, it's not the best, and it will never be. It's quite a blunt tool, so it's always a component of a basket.

So we would absolutely advocate gold. It's not going to solve all your problems, but it's not going to be a great burden on your portfolio, which is why a 2-10 per cent allocation is generally what the research says is the right thing to hold.

» **Chair:** What other risks and challenges are sitting at the top of both yours and your pension fund clients' agendas? How are you going to be preparing for these?

» **Pickford:** There is a huge array of risks and challenges at the moment. When it comes to DB, high up on the priority list, if not at the top, is thinking about endgame portfolios. With funding levels having improved, clients are increasing looking at buyout, which is the best way of removing both known and unknown risks. Clients want to reduce the risks around a deterioration in pricing, so that means not only increasing rates and inflation hedging, but other factors that affect pricing, such as credit spreads. Partial buy-ins and de-risking growth portfolios can also help with getting ready for buyout.

I think the biggest challenge for DC is the trade-off between getting access to a wider range of diversifying assets and keeping management costs low. We know that traditional assets are expensive and therefore the risk of equities returns disappointing is elevated, but getting high returning and genuinely diversifying assets within a competitive fee structure is really difficult.

» **Rose:** I think targeting net zero is going to be a big part of the asset case going forward, and secondly the move towards buyout and self-sufficiency too. The potential change in that market will be the capacity in terms of people being able to do larger schemes, or the market not being able to do larger schemes; that's going to affect quite a bit of the industry going forward. On investments, it's also being able to cope with a sustained down period. It's something we haven't had.

» **O'Brien:** We regularly poll our clients on this, and prolonged low interest rates persistently ranks top of the list across our client base. It is the thing that many of our investors are most worried about, and all the anaemic investment returns and so on that come out of that. Given the high levels of debt that we have post Covid as well, somebody's going to have to foot a bill eventually for that. That is going to have implications that perhaps we don't really understand as yet, nor do we understand the ultimate cost of net zero, or the cost of other issues such as aging populations that are in train at the moment. When you put all of that together, who pays and what will the implications be for investments? Is that going to come at the expense of increased taxes for retirees et cetera? That's something that needs quite a lot of thought.

"If you think inflation is hard to forecast and manage, then you should try predicting longevity!"

On the DC side, we mentioned purchasing power already, and diversification in DC is very important as well – a very important part of creating better futures.

» **Mody:** I'll inject the topic of life expectancy and longevity. It's linked to what we've been talking about with inflation. If you think inflation is hard to forecast and manage, then you should try predicting longevity! Why is there a link here? Because pension schemes are already reserving for improvements in longevity, so this is built into their long-term funding targets and endgame targets. If you combine the effect of forecast prudent life expectancy with forecast prudent inflation expectations, and if you think about how that builds up, it compounds at the end of the member's lifetime. That's when you've got the whole lifetime of inflation's worth accumulated, and you've got the end-of-life period – the tail risk longevity period.

But what if that doesn't come to pass? Then all these metrics are mis-calibrated. You've been forecasting and measuring against the wrong target. You may have been hedging against the wrong target. You may have got a fundamental misallocation of risk budget in your asset portfolio, because you're planning against a maturity profile and duration of pension scheme that just won't come to pass. So, there are a lot of consequences around the issue of life expectancy.

» **Collins:** I agree – longevity is key. Even in one of those perfectly hedged schemes, if everyone lives another five years, it's all off. We haven't hedged enough.

One of the accidental benefits of the Covid pandemic has been the surprise elimination of flu almost. So, the good news for our pensioners is that they could be living a lot longer. That's the opposite of what we first thought going into the pandemic. That just shows how small things could change longevity quite markedly.

» **Cole:** There's a lot of basis risk within pensions. Whether it's mortality, inflation or rates. It's about keeping a degree of prudence and ensuring you have a clear long-term strategy.

The difficulty that I foresee today is on the DC side – are we offering our DC members the right products and are the individuals on the DC side fully aware of the investment risks they are taking?

» **Chair:** After listening to everybody today and thinking about all the topics that we've covered, I'm going to a steal a quote from an article I read in *The Times* this morning, because it actually sums things up pretty well in terms of what might happen ahead: "It may be a case of praying for the best but having to prepare for the worst." ■

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INVESTMENT

Infrastructure: An investment powerhouse

Francesca Fabrizi looks at why infrastructure is continually ticking all the boxes for European pension fund investors

WRITTEN BY FRANCESCA FABRIZI

In September, pensions giant APG announced it had invested, on behalf of its pension fund clients, USD 500 million in the deployment of fibre glass in the United States, taking a 16.7 per cent interest in US fibre glass production company SiFi Networks America.

In the same month, it announced a €500 million investment in the Smart City Infrastructure Fund, which focuses on investments that aim to make cities more energy efficient.

In May, a consortium comprising APG, PGGM, Alecta, Keva and AXA Investment Managers announced their acquisition of a 50 per cent interest in Stockholm Exergi Holding AB – the largest supplier of district heating in Sweden.

These are just several examples of how the European pension fund sector is reinforcing its commitment to infrastructure – the reasons being that, as an asset class, it not only hits the spot on the risk/return front, but is also favourable against rising inflation, has cash-flow generative characteristics, and is increasingly helping pension funds meet their sustainability needs.

“There has been a noticeable pick-up in interest from European pensions funds around infrastructure over the past few years,” says BNP Paribas Asset Management head of infrastructure debt, Karen Azoulay. “This growing interest has been largely driven by pension funds wanting to diversify their income sources away from traditional asset classes, such as equities and fixed income, and into alternatives.”

Specifically for infrastructure debt, she adds, pension funds, like many institutional investors, are developing a better understanding and appreciation of the asset class, particularly the stable additional income and security compared to equivalently rated corporate bonds.

Furthermore, environmental, social and governance (ESG) considerations are playing a major role in building interest, she says, and to their credit, pension funds have added ESG factors to their investment focus. “This has really brought infrastructure investing to the forefront, as ESG factors are very visible and palpable in this asset class, with the financing of solar power and wind turbine projects as examples.”

KGAL Investment Management head of international institutional business, Christian Schulte Eistrup, concurs that, in their experience, European pension funds are increasingly discovering infrastructure as an interesting investment, and are also understanding the asset class better, with the firm seeing strong and growing interest, particularly in renewable energy. “We are also observing that quite a few pension funds have developed strong expertise in the area and are bringing a high degree of sophistication to the asset class as they continue to build out their infrastructure allocations.”

One other major factor nudging allocations towards infrastructure is the fear of rising inflation – Alecta, for example, has been reducing its holdings of stocks and bonds in favour of alternatives for a number of years, in response to potential inflation increases.

“Inflation fears are impacting this trend quite heavily,” argues Alecta head of real assets, Axel Brändström. “From our perspective, we began to raise our allocation towards real/alternative assets, which includes real estate, infrastructure and alternative credits, from equity and bonds in 2016, and will continue to do this in the coming years. This is a part of our strategy to create a portfolio that is more resilient to rising inflation, but also will give our customers equal expected returns, with lower risk.”

Addtionally, the stability of cash flows and access to exposure to corporate activity that is not heavily correlated to GDP growth are also key factors influencing Alecta's asset allocation decisions. "Private markets tend to be more long-term focused, which is something that pension money appreciates. There is also a complexity premium in some of the opportunities that large pension institutions can invest in due to their scale," adds Brändström.

The ability to access assets that are contractually linked to inflation is also one of the many attractive features of infrastructure, agrees Willis Towers Watson portfolio manager, Duncan Hale: "This is particularly important for those investors that have inflation-linked liabilities, because increasingly investors are looking at assets like infrastructure (and particularly lower risk infrastructure) and real estate as assets that can help them manage their liabilities."

Willis Towers Watson is indeed seeing lots of investors looking to invest into low-risk infrastructure (alongside other similar assets like certain types of real estate) for its cashflow generative properties.

"In a world where traditional cash yielding assets (like traditional sovereign and corporate bonds) offer very low income, many investors are looking at certain types of infrastructure and real estate that deliver long-term, inflation-linked, predictable yield as a way of generating income to supplement the low yield received from those traditional assets."

Similarly, he adds, the focus on sustainable investment is also making investors look closely at their infrastructure portfolios, as infrastructure is a sector where there are assets that will benefit from the transition economy and those that will not. "In terms of those assets that will benefit from the transition economy, this includes the obvious – things like renewable energy are at the forefront of the decarbonisation agenda; but also things that are less obvious. Utilities and certain transport assets are just two examples of areas where additional capital will be required as we move to a net-zero world, and this potentially offers opportunities for investors in these areas. At present, we are seeing more capital being allocated to investments and strategies that are positively skewed to this type of risk, versus those that are not."

Infrastructure in a post-covid setting

Infrastructure also boasts key attributes pension funds are looking for given the current economic environment and the long-term impact of a turbulent eighteen months since Covid-19 first started to make a real impact. "In a post-Covid world, pension fund investors, like many others, are seeking investments that provide meaningful income without taking on too much added risk," comments Azoulay.

"During the height of the Covid pandemic (March to May 2020), we experienced elevated volatility in most markets, which drove up credit spreads and hampered equity prices. Whilst we have experienced a strong recovery across most major markets since then, investors are keen to avoid such levels of volatility and uncertainty. For this reason, infrastructure debt is a particularly compelling investment option, given its key attributes are long-term stable income, security and diversification."

Notably, she affirms, these key attributes were on full display during the height of the pandemic, with the asset class as a whole delivering resilient performance. "Due to the essential nature of the services provided by infrastructure projects, such as power generation and telecommunications, operations of these infrastructure projects continued," she adds. "Importantly for infrastructure debt investors, this continuing operation meant that cash flows were maintained throughout the year."

Furthermore, in a post-Covid world, investors are re-focussing on ESG and sustainability, says Azoulay, and are more and more looking for assets with a "positive/ strong net environmental contribution; and they expect managers to report on the investment impact".

KGAL head of portfolio management and sustainable infrastructure, Andreas Ochsenkühn, agrees that infrastructure investments have proven to be particularly resilient to the external shocks that occurred during the Covid-19 crisis, which has led to even more interest from institutional investors in the whole sector, while Eistrup adds that diversification and attractive relative returns versus traditional asset classes remain centrally important attributes of infrastructure investment. Additionally, he echoes the importance of infrastructure's sustainability attributes. "We see clearly that pension funds are increasingly looking beyond those financial attributes toward the important goal of genuinely sustainable investment.

"Particularly in today's climate and Covid context, many pension funds are seeking to simultaneously pursue their financial goals and create a positive impact on the global environment. This dual goal is leading to increased interest in investing in renewable energy generation and the broader energy transition." ■

CRYPTOCURRENCY

A case for crypto?

The benefits of cryptocurrency have been promoted across the internet by the likes of Kim Kardashian and Elon Musk; but is it all hype, or does the asset class hold a genuine opportunity for institutional investors such as pension schemes? Sophie Smith reports

WRITTEN BY SOPHIE SMITH

Interest in cryptocurrencies has surged in recent years, particularly as social media influencers began to promote investment in the latest trending asset class. But it is not only hopeful individuals who are looking to the asset class as a potential opportunity.

A recent shift in German regulations, which allows Spezialfonds to hold up to 20 per cent of their assets in cryptocurrencies, is expected to "open the gates" for pension funds, with Spezialfonds to able to hold more than USD 400 billion of crypto investments, according to Global Digital Finance.

Nickel Digital Asset Management founding partner and CEO, Anatoly Crachilov, agrees that this will "open access to this market to a very significant capital pool," describing the plans as a reflection of a "rapidly improving perception of this asset class by European regulators and recognition of the structural growth potential associated with this new asset class".

Europe more broadly will also benefit from the introduction of Markets in Crypto-Assets (MiCA) regulation in 2022, Union Investment portfolio manager, Daniel Bathe, points out, stating that this "will provide increasing regulatory certainty for EU investors in crypto assets and thus for technological adoption".

A regulatory gap

However, Crachilov notes that whilst some countries, such as Germany and Switzerland, have made "great progress in formalising legal frameworks", others are lagging behind.

Adding to this, Insight Investment head of currency solutions, Francesca Fornasari, warns that there is also a "significant risk of market manipulation as cryptocurrencies are currently outside the remit of most regulators, as well as a high probability of increased regulation or drastic change".

"Then comes the risks for institutional investors that regulatory interventions compromise the fate of some crypto assets," Candriam head of ESG, David Czupryna, adds. "Whilst hard to predict, the likelihood of such intervention seems quite high, in one way or another. And such in-meddling could very well destabilise the valuation of some crypto assets and send their price sharply downwards."

Wisdom Tree quantitative research associate director, Florian Ginez, agrees that investors are often reluctant to act due to a lack of regulatory clarity, suggesting that the accelerated adoption of digital assets by regulated financial institutions "should and will" encourage regulators to establish frameworks to alleviate this challenge.

However, whilst the UK Financial Conduct Authority (FCA) recently suggested that the "tide of regulation is turning all over the world", it remained unclear as to whether it may have more of a remit to regulate the issue or promotion of speculative digital tokens in future.

Speaking at the Cambridge International Symposium on Economic Crime, FCA chair, Charles Randell, stated: "In regulating the online world, we need to strike the right balance between fostering innovation, providing an appropriate level of protection and allowing individuals the freedom to take decisions for which they are responsible. We also have to recognise that effective regulation of a digital world requires international cooperation and common standards. It will take a great deal of careful thought to craft a regulatory regime which will be effective in the decentralised world of digital tokens."

A volatile market

Regulation is not the only issue for pension schemes to consider, however, as Fornasari warns that limited market liquidity and limited custodial services present further challenges for investors, in addition to concerns around the "extreme volatility" that has emerged amid the "huge" price increase seen since 2017.

Czupryna agrees, arguing that no matter investors' views on the asset class, "nobody can discuss the fact that they represent highly volatile instruments, with a non-negligeable risk of short-term downsides".

However, Crachilov suggests that a market-neutral arbitrage strategy could be "an excellent way of having exposure to this asset class while minimising the volatility".

"With 13 YTD return and volatility of below 5 per cent it would provide strong source of uncorrelated returns for pension schemes," he says.

DeVere Group founder and CEO, Nigel Green, also identifies bitcoin in particular as being the digital asset that would be most appealing to European pension schemes currently, as it not only acts as a "shield against inflation", but is also frequently branded "digital gold" due to its safe haven attributes.

"In addition, it can serve as a diversifier as it is uncorrelated to other asset classes;" he continues, "it can counteract pensions schemes' typical lack of transparency as it is traded on the blockchain, a shared and decentralised ledger; and it has an enormous potential upside as younger generations are 'digital natives' and geared towards technology."

An internet revolution

And there is an advantage in moving sooner rather than later, as Ginez, explains: "Starting with bitcoin or ether allows investors to start working with the asset class, build up expertise and opportunities to engage with service and product providers. This helps investors build the knowledge and confidence that will be required to explore the space as it develops."

Czupryna warns, however, that whilst the interest by pension schemes is understandable given "paltry investment returns and stagnating growth", it is important to "take a hard look" into the base characteristics of any crypto assets being considered using the tools of prudent investors.

"This would mean analysing counterparty risk, credit risk, regulatory risk, market risk, and maybe adding to these 'classic' risks the reputational risks faced by the pension fund itself," he continues. "If the risk-return profile of a given crypto assets stands out after undergoing such stringent but basic scrutiny, it could then constitute an interesting diversification option." ■

Mining for modern gold

"FROM AN ENVIRONMENTAL, social and governance (ESG) standpoint, crypto assets can hardly be seen as a monolithic reality," Candriam head of ESG, David Czupryna, warns, explaining that the best known of these assets, bitcoin, is coded in a way that requires a growing quantity of processing power to mine additional coins.

Indeed, GlobalBlock sales trader, Marcus Sotiriou, points out that bitcoin's carbon footprint is currently equal to the country of Columbia, also noting that, as the crypto industry is still very young, this information is not being communicated by a central body.

"However, these risks are publicly displayed by analysts, as well as the reasons why these risks may not be significant for long-term investors," he clarifies, stating that the total energy consumption of the cryptocurrency industry is around half that of gold mining, which has "never been a consideration when investing in gold".

And change is already taking place; Nickel Digital Asset Management co-founder and CEO, Anatol Crachilov, notes that some 79 per cent of bitcoin miners already use some form of renewable energy in their energy mix, and over 40 per cent of miners use renewable energy sources only.

"This is set to increase further, as ongoing relocation of miners from China is usually associated with switchover to green sources," he suggests. "Moreover, most of other crypto assets are relying on a different, far less energy-intensive consensus protocols. For example, ethereum is currently migrating to a proof-of-stake protocol, reducing energy use by a staggering 99 per cent."

Despite this environmental progress, Sotiriou warns that there is also the "often-mentioned use of bitcoins to finance shady operations in the underworld".

"No institutional investor wants its name associated with such illegal activities," he says, warning that there is a "very tangible risk" that regulators might force more transparency upon bitcoin holders based in their jurisdiction, "blowing to the surface the murky world of underworld financing and sending the valuation of these crypto assets downwards".

Real assets:

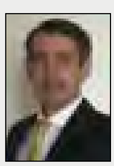
BRINGING A HOST OF ADVANTAGES TO PENSION FUNDS TODAY

Our panel of experts discuss what real assets can offer pension funds today, which assets are proving most popular and why, and how real assets can assist pensions funds in meeting their ESG objectives

Chair:

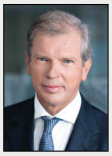
ANDY CHESELDINE
Professional Trustee, CCTL
Before joining Capital Cranfield, Andy acted as an adviser to trustees and employers at Watson Wyatt, Hewitt Bacon & Woodrow and latterly as a partner at LCP. Using his experience of over 30 years in consulting on both DC and DB pension arrangements and liaising with regulators throughout the pension and financial services industry, he is able to use his wide knowledge and understanding for the practical benefit of trustee boards.

Panel:



MARTIN COLLINS
Trustee Director, 20-20 Trustees
Martin has worked in pensions for 30 years as a scheme actuary, a derivative structurer, a chief investment officer and as the employer for a £40bn pension scheme. This experience gives him empathy and understanding of the issues an employer faces, as well as the technical skills to be a first-class trustee. His particular strengths are investment and funding strategy and financial risk management. Martin is a regular contributor to the pensions press.

PAUL JAYASINGHA
Global Head of Real Assets, Willis Towers Watson
Paul joined Willis Towers Watson in 1998 and has been involved in manager research since this time. He is a senior investment consultant who heads Willis Towers Watson's real assets research team, which incorporates real estate, infrastructure and natural resources. Paul has previously been a member of Willis Towers Watson's portfolio construction group, which helps to determine the construction of certain client mandates.



CHRISTOPHE MONTCERISIER
Head of Real Estate Debt, BNP Paribas Asset Management
Christophe is head of real estate debt at BNP Paribas Asset Management. Having taken the role in March 2020, he was previously investment director, acting as team deputy head, since joining the company in early 2019 from Société Générale. Christophe has 31 years of industry experience. Prior to Société Générale he was head of business development at GE Capital Real Estate in Paris.

JASPAL PHULL
Senior Vice President, Redington Manager Research team
Jaspal is responsible for manager research and selection across real estate and infrastructure strategies at Redington. Prior to Redington, Jaspal was head of research and strategy for a real estate investment company, where he was involved in the acquisition and disposal of c£500 millon of commercial and residential real estate. Jaspal has recently assisted London CIV in a manager selection for the LCIV Renewable Infrastructure Fund.

STUART PAWSON
Senior Member, Real Assets Research Team, isio
Stuart is a senior member of isio's real assets research team. He has been at isio, formerly KPMG's UK pensions practice, for 11 years. His responsibilities include coverage of real asset opportunities and manager research, alongside ongoing client management. Stuart often speaks at industry events, and is a regular contributor to the pensions and investment press.

AMARIK UBHI
Global Head of Infrastructure, Mercer Alternatives
Amarik joined Mercer in 2003. He is responsible for overseeing the sourcing, due diligence and monitoring of infrastructure opportunities, and also the construction of portfolios on behalf of Mercer's clients. He is a member of the Infrastructure Investment Committee. Amarik began his career with Mercer as a consultant.

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Chair: What are the general themes in the pension space today and how integral are real assets to pension investment?

» **Collins:** The big thing that's changing in the pension space is maturity – all schemes are maturing. Also, one of my clients is a consolidator which is, by its very nature, all about the end game. So there's been a trend towards lower risk assets; more and more credit. Part of the challenge is getting diversification within that universe.

Then, between the different clients, there's a different appetite for illiquidity. If you've got a chance of buy-in or buyout, then you have to be careful, because you're going to have to liquidate. But for those who have a long-term future, like the consolidators, then illiquidity premium is a big play.

» **Jayasingha:** I don't think real assets are integral to all pension investments today. Pension funds can choose to be completely liquid. For a scheme that's looking to buyout, for example, that could be a sensible approach.

On the other hand, if you're a longer-term investor, like a pension fund typically is, why would you want to be completely liquid? You can get an attractive illiquidity premium from real assets; you get advantages around diversification; and you can play attractive thematics in real assets too. That's why they have become integral to many pension schemes.

In terms of how things have evolved over time, over the last five years or so, real assets have been built into solutions that address the challenges pension funds face, liability solutions in particular. Over the next five years, we might see pension funds using real assets to address how they manage climate and carbon exposures within their schemes. Real assets are in fact blessed with having useful climate solutions within their spectrum, particularly within infrastructure. That's how the real assets space is likely to further evolve over time.

» **Montcerisier:** Real assets were not an existing asset class for non-bank investors 25-30 years ago. Today, however, you clearly see it increasing, year-on-year, in institutional investors' portfolios. One of the reasons is that, as interest rates were declining, and central banks were fighting against inflation, investors have been looking for an investment that provides them with extra yield but limited risk, and diversification was one key objective at a time when bonds were not offering optimum returns.

The other thing is that real assets comprise of a variety of products, ranging from equity to debt, so there is a lot they can offer pension funds.

» **Pawson:** What we like about real assets is the tangible nature of collateral and the contractual nature of returns. We've done a lot with our clients – those that are more mature and at better funding levels – around constructing portfolios with cash-flow driven investing strategies, where the cash raised from investments like real assets – which could be property, infrastructure and timberland, for example – spits off cash-flows that pay pensions. That's why we like them.

The difficulties are around how you plan for that illiquidity in the future life of the scheme. A lot of our mature DB schemes are 10-15 years from endgame, and you need to be able to plan and manage the exit from the investments.

» **Phull:** A significant number of our clients are DB pension schemes, so where they are in their "flight path" can impact their ability to invest in real assets. What pension funds are increasingly interested in, however, is what role real assets can play in relation to climate transition as well as from a social perspective – these things are becoming more and more integral in their thinking. Going forward, that's going to have quite a big impact on how people invest as well as why people choose to invest in real assets.

» **Ubhi:** I agree that, on ESG, not only are we seeing interest with respect to climate change, but also the desire to demonstrate some kind of positive social outcome. That is particularly relevant to local authority pension funds, but also certain corporates as well.

On the DC side, we have seen the likes of Nest, for example, issue infrastructure mandates recently. This is also picking up the fact that real assets can play a diversifying, stabilising role within DC plans as well, but again the key is making sure that the structures are correct to allow for sufficient liquidity.

Finally, across different types of clients, the majority are surprised by the ability to take on illiquid exposure. Many pension schemes are conservative and risk averse, but when they actually consider, through modelling and scenario analysis, how much illiquidity they can actually take, versus how much they are currently exposed to, there is, in a lot of cases, some potential upside to allocations to illiquid assets.

Real asset allocations

» **Chair: Which real assets are being considered most by pension funds?**

» **Montcerisier:** It depends on each individual investor – the way they manage their assets and liabilities, and the time horizon that they have. Investments in alternative real assets are usually illiquid, so you have to have a balance sheet that allows you to invest into relatively illiquid assets. Having said that, real assets comprise of corporate loans, infrastructure equity or loans, real estate equity or loans, and so on – you have a variety of products and each individual product has different characteristics, in terms of the return, investment horizon, liquidity, maturity and so on.

An approach we have taken at BNP Paribas Asset Management is to offer those investors who have not specialised in each individual alternative asset class a mandate whereby we will allocate, as their manager, the percentage that will be put into each asset class, depending on the investor's liability matching.

So, you look at the time horizon of the investments, the maturity that they would be expecting, and then you blend all those categories into one management contract/fund, that is going to manage the mix between the assets.

» **Ubhi:** Data from our clients suggests that the most popular asset classes within real assets have been real estate, particularly core real estate, High Lease to Value (HLV) and infrastructure.

Our last European asset allocation survey suggested that the number of plans with an allocation to core real estate went up from 33 per cent to 39 per cent over the course of the year. Within that context, average allocations are around 7 per cent, and this is across a wide range of different types of pension funds across Europe.

Interestingly, that doesn't translate across to the more value-added or opportunistic nature of real estate. That market can sometimes be crudely segmented by vehicle structure, as well: a lot more interesting, the lower risk, open-ended type structures, as compared to the more closed-ended, more private equity like structures.

However, in contrast, in infrastructure, we've seen a general increase in demand, across both open and closed-ended, and across the risk/return spectrum.

» **Phull:** If I look across our client portfolios, allocations in real assets have been typically in UK core property and long lease funds. Even looking from an infrastructure perspective, a lot has been in core type funds, or when you're looking at renewables, much more the operational core side of that.

Where we've seen the most interest over the last eight to 12 months, and where we've been allocating client money the most, is renewable infrastructure. Over the last eight to 12 months, we have seen clients allocate c.£800 million in renewable infrastructure. That's across a number of different mandates. That seems to be where the client interest is.

» **Jayasingha:** In terms of strategies being considered today, the contractual cash-flow assets have been talked about. That's been a big beneficiary. Alternative property sectors too, so healthcare, property, sustainable agriculture – these are all areas that we've been involved in with our clients.

I am not sure if it's captured in this space, but we've been big advocates of listed real assets because there are times, such as last year, when you can buy into very high quality real assets on the listed market at big discounts of net asset value. As long as clients can look through the short-term volatility of listed real assets, they offer a wide opportunity set for clients.

Benefits of real assets

» **Chair: How can real assets address pension fund concerns?**

» **Montcerisier:** Firstly, to put it simply, real assets provide a higher return than bonds of similar ratings.

Second, they offer diversification, as compared to public bonds. If you look at the real estate sector, for example, you can buy public bonds issued by listed property companies, but they are going to be mostly retail, maybe some office exposure. You may find some residential exposure, but it's not a very deep market.

So, if you want to truly invest in real estate, private debt is probably a better way than via public bonds.

Yes, public bonds are liquid, and private debt is illiquid, but the scale of the market is very different when it comes to private debt. For example, commercial real estate (CRE) debt has €250 billion origination in Europe per year, so it's a very deep market, much larger than the public bond market, as far as real estate is concerned.

> *"Real assets provide a higher return than bonds of similar ratings"*

» **Ubhi:** The key challenges that pension schemes are facing, and are looking for real assets to solve, are some combination of cash-flow generation, inflation sensitivity, or ideally some form of inflation protection, stability and consistency of return, and also diversification from other asset classes.

Some real assets can help with some of those better than others, but there are also some challenges associated with getting all of those desired outcomes. One of the challenges at the moment is valuation in some parts of the market, particularly the lower risk, lower return end of certain real asset classes, as investors have moved in to try and capture yield and de-risk.

So, investors are struggling to make decisions. They're typically looking to de-risk from equities into other forms of asset classes, but the question is, what do they de-risk into? Notwithstanding the volatility we've seen in equity markets, if equity markets continue to perform so well, that also makes that decision a bit more challenging.

» **Phull:** In terms of the issues which real assets can address, there's the cash-flow generation perspective, and the yield that real assets can now offer. One of the other big aspects is around impact and the fact that you can use infrastructure, for example, to address climate transition, and you're even seeing more offerings now in real estate that can help on that side, as well.

The social impact side of things is also key. There's been a big emphasis on 'E' in ESG, the environmental impact, but more and more investors are also looking towards real estate, particularly the residential sector, as a way of addressing social impact.

» **Pawson:** A key point is ESG, how trustees can navigate sustainability and impact and how they can introduce that into their strategy. Real assets offer a really good opportunity to look at your portfolio and add something that does that job properly.

The spectrum of opportunity is great for pension schemes to be able to dip into and use. There has been a lot of focus on the question of how can we support a decarbonisation of the economy – and renewable infrastructure comes into play here. There's an awful lot of capital that's following this because it is a great asset class that delivers on loads of those metrics, and we're still seeing positive flows into that area, and we expect that to continue.

Social housing is the other area we've started to commit to, in terms of really hitting that 'S' of ESG and really making a change.

There are other concerns around the direction of travel of the funding code – how are you going to meet this long-term return objective that is actually relatively low, compared to where many schemes are now? You also need to do that on a sustainable basis and real assets can offer that, because there's a spectrum of risk/return targets that can operate in real assets. Everything from the high return opportunistic, all the way down to quite low risk such as ground rent/social housing strategies.

» **Jayasingha:** I would argue there are four major challenges that real assets can solve. The key one for a pension fund is paying pensions as they fall due. Within real assets, we're very fortunate of having certain assets that offer that long-term contractual and inflation-linked income. The low yield environment is another challenge that real assets can clearly solve.

Also, uncertainty around inflation is key here – real assets offer strategies that provide both an explicit link to inflation but also an implicit link. That implicit link is really important at a time when governments are changing the rules of the game around measures of inflation. One of the big benefits of real assets is that, over the longer term, you'd expect them to meet an underlying inflation measure over long periods of time. That's key in the current environment, where there's been lots of money printing and changes in measures of inflation.

Finally, as has been noted, real assets can help meet pension fund needs around carbon emissions and demonstrating to their members their positive societal impact.

Drawbacks of real assets

» Chair: What are the obvious drawbacks of some real assets?

» **Montcerisier:** The number one issue is accessing the markets. That's very difficult – you have to have your own network, your own origination capabilities, and that is not a given for all players in the market. The way that can be addressed is by selecting an efficient asset manager, especially in the asset class you are investing in, so that the asset manager will have the network and the capabilities to originate transactions.

Currency is also a potential issue, because hedging currencies can prove very difficult within funds. We tend to focus on funds which will be invested into one single currency. It could be sterling, it could be euro, but it's very difficult to have funds which invest in both currencies, because it is very difficult to hedge. So it's up to the investor to decide whether they want to invest into a euro fund or a sterling fund.

"The low yield environment is another challenge that real assets can clearly solve"

» **Ubhi:** In terms of the drawbacks, the potential valuation challenges in some parts of the market come to mind. To me, that would suggest taking an approach which seeks to build a well-diversified and not just a high quality allocation to real assets. So we're looking at different types of asset classes, but then good portfolio construction, holistically, across the piece.

The associated challenges there are the governance requirements, because these asset classes are more complex than traditional asset classes, and it does take more trustee or investment committee time and resource to get familiar with these asset classes and build an allocation.

One of the other challenges we're seeing is, whilst you have a number of these push factors towards real assets, the big stumbling block can be governance rather than size. Very rarely have I seen the size of a pension scheme be a limiting factor in making an allocation to illiquid assets. It's typically been those discussions around time, effort and resource that is needed.

» **Phull:** On the valuation point, over the last year, as we have been in lockdown, many clients will have been sitting on the side-lines with regards to real estate and infrastructure, partly because of concerns around valuations. You saw that play out in real estate when funds were suspended because of the material uncertainty clauses. There were also concerns around infrastructure assets, although valuations have proved to hold up very well – but there was a concern during that pandemic period as to what would transpire.

» **Pawson:** In terms of drawbacks of real assets, where real assets have really succeeded in the past is bricks and mortar, tangible assets, things that trustees can see and understand. What's helped with our discussions in the past is that you can often go and visit a real asset and see it and know what you're investing in, know how you get paid.

When you start talking about more complex structures, however, or things like carbon credits, then you need to ensure that trustees can follow that narrative and understand what you're investing in.

Some of the liquidity issues and associated costs are also drawbacks, to an extent. We're supportive of the government's objectives around getting DC money flowing into infrastructure. I don't know, however, how they're going to square the circle in terms of management costs. How do you make it accessible for DC investors? At the moment we, as consultants, feel quite constrained with daily liquidity, default charge caps, and so on, so how do you square that circle to get infrastructure into DC?

» **Jayasingha:** In terms of drawbacks, it's interesting to consider how the industry had evolved. It has changed now to a certain extent, but it had evolved to perhaps starting with too high a leverage, too high risk strategies than what clients actually needed – certainly what pension fund clients actually needed.

That has changed somewhat, but that's been one of the drawbacks of the industry, although client engagement has now helped them get to a better point about what solutions work for them.

» **Chair:** As a trustee, how do you bring all of this together?

» **Collins:** With these types of assets, as trustees, you have to remember that there are always specific risks that you need to understand before you commit. Risk in itself is fine – it doesn't mean you can't invest, but you have to have diversification of risk and reward for risk, that's the issue. So how do you do the necessary due diligence to make sure you understand the risks that you are getting into?

For smaller schemes, fiduciary is often the only practical way to do it. Consultants are fantastic, too, so you can lean upon them, but it's important that the board understands what they're doing.

Another risk is getting adequate diversification – the bigger you are, the easier it is to do this.

In terms of DC, there's a specific risk around liquidity. A lot of these attractive assets aren't easy to price, so you have issues around how you price people coming in and out. It's a shame because, particularly on the ESG side, there are some exciting things that DC investors would like to get into, but there are practical challenges about fairness of pricing before you can use them.

One Covid-related issue I'm concerned about is the change in the use of office space, because commercial property is such a big chunk of our portfolios. People are going into the office less and less. When you're committing to 25 years, to an illiquid asset, that's a concern I have as a trustee.

» **Montcerisier:** Picking up on the point that was made on real estate and the question marks around the liquidity, and the long-term view that you have to take – that is absolutely true. Something we are promoting now is real estate debt. When you invest into real estate debt, you invest into a much more secure asset than when you invest into a property.

You don't get the benefit of the upside on values if the property value increases. However, given the timing we are at right now, where property values have increased significantly over the last decade, is it not worth investing into different asset classes on the same property – the underlying collateral – which provides approximately the same return? Because when you think about it, if you want to buy a prime property, in any large city within Europe, you'd probably buy it on the basis of a cap rate of 3 per cent or just below 3 per cent.

Real estate debt can provide the same kind of return, so if you put aside any capital gain down the road, you have a very compelling investment instrument with a much lower risk because, basically, you lend – depending on whether it's a senior or a junior strategy – 60 per cent of the value of the collateral. So you are very well protected in case values are declining.

Picking up on the point about fewer people using offices – and without getting into detail about the future of real estate and the impact of working from home on office markets and so on – it is important to stress that you have to deal with an asset manager that is very specialised in the asset class you are going to invest in, because you have to take into account all the future trends and try to navigate through the risks that are already on the table.

Real estate debt

» **Chair: Why, in uncertain times with significant structural shifts, are real estate debt investments a good opportunity as an alternative to real estate equities? Why is private real estate debt more attractive than listed real estate debt? What is the outlook for real estate debt?**

» **Collins:** In terms of the preference for real estate debt over equity, as schemes mature, it's a lower risk way to access the same source of alpha. That's the attraction. So, you're more protected as a debt investor against risk than as an equity investor. That's an argument for debt rather than equity.

As an investor, you should always be thinking: what's the best way to get paid for exposure to the same asset class? So valuation comes into it as well.

Often as a trustee, as well, when you're structuring your mandates, you don't want to artificially tie the hands of your manager. For example, if you have a manager that could invest in both, make sure they're able to tell you if they think you're in the wrong one, in terms of valuation. It's very easy to tie their hands in ways to give the wrong outcome.

In terms of private versus listed, private is always harder work, and there's more specific risk, but there's the opportunity for good returns. So again, if you've got the right managers, then private is something to look at.

» **Phull:** Given where we are in the current cycle, it does feel that we are at the top when it comes to property prices so perhaps, from a risk perspective, real estate debt looks very attractive now. We don't know where the economy's going, or what the overall fallout with Covid is going to be, so real estate debt does give you that cushion versus the equity side.

There is a lot of protection there. You have increased covenants and inbuilt protections into the funds. Also there are perhaps good opportunities now, because the banks have been withdrawing from the market and there is a lot of alternative lending (and that has probably even accelerated during this pandemic). That perhaps gives rise to opportunities for certain sectors, such as retail or office development loans – areas that people are concerned about, but probably still have some attractive opportunities. Specialised funds will be able to go into those and get those best opportunities. So, it does look attractive from a number of perspectives.

It does require a lot of specialisation among fund managers. If you are invested in certain positions and you have, for example, a foreclosure on those loans, can the manager then deal with the position that they're going to inherit? You've got to look at the capabilities, depending on where you invest, within the team and within the structure to manage those situations.

» **Ubhi:** The point about debt versus core, core plus equity is an interesting one. We do see that within the infrastructure space, as well. So, for investors that are able to take a more pragmatic, more holistic view of asset classes in their real assets portfolios, that arbitrage between debt and equity at this point in the cycle could be quite interesting, given the relative risk return that's on offer.

The other comment I would make as to why private real estate debt might be more attractive than public real estate debt – and again, this applies to the infrastructure debt space as well – is that the opportunity set is likely to be much larger. So the potential to identify good risk-adjusted opportunities is greater. Also, the ability to bilaterally structure and negotiate transactions, as opposed to transactions that may be larger and more syndicated in public markets, again is another source of potential value-add.

Finally, a lot of the work that we do, as specialists in the space – and trustees and investment committees do as well – is look at the bottom up; the specifics of a particular opportunity, or a particular fund or a particular manager. We also do need to increasingly pay attention to some of these thematic risks. Not to suggest that portfolio construction should be entirely top down, but the shift to working from home, and also what is going on, potentially, within the retail space, needs to be considered – what do these themes mean for particular subsectors?

Similarly, within the infrastructure space, we see the emergence of renewable energy and digitalisation and the move away from supported revenue structures and price mechanisms to merchant pricing: what does that all mean? If you've bought in on the basis of something being the same as it was forever more, but then the world changes, what does that mean for your investment thesis and your investment outlook?

» **Jayasingha:** Firstly, debt can offer some very safe investments, but it could offer less inflation protection than an unlevered exposure to a long lease property investment.

If you take the example of commercial ground rents, we can get pretty attractive terms, long duration, contractual income inflation, that's got explicit inflation linkage, and that can often be a more relevant type of cash-flow generative asset than real estate debt, which is typically much shorter in duration.

The second point is that pensions typically compete with insurance companies in the debt space. Insurance companies like that debt space because it has favourable Solvency II regulations around it and they don't have as much of that competition in the equity space.

So, if you're a pension fund, then there are greater headwinds in the debt space generally. That's not to say there are no opportunities. So, we're positive on the debt space. We'll pick out opportunities there. There has been regulation which has made it less attractive for banks in certain segments of lending, so there's an opportunity for pension funds but, generally, we want to be comparing private real estate debt to other types of bonds, rather than to equity.

We do think that the private debt space can offer less volatile, less reliance on larger issuers who have more negotiation power, so you can get better terms if you're a private debt investor generally.

In the near term, there could be opportunities for transitionary capital there. We talked about offices and how they need money to change and retail needs to change. So there could be opportunities for equity investors in real estate to tap into the debt market, as they transition their properties to something that's more relevant.

» **Pawson:** In terms of setting out what is an attractive asset, you need to define what you're looking for and set the investment objective of that asset. There are roles for both real estate equity and real estate debt in investment portfolios.

Would I say that real estate debt is

better? If you look at some of the portfolios that we've got in real estate debt, the sector allocations and the geographic allocations are actually quite different to what we're investing in, in terms of property equity. So you need to compare apples with apples, and make sure that you understand what you're getting into and what you're buying into.

In that context, a long lease equity portfolio may be a better risk-adjusted return than a five- to 10-year real estate debt fund that has quite high retail exposure.

In terms of private versus listed, our general view is that having private exposure with mostly bilateral negotiated debt is a more attractive position to be in than taking a vanilla piece of debt from the market and just buying your slice. Usually you get better contractual terms, you can put covenant protections in there, and we find that better for most DB schemes. Listed is easier to access, to get in and out of, but you are taking some of that market risk.

In terms of private credit, we expect that there are going to be winners and losers in the asset class over the next five years or so, we like broader private debt mandates that have the opportunity to selectively dip in and out of real estate debt.

» **Montcerisier:** I agree we shouldn't regard this as a competition between debt and equity – they can be quite complementary and debt can offer a way to diversify at a point in the cycle where it may make sense to do so.

As far as real estate is concerned, listed debt is very narrow, in the sense that when you look at the large, listed property companies, it's really retail property companies. You have one large residential in Germany, otherwise it's mostly retail, maybe a little bit office.

If you want to diversify your exposure to something different, such as healthcare assets, or data centres, it's impossible simply to invest into listed debt and do that at the same time, so private debt is the option in that space.

Infrastructure

» Chair: How has the role of infrastructure in pension portfolios evolved? Are pension funds making the most of infrastructure?

» **Montcerisier:** Infrastructure is definitely a desired asset class right now, within the alternatives space.

"We shouldn't regard this as a competition between debt and equity"

Infrastructure is usually a longer maturity debt as compared to real estate, and usually, depending on whether you finance brownfield or greenfield, it tends to be longer in terms of drawdown, so the cash-flow profile is different. You don't invest immediately, usually, in infrastructure debt. It takes some time to deploy capital, and it's a longer maturity for the debt.

So, depending on the asset and liability constraints of each individual investor, that has to be taken into account but, having said that, it's a very low-risk asset class. You have to look at the pricing of equity, because it's high right now, but if you are in the debt space, it's a great asset class to be in, as a source of diversification.

» **Ubhi:** The role that the asset class plays within portfolios has clearly evolved. It has gone from people not knowing what it was, to establishing its credentials as an asset class in its own right. It's not real estate, it's not private equity, it has its own particular risk/return characteristics, and therefore potentially merits an allocation on a standalone basis.

The roles in which investors are using the asset class within portfolios have also evolved. The first, and I would say most common, use of infrastructure within a portfolio is as a diversifying asset class, as a way of de-risking portfolios, but still providing a long-term source of equity-like return, but ideally at lower volatility and providing genuine diversification within a portfolio from public equities and fixed income.

We have also seen infrastructure broaden out both at the lower and upper ends of the risk/return spectrum. Looking at the lower end of the spectrum first, we have seen lower risk equity strategies in the core, core plus space, incorporating unlevered equity, form part of cash-flow generating type strategies, particularly important to pension scheme investors. Then typically combined with other types of equity in that space, so typically real estate, HLV, et cetera.

Then, if we take a step lower on the ladder, we have junior infrastructure debt, which we've found has been used as part of broader private debt portfolios, maybe as a lower risk form of private debt, asset backed.

Then an area that we haven't seen grow as much as expected is senior secured infrastructure debt as part of a liability matching portfolio. We've seen some of our more sophisticated clients incorporate portfolios, typically on a bespoke basis, into their broader LDI strategies, and do that successfully, but it's not as common as I would have thought it might have become.

Then, at the upper end of the spectrum, the asset class itself is growing and evolving, and within that context the approach that managers are taking within the space has also evolved over time. We're perhaps seeing some unwelcome trends in that regard, in terms of ever-increasing fund sizes and an element of style drift.

Interestingly, one way of potentially capturing that is to think about some of those strategies as being asset-backed private equity, rather than infrastructure. So, if you're looking to diversify your private equity portfolio, can you do that using some of those types of approaches instead?

Then there is the increasing focus on climate change within portfolios. Our asset liability modelling has incorporated a climate change filter, effectively, for a number of years now, providing another perspective on traditional mean variance analysis. Infrastructure is being considered within that context, both as being climate change positive – if you think about renewable energy and energy transition – but also having legacy climate change negative impacts for investors.

If we extend that further into the desire to have more of a positive impact, achieve some kind of social outcome, our experience has been that good investment performance in infrastructure is almost invariably linked to good ESG integration. There is a natural alignment between getting a positive outcome or some form of social good indirectly, through having an infrastructure portfolio that is performing well from an investment perspective.

» **Jayasingha:** In terms of how a pension fund uses infrastructure, it's more buy and hold now. We're seeing far more buy and hold strategies, rather than buying a good quality asset and then selling at an arbitrary date just because their fund is expiring.

There is also an expanding number of sub-asset classes within infrastructure, so tech-enabled infrastructure, for example. The idea that broadband and fibre is seen as a utility now, alongside water and power, highlights this point. This has to of course go alongside a skill-set from the managers that allows them to effectively manage those assets.

Then the idea of infrastructure being used partly as a climate solution is key, so not just renewables, but also battery technology – electricity networks are being seen as needing more capacity, if we're going to move up to greater electrification, as well.

"There is still some reticence about using infrastructure"

» **Pawson:** In terms of the role of infrastructure and how it's evolved, the types of assets are broadening – the area of technology being a prime example. We're all working from home more, so we need greater broadband infrastructure, and that investment is going to need to come from somewhere.

In terms of how fund managers are dealing with infrastructure and building products that meet client needs, this is evolving. There's a much better dialogue about what risk/return target clients need, and how we build a product that delivers that. If you go back 10 to 15 years, everything was PE structured, everything had a 10-year life, it was all centred around IRR, and that ticked the box – and that's just not what clients want. Clients want to be able to see cash-flow come through from the assets to a portfolio that meets their required return. We're building portfolios around that basis and working with managers to develop those solutions.

That's not just in relation to infrastructure. That dialogue and that improvement of working with the management industry is something that's happened over the last 10 to 15 years, and it's really about getting better solutions and better client portfolios.

Are pension funds making the most of infrastructure? I don't think so. There's still some reticence about using the asset class. In terms of understanding what the assets are and how you get paid, that's something that is not understood by many pension scheme trustees.

Our job as consultants is to interpret and help clients on that journey, and build it into portfolios, and we've had some great success in the last few years with putting some new infrastructure mandates in. Renewable energy is one of the ones that there's been a lot of focus on in the last couple of years. That is improving, but there is still a large proportion of pension scheme trustees that are not investing in infrastructure, and they're ignoring a positive, attractive asset class.

» **Phull:** Pension funds have historically been attracted to the stable, Inflation linked cash-flows and diversification that infrastructure provides. Today, it also offers the opportunity to invest in Key themes and global structural trend's that have accelerated due to Covid. You're seeing more funds focusing on mega trends such digitalisation & energy transition as well as demographic changes.

One concern is when you look at funds moving into some of these areas, what is the incremental risk that these funds are now taking on? From our perspective, it's about trying to understand what that risk is and what the client is actually buying into. So the biggest concern is when we see investors moving away from infrastructure into the more private equity realms of investing.

I agree pension funds are probably not making the most of infrastructure, but that's generally down to a lack of understanding. These are complex asset classes. Whether it's renewable infrastructure, whether it's social infrastructure, it can be challenging for a pension fund to understand. Saying that, trustees are becoming more engaged and wanting to understand more, because they've realised that there is a big part that infrastructure across the board can play in their portfolios.

» **Collins:** Infrastructure offers the potential for great returns and diversification, but for trustees it also gives us extra governance challenges. So you must understand the specific risks of the investment and think about your correlation with the rest of the portfolio.

One thing I've always been wary of with infrastructure are inflation-linked returns, because sometimes they're artificially created. I don't like those within infrastructure, because I can hedge that risk precisely and more efficiently with LDI, and sometimes I'm being overcharged for something that's been artificially created. I'm wary of inflation. My message to the management community is, don't try and create a product that solves all my problems. Just give me some great infrastructure at a great price. For me, it's about getting access to a great class of assets that's just not represented in the listed markets.

On the topic of ESG, I'm particularly excited in the UK about the green infrastructure opportunities that are starting to arise. If the government does go with the green revolution it's talking about, there should be a lot more. For me, as an investor, that's about two things. We all want to use the assets we control for good, if we can, but we can't get somebody else to pay for that indulgence. It's got to be at a good price.

This is an area where it could come together, where there's going to be a need for investment, so it can be priced appropriately and you can hit both targets. You can use the assets for good, and get great returns, potentially, for investors.

Also, on ESG, it's introducing a whole range of new risks, because it is getting well priced into assets now, so there's the risk of a pricing hit because something goes wrong, but also then possibly being overpriced, because there's a stampede into them, so it's something to think about.

» **Pawson:** To date, a lot of our discussions with clients on ESG have been about assessing where managers are and how they're managing their long lease assets and dealing with tenants. Clients really do want to see change in portfolios, to be doing ESG well. It's not a tick box exercise.

Where we're really getting traction is looking at impact portfolios or portfolios focusing on sustainability, because clients really see this as a long-term risk. If you've got a long lease, for example, it's 20 plus years. If you've got an infrastructure asset, it's 30 years. Climate transition is going to impact these assets and we need to be aware of those risks.

There's also the opportunity side, in terms of climate transition and making sure that you're an early mover in things like renewables or timberland – making sure you're ready for that transition, and making sure that your scheme is set up for it.

The other thing that I must mention is – and we're working with the Investment Consultants Sustainability Group on this – managers reporting on key metrics and KPIs. How are we actually measuring ESG in portfolios? This is something that all managers need to take on board and improve, and across all asset classes. We need to know what the current impact is, what the current climate emissions are. Clients are already starting to need to report on TCFD, and we're not getting the data from managers. It's a fundamental thing that the management community need to take on board and improve, quickly.

» **Montcerisier:** We take ESG extremely seriously at BNP Paribas Asset Management, and one of the key points effectively is to say: how can we measure the impact we make, be it in relation to infrastructure, real estate, and so on.

We are also encouraged to do so because of this European legislation around SFDR.

We have worked with many third party providers, and we have found the solution to quantify precisely, for each investment we make, the environmental contribution of this investment. We call this the Net Environmental Contribution. That is going to be extremely powerful.

» **Phull:** From a historical perspective, ESG has just been about looking at the risks and trying to manage those risks in relation to the kind of building that you own or you are building.

Going forward, there's a realisation that the best in class buildings, with the best ESG credentials, will hold more value, not just from an environmental perspective, but social, health and wellbeing. These are the buildings that we require, the workforce requires. From a manager perspective, there's a realisation that you can't think about this in five years, because by that time it might be too late. Because once all these issues become factored in, it's going to hit the value of your building, so you've got to address it now. ■

ESG RISK MANAGEMENT

Ask the industry:

The European Fund and Asset Management Association (EFAMA) recently came out in support of extending the EU Taxonomy but also stressed against the use of blacklists. Is the industry currently too focused on divestment for meeting its environmental, social and governance (ESG) aims, or are engagement approaches also effectively used enough by European pension fund investors?

Historically, the industry was too focused on divestment for meeting client ESG aims, but in recent years the impact and performance benefits of continuing to hold 'bad ESG' companies and instead engaging with them has become a strong alternative.

The issue with divestment is that the problem is being passed on, not solved, as someone else buys those assets from those selling. Whilst this may appear to improve that investor's own risk profile, or ease their conscience, it has very little real-world impact. Holding onto that investment and engaging for change at the company can potentially have a stronger real-world impact and align far more clearly with an investor's ESG aims. Divestment can then be used as a last resort should the engagement not work.

There is a performance trade-off as well. The longer the exclusion list, the more narrow the opportunity set and theoretically the lower chance of returns. Studies have shown that poor ESG companies that can evidence improvement tend to outperform the broader market. Excluding them will leave those potential returns on the table, and most investors are not in a position to forego that opportunity.

NICK SAMUELS
Redington head of manager research

We view blacklists as a form of ESG exclusion and there are drawbacks to applying ESG-motivated tilts to broad asset categories or investing through ESG-oriented index funds focused on exclusion. Our view is that the greatest potential from ESG is its application as close to the actual investment as possible through ESG integration or impact investing.

These approaches allow for thoughtful exclusion of companies where required but also the opportunity for engagement. Each investor should make their own choice based on their ESG beliefs and specific circumstances, but we think there is a significant opportunity for the industry to adopt engagement-oriented approaches.

The industry is using divestment to meet ESG-related objectives, particularly as it relates to carbon-intensive industries and some asset allocators are implementing this through index funds, which rely on ESG ratings from various ESG evaluators to exclude companies. However, this approach can lack precision and can introduce potentially unintended tilts and exposures such as a bias towards large cap companies and certain sectors.

TONY KAO
SECOR Asset Management managing principal and chief investment officer

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Ignorance or avoidance has never been a good investing strategy. In fact, many ESG issues have proven to be financially material and thereby merit inclusion in the investment process for portfolio risk/return reasons alone.

That discovery has made ESG integration a commonly discussed, although poorly defined approach, which can be especially challenging to members, clients, prospects, and the industry at large.

While excluding a stock from a portfolio may marginally increase the cost of capital to that business, it probably won't affect the company's behaviour. However, engaging, voting, and influencing the same company to improve its sustainability can indeed influence capital expenditure, which can, in turn, potentially affect long-lasting change.

That's why active engagement in tandem with active management can improve both the risk/return prospects of an investment and the company's sustainability practices. It's a win-win.

NIGEL ASTON SEI Institutional Group DC director

Divestment can be powerfully symbolic and in the case of fossil fuels can also protect portfolios from stranded asset risk, but it is a side show in terms of real-world impact. Using climate change as an example, the world needs asset owners to push companies that use fossil energy to transform their business models for a low-carbon future – ie engagement – but beyond that there also needs to be massive and rapid primary investment in infrastructure and capacity for renewable energy. And for our clients, the single highest impact per pound or euro spent is in the funding and scaling up of innovative clean technologies that can have a multiplier effect on industrial transformation.

Different ESG topics each merit a different emphasis between exclusion, engagement and positive investment, so that asset owners can make the biggest impact for the time and capital deployed. Nevertheless, in many areas real money invested will have the biggest ESG impact for most investors

SIMON HALLETT
Cambridge Associates head of European endowment and foundation practice

We agree wholeheartedly with the EFAMA position that blacklisting and disinvestment are not the correct approach. While these may allow individual investment products/funds to demonstrate – on paper – attractive 'ESG statistics' (like favourable ratings), the companies that have been disinvested will still be owned by someone else. That someone else is, all else equal, now likely to be less scrupulous, less concerned about environmental or social damage and if anything we have moved further away from a climate goal rather than achieving any meaningful progress.

It is unfortunate but unavoidable that we will still require companies like cement producers or steel mills in order to satisfy ongoing needs for infrastructure. Even in the UK we are still forced to restart some coal-fired power stations periodically when weather conditions make green power unavailable. We need to engage with the companies to encourage and help them to become greener.

We would further argue that in emerging markets the issue is more acute. On a per-capita basis emerging market emissions are comparable to the EU (and lower than say the US) but because of the large population sizes (eg China and India), the emissions in aggregate are substantial.

We cannot solve the carbon crisis without bringing the emerging markets along. Now, it is often the case that large emerging market companies are still controlled by founders or founding families who have little incentive on their own to change how they operate in the absence of a newfound sense of 'duty'. More likely they will need either government regulation or robust shareholder engagement.

If we as investors blacklist the enterprises we lose our ability to engage and any progress would then be down to government action. That has been successful in some areas – for example, the cleaning up of the air around the Beijing Olympics, which was driven by government policy, as is the rise of electric vehicles and solar power in China, but these initiatives are sporadic and probably insufficient to transform wide swathes of the economy. And not all governments have the political will or ability to act like this. By engaging we have the opportunity to drive best practice reporting and action across the investee companies.

LARS HAGENBUCH
RisCura consultant

In their own words...

Industry personalities' comments on the hot topics affecting the European pensions space

On Danish proposals to ban pension companies from offering pension and health, and accident insurance products as a bundle

"It is absolutely central to the success of health and accident insurance that companies continue to be able to 'bundle' savings and insurance into one pension product. Bundling products has benefited millions of Danes who have received both a good pension offering and health and accident insurance. That safety and security for individuals is also of great value for wider society."

Insurance and Pension CEO, Kent Damsgaard

On the draft code of practice from the Irish Pensions Authority

"I think there is a lot of concern around how practical it is and how much additional work is required. That leads to a general concern of whether it will improve member outcomes or whether it will just lead to additional work and costs, which ultimately will come back to members and employers anyway as someone has to pay for all of these additional functions."

Irish Association of Pension Funds CEO, Jerry Moriartry

On the need for more government action in the climate change fight

"Strong policies, in line with limiting global warming to no more than 1.5-degrees Celsius, can accelerate and scale up private capital flows towards the net-zero transition. Full implementation of the Paris Agreement will create significant investment opportunities in clean technologies, green infrastructure and other assets, products and services needed in this new economy.

"In turn, investors can use capital allocation and stewardship to support sustainable activities that generate jobs and economic growth, transition away from carbon-intensive activities and increase resilience.

"We encourage governments to engage closely with investors to make sure these opportunities are fully realised. As investors, we are committed to working with governments to ensure policy mechanisms are developed and implemented to transition to a climate resilient net-zero emissions economy by 2050 or sooner.

"We urge all governments to step up their collective response to the climate crisis."

Signatories to the *2021 Global Investor Statement to Governments on the Climate Crisis,* a total of 587 investors

On pension funds' interest in infrastructure investments

"There has been a noticeable pick-up in interest from European pensions funds around infrastructure over the past few years. This has been largely driven by pension funds wanting to diversify their income sources away from traditional asset classes, such as equities and fixed income, and into alternatives."

BNP Paribas Asset Management head of infrastructure debt, Karen Azoulay

On 12 new asset owners joining the Paris-Aligned Investment Initiative Net Zero Asset Owner Commitment

STEPHANIE PFEIFER

Institutional Investors Group on Climate Change CEO

"As momentum grows approaching COP26 and the focus on climate-related issues intensifies, we are pleased to see more asset owner investors making net-zero commitments. These commitments are incredibly important, and the first step on the path towards investors putting in place a net-zero investment strategy.

"We look forward to working with these asset owners on their net-zero strategies and would welcome other climate-conscious asset owners to consider becoming signatories to the Paris-Aligned Asset Owners commitment."

On how they prepare for market volatility that stems from geopolitical risks materialising

THIJS KNAAP AND CHARLES KALSHOVEN

APG Asset Management economics and strategic asset allocation team members

"We prepare for volatility by constructing portfolios with different assets, the combination of which tends to be robust against shocks; and by regularly executing a rebalancing strategy that often has us buying risky assets after a geopolitical shock, and selling them again when the worst has passed. Because we expect volatility, not every event is a reason to change the outlook. Geopolitical risks tend to be temporary and markets tend to recover from their anxiety. Therefore, it pays to keep calm."

On increasing concerns around the level of financial security in retirement across Europe

STAFFAN STRÖM

Alecta pension economist

"We are at an interesting inflection point where the responsibility for a secure retirement is shifting away from employers to individuals. Access to an appropriate retirement savings vehicle combined with incentives to save are critical for individuals, who have ever-increasing responsibility over selecting investment providers for their pensions planning."

On statistics showing that life expectancy is expected to continue to rise, while the working age population will decrease

"These alarming figures urge governments to assess the adequacy and sustainability of pension systems and to place pensions at the heart of social and economic policies at all levels. In certain countries, governments should be very concerned about the impact of the demographic challenge on their pension systems and act promptly to ensure good pensions for all."

PensionsEurope senior policy adviser, Simone Miotto