European Pensions

Quarter two 2020

Reform in a time of crisis

Does Covid-19 delay hope of German workplace pension reform?

www.europeanpensions.net

See page 38 for an interview with Tela

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Testing resilience

If there is one thing that can determine resilience, it's a pandemic. What an absolutely horrific couple of months. Our resilience has, and still is, being tested every day.

The streets of Europe have been left deserted like a scene from *28 Days Later*, with shops boarded up, and the atmospheric buzz of cities such as Rome and Paris has gone, leaving the cities in silence. We mourn the thousands who have lost their lives, whilst coping with unprecedented lockdowns that infringe on the freedom we've always known. For those who have lost loved ones during this period, this only makes it harder.

> **"PENSION SCHEMES ARE BEING CONFRONTED WITH THE REALITY OF A RISK THAT NO ONE EXPECTED"**

In spite of all of this, we have shown our resilience in the face of a crisis. It's not easy, but we've capably adapted to this socially distanced life we now find ourselves living. The same can be said for the pensions industry, which I believe has shown a fighting spirit, whilst investment returns took a hit and everyday operations suddenly had to be performed remotely.

Investments, in particular, suffered a great setback throughout March. However, schemes in Nordic countries, buoyed on by a successful 2019, have managed to maintain strong solvency ratios and have already begun recovering some of those losses as markets rallied in April. Those in the Netherlands have had to take a more sombre approach, warning members that pensions may need to be cut in 2021. Despite this, I have been impressed with the clear communication and updates for members.

Much like the communities that have come together to support each other during this crisis, it's great to see schemes investing in bonds and funds that aim to provide relief to those impacted by Covid-19. This is covered in our news roundup on page 9.

Unfortunately, the Covid-19 outbreak has reached far and wide in terms of impacts on the pensions industry. In this issue, we look at what schemes can do to protect themselves from cybercrime [*page 46*], following the warning from the European Insurance and Occupational Pensions Authority (EIOPA) that this threat has increased with more people working remotely.

Pension schemes are being confronted with the reality of a risk that no one expected – one that starts a domino effect of other risks materialising. That's why it's so important for schemes to be on top of these risks and as resilient as they can be.

Natalie Tuck, Editor

European Pensions has agreements with several associations to reach their membership. For details contact john.woods@europeanpensions.net

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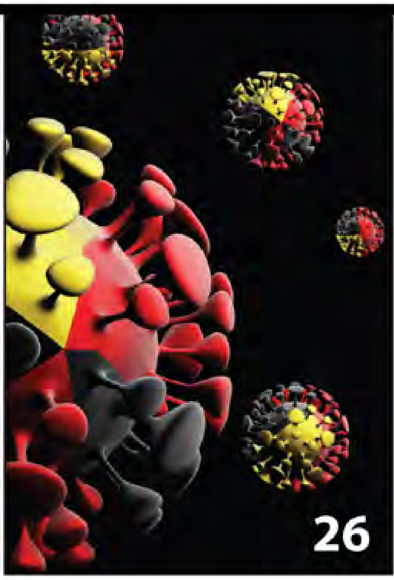

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PensionsEurope calls for 'close collaboration' in response to Covid-19

IT SAYS SCHEMES MAY NEED SUPPORT TO COPE WITH THE CRISIS

Written by: Jack Gray, Natalie Tuck and Sophie Smith

PensionsEurope has called for close collaboration between member associations, European Union (EU) level and national regulators, and supervisors, to ensure that pension funds can overcome the challenges caused by the Covid-19 pandemic.

In a wide-ranging statement, the association called for a number of measures to be taken to help pension funds during the crisis. It said the outbreak of the virus has resulted in "unprecedented turmoil" and will be followed by recession, high numbers of bankruptcies and rapidly rising unemployment.

"This crisis is symmetric and poses huge challenges for the EU and the member states. Funded pensions depend on the economy and financial markets and the short-term impact of the crisis is severe. Pension funds are long-term investors with long-term liabilities and with the right policy measures they will be able to get out and recover from this crisis and contribute to financial market stability and the swift recovery of the financial markets and the real economy," it said.

Therefore, the association said it is "vital" that the EU and member states do their utmost to alleviate the adverse short-term effects of the crisis.

"Many EU countries mainly rely on pay as you go (PAYG) social security pensions. Low economic growth and even contraction of the economy will also impact them especially if high unemployment resulting from the crisis turns into lower employment levels.

"The EU policy to have adequate and sustainable pensions in the future has been based on compensating and complementing lower social security pensions with funded workplace pensions or personal pensions and this will be even more important after the crisis," it said.

The financial impacts of coronavirus have hit penson funds across the board. Irish managed pension funds declined by 15.8 per cent in the first quarter of 2020, one of the worst results since the 2008 financial crisis, according to Rubicon Investment Consulting.

As a result of the crisis, the Pensions Authority in Ireland has said it will take into account current circumstances when assessing trustees' compliance with their obligations.

The statement was made within guidelines for trustees, employers and those in the pensions industry on how to deal with the "most immediate issues" caused by the Covid-19 crisis.

However, the authority said it expects that reasonable efforts are made, and that trustees and their service providers are proactive and member-focussed.

In particular, the authority said trustees should confirm the following: that pension payments to retired members are paid as they are due; that other benefits are paid in a timely manner; and, that contributions paid by members and employers are remitted promptly to the scheme.

Despite the initial turmoil, April brought some positive news as financial markets regained some of their losses. Dutch pension funds began their recovery, as average funding ratios rose from 85 per cent to 90 per cent over April, according to the latest analysis by Aon Netherlands.

Publishing its monthly Pension Thermometer update, Aon said that stock prices started a strong recovery after suffering massive losses in March. However, interest rates fell to around 0 per cent in April due to weak economic predictions.

Despite minor improvements, the policy-funding ratio remains in the "danger zone" at 99 per cent, Aon said. This ratio is based on the average funding ratio of the past 12 months. The adjusted temporary statutory minimum is 100 per cent. Aon believes that discounts before the end of 2020 will become a realistic scenario.

In additon, Danish pension provider, PFA, said that it has recovered approximately half of the losses it suffered in Q1 2020. It said that improving financial markets have helped it to recover those losses.

The provider saw a loss of DKK 33bn in Q1, which was a sudden downturn from the positive return of 2019, in which it made DKK 57.6bn.

Its investments in listed shares saw the greatest decline with a negative return of -17.7 per cent. However, its large share of unlisted investments demonstrated its strength during the market turmoil, as PFA's property portfolio had a return for the first quarter of -1.6 per cent, while the return on the portfolio of alternative investments was -10.8 per cent.

"Pension funds are long-term investors with long-term liabilities and with the right policy measures they will be able to get out and recover from this crisis"

In the UK, The Pensions Regulator (TPR) has been publishing regular updates to try and support schemes. UK employers' auto-enrolment duties towards their staff will continue to apply "as normal", despite the ongoing challenges posed by the coronavirus.

TPR said that this includes paying minimum contributions, as well as re-enrolment and re-declaration duties.

However, if an employer has put a worker on the Coronavirus Job Retention Scheme, then the government will cover the minimum auto-enrolment contribution of the furloughed employee's 80 per cent salary.

TPR also confirmed easements for employers to suspend deficit repair contributions (DRCs). The guidance, directed at sponsoring employers and trustees, also included a number of provisions around scheme valuations and transfer requests.

TPR has told trustees to be "open" to requests to reduce or suspend DRCs "in line with the principles set out in our guidance published 20 March".

Meanwhile, Finland has reduced employer earnings-related pension contributions by around 2 per cent as a measure to deal with the financial impact of the Covid-19 pandemic.

In an update from the Finnish Centre for Pensions (ETK) on the country's response to the virus outbreak, ETK director, Jakko Kiander, explained that the earnings-related pension system "quickly became a considerable part of the crisis management package" in Finland. The measures were agreed on in tripartite negotiations between labour market organisations and the government.

Since the outbreak, a thinktank, 2DII, has developed what it believes to be the first stress test based on Covid-19 scenarios to assess the financial risks of the virus.

News in brief

■ The total number of earnings-related pension insurance policies transferred from one pension insurance company to another reached almost 4,800 in **Finland** during Q1 2020, according to the Finnish Pension Alliance (Tela). Transfers under the Employees Pensions Act totalled 1,959 and those under the Self-Employed Persons' Pensions Act came to 2,813. The monetary value of these transfers amounted to €116,975.

■ The jointly owned investment company of the first, third and fourth **Swedish** AP funds, Polhem Infra, has invested in one of the country's largest wind power projects. The investment has been made in partnership with other institutional investment partners such as KLP and BAE Pension Funds. The Skaftåsen wind farm will have 35 turbines and is expected to produce around 535GWh of electricity.

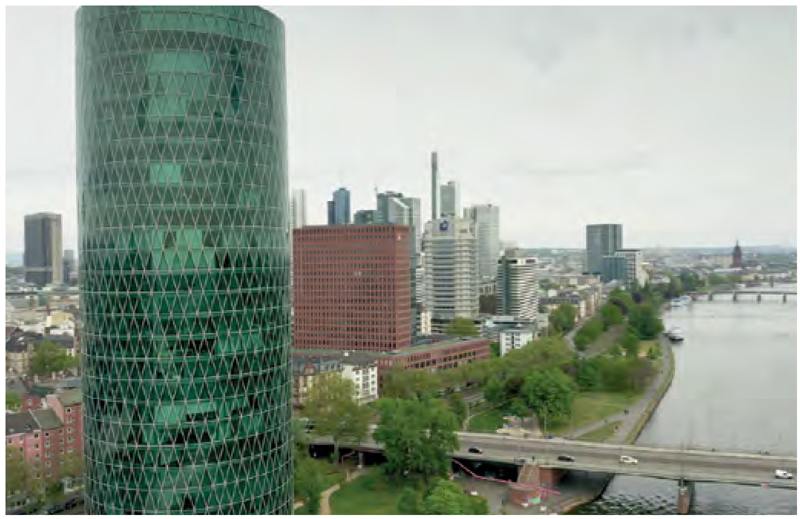
■ **Italy's** Fonchim Pension Fund has awarded a new €110m emerging market debt mandate to Payden and Rygel. The pension fund is for Italian chemical and pharmaceutical workers in Italy. It brings the total number of institutional mandates managed by Payden and Rygel for Italian institutional clients to 11.

■ The €252bn **Dutch** pension fund asset manager, PGGM, and €900bn **Swedish** pension fund, Alecta, have partnered up to co-invest in credit risk sharing transactions. In credit risk sharing transactions banks transfer part of the credit risk of a portfolio of loans to investors while continuing to hold a share as well. In each deal, Alecta will buy 30 per cent and PGGM 70 per cent.

EIOPA recommends allowing delay in mandatory annuitisation amid crisis

THE AUTHORITY MADE THE SUGGESTION TO TRY AND EASE THE IMPACT OF COVID-19 ON THE OCCUPATIONAL PENSIONS SECTOR

Written by: Natalie Tuck



Picture source: Novikov Aleksey / Shutterstock.com

Pension scheme members of defined contribution (DC) schemes who are due to retire, and have to take out an annuity under their domestic pension laws, should be given the option to delay this, the European Insurance and Occupational Pensions Authority (EIOPA) has said.

The suggestion was made in a statement on the principles countries and schemes can take to mitigate the impact of the Covid-19 pandemic on the occupational pensions sector.

EIOPA said national competent authorities (NCAs) should, where relevant in collaboration with the national legislator, encourage flexibility to safeguard members' pension rights and, particularly in DC schemes, allow members to choose delayed application of lump sum payments, or of mandatory annuitisation.

It was part of a range of guidelines set out by the supervisor, in which it said it expects NCAs to adhere to using a risk-based and proportionate approach.

EIOPA said countries should ensure that occupational pension schemes (IORPs) prioritise the continuity of key operational activities, including outsourced ones, like the timely investment of contributions, the management and safekeeping of assets, the timely and accurate payment of retirement benefits and service continuity towards members and beneficiaries.

IORPs should be given flexibility in the collection of contributions from employers facing liquidity pressures, also in anticipation of envisaged wage support measures, it stated.

"To accommodate IORPs' focus on key operational activities, NCAs should be flexible with respect to deadlines for publication of documents and data considered less urgent given the current circumstances as well as in respect of national reporting requirements.

"The timings for the provision of occupational pensions information to EIOPA are extended by two weeks for the information regarding the first quarter of 2020 and by eight weeks for the information regarding annual reporting with reference to the year-end 2019," it stated.

EIOPA also warned of the increased risk and exposure to fraud, and told NCAs to "carefully consider and effectively manage" this risk caused by the disruption to society. This includes cyber security and data protection, in particular, relating to staff working remotely.

Prior to this statement, in regards to its monitoring of IORPs, EIOPA said that it plans to expand the remit of its costs and past performance annual reports to include occupational pension funds.

In its *Costs and Past Performance 2020 Report*, the authority said it anticipates occupational pensions will be included in the scope of the analysis by leveraging on the newly implemented IORP II reporting framework. It also plans to work on a simplified methodology relying on the sole reporting package.

Currently, the report only includes insurance-based investment products and personal pension products in the European Union. The report is published following a request from the European Commission to the European Supervisory Authorities.

Its latest analysis found that unit-linked products can offer high returns but also pose risks for consumers during periods of poor market returns.

Schemes join Covid-19 aid effort with investments in special bonds and funds

PROVIDERS AND SCHEMES IN SWEDEN AND THE NETHERLANDS HAVE BEEN INVESTING IN SPECIAL BONDS AND FUNDS

Written by: Natalie Tuck

Pension schemes and providers, primarily in Sweden and the Netherlands, have made investments aimed at helping those impacted by the Covid-19 pandemic.

For example, Swedish pension provider Alecta has invested SEK 2bn in a social bond to support companies that have been negatively affected by Covid-19. The bond has been issued by the International Finance Corporation (IFC) and is aimed at giving financial support and loans to companies that are adversely affected by the spread and turmoil linked to Covid-19.

Primarily, the support will be for companies in developing countries to enable them to continue to undertake their business and retain employees.

Fellow Swedish pension companies, Skandia, Länsförsäkringar and KPA Pension, have also invested in a social bond that aims to fight against the pandemic, specifically in Europe. Skandia has invested SEK 450m, whilst Länsförsäkringar has invested SEK 380m and KPA Pension SEK 100m. The social awareness bond is focussed on health and is issued by the European Investment Bank (EIB).

Social awareness bonds usually have a general healthcare orientation, but due to the emergency situation, the EIB is directing funding to activities linked to the Covid-19 pandemic.

KPA Pension has also invested SEK 430m in a bond issued by the Nordic Investment Bank. The bond will fund projects in Nordic countries and Baltic states, and is primarily aimed at promoting effective healthcare systems and providing financial support to reduce the disruptions that have occurred in various supply chains.

Focusing on help in Africa during the crisis, Skandia has also invested SEK 1.5bn in a bond issued by the African Development Bank.

Furthermore, the Dutch pension fund ABP, for those working in the government and education sectors, has invested €288m since the end of March in various bonds targeted at the fight against the coronavirus.

Some of the investments include improving healthcare and supporting small and medium-sized enterprises in Europe and globally. It recently bought €176m of 'corona bonds' from the World Bank.

Issuance of this bond contributes to a €13bn emergency package to support countries affected by the coronavirus. The proceeds will finance, among other things, expansion of testing capacity, training of medical personnel and the purchase of protective equipment.

It has also invested €12m in a bond from the Inter-American Development Bank and €25m in the United Services Automobile Association, an organisation that provides US defence personnel with affordable insurance and banking services. The proceeds will be used, among other things, to support soldiers and their families who have run into financial difficulties.

In addition, several Dutch pension funds have joined a group of international investors calling on the pharmaceutical industry to work together in the fight against the Covid-19 pandemic.

Led by the asset manager, Achmea Investment Management, the group has drawn up an investor statement. Pharmaceutical companies have been asked to join forces "to minimise the spread of the virus and its consequences".

In total, more than 40 investors have joined the initiative including asset managers, pension funds and insurers.

Norges Bank under fire from watchdog over NBIM CEO hiring

THE EXECUTIVE BOARD HAS FACED CRITICISM FROM ITS WATCHDOG OVER INCOMING NBIM CEO NICOLAI TANGEN'S HIRING

Written by: Natalie Tuck

Norges Bank's Executive Board has been criticised by the bank's Supervisory Council in relation to the recruitment process of incoming Norges Bank Investment Management (NBIM) CEO, Nicolai Tangen.

Tangen is due to take over as NBIM CEO, responsible for the investments of the country's Government Pension Fund Global (GPFG), from Yngve Slyngstad in September. However, following a newspaper report on potential conflicts of interest over the hiring of Tangen, the board has faced questions from the council.

Following a response from the board, the council has now published a letter to the board detailing its concerns. "It is important that Norges Bank does not place itself in a position so that this confidence is weakened," the council stated.

"Doubts about the recruitment process, potential conflicts of interest, and uncertainty over ethical tax relationships could pose persistent challenges if these issues are not resolved quickly and clearly." It also said that it was "unfortunate" that not all conflicts of interests were dealt with before appointing Tangen as CEO.

In particular, the council has concerns on three key points, the first being Tangen's continued ownership of AKO, of which he is a founding partner. It stresses that this should not conflict with the running of the GPFG. Secondly, his tax affairs should be in line with both Norway's and the GPFG's own rules. This comes after revelations that some of his companies are registered in tax havens.

Finally, the council stressed that Tangen's employment contract should be subject to the same rules as all other employees. Norges Bank governor, Øystein Olsen, in response to the criticism, said the bank is "currently working on the employment agreement" and will "take note" of this.

"In our letter of 29 April 2020, the Executive Board addresses why specific

solutions to ensure sufficient distance could not be in place until after the employment had been made public," Olsen said in defence.

"Work is in progress to ensure that necessary distance is established between the Government Pension Fund Global, the AKO system and Nicolai Tangen's personal wealth. In accordance with the premises for the Executive Board's decision of 24 March, the very starting point is that Nicolai Tangen will no longer exercise ownership or have control over AKO's management."

As part of the council's scrutiny, it was also revealed that Tangen has had contact over several years with Slyngstad prior to his appointment. Since this Norges Bank has released all correspondence between Tangen and Slyngstad over the years.

In an email dated 6 January 2020, Tangen asks Slyngstad for "a little favour", in which he goes on to ask whether Slyngstad has time for a 30 minute call to talk about "what the job involves in terms of political guidance, opportunities, and the like". Slyngstad never responded to this email.

Despite the scrutiny, the board remains of the position that Tangen is the "best candidate" for the job. "Norges Bank's Executive Board believes that Nicolai Tangen will continue to develop both the organisation and management of the GPFG in line with the fund's purpose," Olsen said.

Finnish earnings-related pension assets hit €215bn in 2019

STATISTICS FROM TELA SHOW THAT ASSETS INCREASED BY €21BN TO €215BN YEAR-ON-YEAR, WITH THE ORGANISATION SEEKING TO DIVERSIFY INVESTMENTS INCREASINGLY INTO THE GLOBAL MARKET

Written by: Natalie Tuck

The total amount of assets in Finnish earnings-related pension savings reached €215bn at the end of 2019, according to the Finnish Pension Alliance (Tela).

Statistical analysis by Tela found that investment assets increased by €21bn during the year. Growth in the final quarter of the year totalled €6bn. The return on investments for the whole year was 12.5 per cent nominally and 11.5 per cent in real terms. Investment assets in the private sector amounted to €135bn, and €81bn in the public sector at the end of the year.

In terms of assets held, investments in equities and equity-like instruments accounted for €106bn (49 per cent) of assets rounded to the nearest billion, fixed income for €73bn (34 per cent), real estate for €18bn (9 per cent) and alternatives for €18bn (8 per cent).

The regional distribution of investments changed little during the past year, Tela said. The share of domestic investments and euro area investments fell by about one percentage point each.

The relative share of investments outside the euro area increased by about two percentage points. At the end of the year, less than a quarter of investment assets (23 per cent) were invested in Finland, with 59 per cent invested in countries outside the euro area.

PFA reports construction firms to police for attempted fraud

PFA REPORTED THE TWO COMPANIES TO THE POLICE AFTER CONCERNS AROSE THAT THEY HAD FORMED AN ILLEGAL AGREEMENT THAT INCLUDED A 'RETURN COMMISSION' STYLE BRIBE TO WIN A CONTRACT

Written by: Natalie Tuck

One of Denmark's largest pension companies, PFA, has reported its construction adviser V2C and construction company WR Enterprise to the police over an alleged fraud attempt.

According to a report by the *Danish Broadcasting Corporation* (DR), the accusation centres around the DKK 2.6bn 'Redmolen' project, planned to be a 55,000sm building in Nordhavn, Copenhagen.

PFA had appointed advisers V2C in August 2019 to hire contractors for the project. However, V2C is now being investigated by the police as it is alleged the adviser entered into an illegal agreement with WR Enterprise.

In another incident being investigated, V2C had considered giving a commission to the company Pihl to work on part of the project. However, *DR* reported that Pihl board chairman, Jesper Koefoed, was contacted by V2C demanding a 'return commission' or 'kickback'.

Koefoed told *DR* that he rejected the demand and then contacted PFA. Following this, V2C stated that it had released a co-owner, Lars Blaaberg, from the firm.

V2C owner and CEO, Peer Kisbye, through his lawyer, told *DR* that a return commission was made but it was the responsibility of Blaaberg, who left in October. However, *DR* said the contract includes Kisbye's name.

WR Enterprise founder and director, Willy Rasmussen, told *DR* that he is not aware of a cooperation agreement.

Sweden's AP1 to divest fully from fossil fuels

THE FUND ANNOUNCED THE INVESTMENT CHANGES TO HELP MEET ITS TARGET OF A CARBON NEUTRAL PORTFOLIO BY 2050

Written by: Natalie Tuck

Sweden's AP1 fund has announced that it will no longer invest in fossil fuels as it targets a carbon neutral portfolio by 2050.

It said the decision is due to the fund's work to identify and analyse climate-related financial risks in the economy, and in the fund's investment portfolio.

Evolving regulatory actions, increased taxation and emerging new technologies are expected to contribute to a reduction of global carbon emissions. In addition, a shift in demand from households and corporations away from carbon intensive products may increase over time, it said.

Therefore, the fund concluded that the transition towards a low-carbon economy, less dependent on fossil fuels, represents a substantial uncertainty for companies involved in coal, oil and natural gas activities. It believes continued investments related to these activities can increase the financial risk exposure of the fund.

Commenting, AP1 chairman Urban Hansson Brusewitz, said: "Our assignment is to manage the fund's assets in an exemplary way through responsible investments and achieve high returns for the long term, while supporting sustainable developments without compromising the fund's targeted investment returns.

"An integral part of this ambition is to manage our climate-related financial risk exposure and align it with the overall risk level of the fund. Divesting from fossil fuels is an efficient way for the fund to manage the financial risk associated with a transition in line with the Paris Agreement. Furthermore, we have decided to develop a roadmap and measurable targets towards reaching a carbon neutral portfolio by 2050."

AP1 said it has been working on identifying and assessing the impact of climate change, and the transition to a low-carbon economy, on the fund's investment portfolio. It noted that a transition in line with the Paris Agreement is expected to result in measures to support a shift to an economy less dependent on fossil fuels.

As a result, managing the fund's exposure to climate-related risks has been a prioritised focus area for some time, and has resulted in a steady reduction of the risk exposure. At the end of 2018, a decision was taken to no longer invest in companies involved in thermal coal and oil sands.

Meanwhile, the combined earnings of Sweden's AP funds (one to four) amounted to SEK 236bn in 2019, the highest return so far.

The latest return amounts to an average return of 17.6 per cent, and for the past five and 10 year periods, the AP funds' average annual return was 8.1 per cent and 8.8 per cent, respectively. This exceeds the return of the country's income index, which saw an annual average increase of 2.5 per cent (five years) and 2.4 per cent (10 years).

Since its inception in 2001, the AP funds have generated SEK 727bn in returns that exceeded the income index. The funds said the return has "greatly contributed" to the pension system, and is why the funds' share of the system is now just over 15 per cent compared to less than 10 per cent in 2001.

At the end of 2019, the funds' total fund capital amounted to SEK 1,559bn, which is an increase of SEK 210bn compared to the end of 2018.

In a joint statement, AP1 CEO Teresa Isele, AP2 CEO Eva Halvarsson, AP3 CEO Kerstin Hessius and AP4 CEO Niklas Ekvall, said: "We are proud to deliver a strong result for 2019."

UK pension transfer times see improvement - Origo

THE TRANSFER SERVICE FOUND THAT SIMPLER TRANSFERS HAD FALLEN TO AN AVERAGE OF JUST 7.9 DAYS, WHILST OTHER TRANSFERS TAKE AN AVERAGE OF 8.8 DAYS

Written by: Sophie Smith

Average pension transfer times in the UK have improved over the past year, with simpler transfers taking just seven calendar days, according to the Origo Transfer Index.

The index showed that average times from point of request to transaction had fallen from 9.3 days in 2018/19, to 8.8 days for 2019/20.

Meanwhile simpler transfers had fallen from an average of 7.9 days in 2018/19.

Origo managing director, Anthony Rafferty, emphasised that the long timeframes being headlined, which were often "over 50 days in some cases", were "far from indicative" of the broader industry's performance.

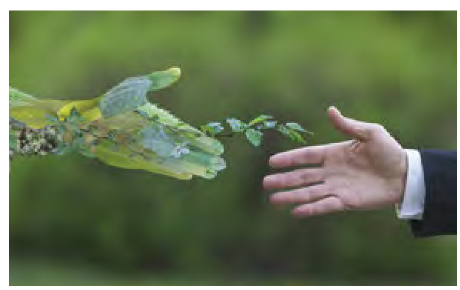
He stated: "The Financial Conduct Authority has transfer times firmly in its spotlight as does Minister for Pensions and Financial Inclusion, Guy Opperman, who has urged providers to be transparent with their transfer times and to work to lower them to provide a better service for consumers."

"The average transfer times being achieved by participants in the Origo Transfer Index overall is to be commended and is good news for individuals wishing to safely and quickly transfer their assets."

Rafferty clarified that the service operates on a calender days rather than working days basis.

The findings come as cash equivalent transfer activity is being put on hold by many schemes under new easements introduced by The Pensions Regulator in April due to the Covid-19 pandemic.

Fees 'most important factor' in pension fund choice for Swedes



RESEARCH FOUND THAT PENSION SAVERS VALUE FEE LEVELS

Written by: Natalie Tuck

Fees are the most important factor for Swedes deciding their pension fund choices, according to research by Novus on behalf of Skandia.

Second to fees, which is a priority for 18 per cent of savers, was risk level (15 per cent) and historical return (13 per cent), with sustainability remaining relatively low ranked (8 per cent), the research found.

Skandia pension economist, Mattias Munter, said it was wise for Swedes to look at both risk level and fees, but warned determining an appropriate risk level is not always easy.

"You have to look at the level of risk based on your financial situation, age and purpose of saving. With higher risk will also be the opportunity for better returns in the long term. Historical returns are often an inappropriate parameter because the rear-view mirror doesn't really say anything about the future. In fact, a fund that has gone up tremendously may indicate you should be careful."

Despite sustainability remaining at the bottom of important factors for savers making pension fund choices, it has seen an increase. Last year just 5 per cent stated the sustainability of fund as an important factor, whereas this year 8 per cent consider it to be important.

"Given that 2019 has been a year that really put climate and sustainability at the centre, it's surprising that savers have not put more emphasis on the issue," Munter added.

News in brief

■ **Canadian** investment management firm, Wellington Management Company LLP, and Ontario Teachers' Pension Plan have extended their strategic relationship to integrate climate science research into the scheme's investments. The partnership is based on a common investment philosophy and long-term perspective. The focus on climate risk is an example of initiatives the two organisations are exploring together that focus on changes in the investment landscape.

■ The **South Korean** National Pension Service has invested over $1bn in a Portuguese toll road operator and property redevelopment project in Manhattan, New York. According to *Korean Investors*, the public pension fund, alongside Dutch pension fund APG Asset Management and Swiss Life Asset Management AG, has acquired an 81.1 per cent stake in Brisa Auto-Estradas de Portugal S.A, for a total of $3.2bn. It was the first major overseas alternative investment by the fund since investments were put on hold by the coronavirus pandemic.

■ **South African** state-owned defence firm, Denel, has been unable to pay its employees' pension contributions as it struggles for cash amidst the Covid-19 pandemic. A letter seen by *Reuters,* which was written by its chief executive, Danie du Toit, confirmed that the firm was having to defer payments to its pension schemes. Denel is one of a number of loss-making state-owned enterprises the government had been keeping afloat with bailouts, and was technically insolvent before the government injected $98m in August 2019.

Canada DB funds hit 2013 low points

IN MARCH 2020, THE COUNTRY'S DB PLANS HIT THEIR LOWEST FUNDING LEVELS SINCE 2013

Written by: Natalie Tuck

Canada's defined benefit pension (DB) schemes' funding levels hit their lowest point since 2013 during the month of March 2020, according to Mercer.

However, since then, DB schemes have had a small bounce back with increases in long-term bond yields just prior to the quarter end. The Mercer Pension Health Index, which represents the solvency ratio of a hypothetical defined benefit (DB) scheme, decreased from 112 per cent at the end of 2019 and 103 per cent at the end of February to 93 per cent at the end of March.

The median solvency ratio of the pension schemes of Mercer clients was at 84 per cent on 31 March, down from 98 per cent on 31 December.

"There is no doubt that funded positions are down and almost every DB plan will feel this economic and public health crisis, but we're optimistic that plan sponsors can avoid a pension crisis with smart and strategic decision making," Mercer Canada principal, financial strategy group, Andrew Whale, said.

Mercer said many DB scheme sponsors may not experience immediate cash implications where recent reform has lowered solvency funding requirements, such as in Ontario and Quebec. Whale said this has granted them "flexibility" to "take action with 2020 regulatory filings".

US judge rules Puerto Rican municipal pension law unenforceable

THE JUDGE RULES MUNICIPALITIES MUST PAY PENSION CONTRIBUTIONS

Written by: Jack Gray

A United States (US) judge has ruled that a new law, enacted in May 2019, that would eliminate Puerto Rican municipalities' requirement to pay for employee health and pension costs is void.

As reported by *Reuters*, Judge Laura Taylor Swain, who is hearing the case on Puerto Rico's bankruptcy, voided 'Law 29' as it violated the 2016 federal PROMESA Act, which established the Puerto Rican financial oversight board and a restructuring of the island's $120bn of debt and pension obligations.

The order took effect on 6 May 2020, after being delayed due to the additional challenges posed by the Covid-19 pandemic.

Law 29 was initially created to try and help localities deal with their ongoing cash issues by removing their obligation to reimburse the commonwealth for the pension costs of employees.

The board estimated that Puerto Rico's government would spend about $311m in the 2020 financial year to fund local pensions and healthcare – costs that the fiscal plan allocates to municipalities.

In her ruling, Judge Swain stated: "It is patently obvious that the elimination of the municipalities' obligation to reimburse the commonwealth for pension obligations is inconsistent with the 2019 fiscal plan."

Diary dates 2020

The latest events occurring across the European pensions market

PENSIONS AGE ANNUAL LONDON CONFERENCE 2020
17 September 2020
The Waldorf Hilton, London

The Pensions Age Annual London Conference, which has become a must-attend event in the UK pensions calendar, offers pension funds and those working in the pensions sector the opportunity to learn and network alongside their peers at one of the most challenging times in UK pensions history. This annual one-day conference is open to pension scheme managers, trustees, finance directors, advisers, pension and HR professionals.

pensionsage.com/autumnconference

ALFI EUROPEAN RISK MANAGEMENT CONFERENCE
26 October 2020
Chambre de Commerce, Luxembourg

The Association of the Luxembourg Fund Industry's (ALFI) European Risk Management Conference will see over 250 risk management professionals from across Europe learn about risk management know-how, experience and best-in-class approaches. Confirmed speakers include BlackRock Luxembourg director, Svetlana Butvina, Deloitte partner, Laurent Berliner, PwC Luxembourg partner, Olivier Carré, and ALRiM president, Dr Luc Neuberg.

events.alfi.lu/

EUROPEAN PENSIONS AWARDS 2020
10 December 2020
London Marriott Hotel, Grosvenor Square

The European Pensions Awards were launched to give recognition to the investment firms, consultancies and pension providers across Europe that have set professional standards in order to best serve European pension funds over the past year. The awards are free to enter and are open to any pension fund or firm that serves European pension funds. The winners will be announced at a gala dinner at the London Marriott Hotel in Grosvenor Square.

europeanpensions.net/ep/events

Not to miss...

IAPF INVESTMENT CONFERENCE 2020
14 September 2020
The Shelbourne Hotel, Dublin
iapf.ie/Events/default

PLSA ANNUAL CONFERENCE 2020
14 – 16 October 2020
Liverpool
plsa.co.uk/Events

WORLD PENSIONS FORUM
Q4 2020
Paris
worldpensions.org/events

PENSIONS AGE NORTHERN CONFERENCE
1 December 2020
Park Plaza, Leeds
pensionsage.com/northernconference

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

SARI ALANKO

The Finnish Centre for Pensions has appointed Sari Alanko as the new head of department of register services, effective 1 May 2020. Alanko was previously the supervisor of the development unit of the register services department. Since 2003, she has held various positions in register services and information management at the Finnish Centre for Pensions. Before joining the centre, Alanko worked in information management at Kesko.

MARCO WILLNER

NN Investment Partners has appointed Marco Willner as head of investment strategy, multi-asset. Reporting to head of multi-asset, Ewout van Schaick, he will be based in The Hague. He has more than 15 years of experience in the European asset management industry, specialising in investment strategy, asset allocation and quantitative investing. His appointment brings the team to full capacity.

NICOLAI TANGEN

Norges Bank Investment Management (NBIM), which is responsible for the investments of the Government Pension Fund Global, has revealed that Nicolai Tangen is to become its new chief executive officer, taking over the position from Yngve Slyngstad. He is currently CEO of AKO Capital, which he established in 2005, and is expected to take up the role in early September.

MARIA RYAN

HSBC Global Asset Management has appointed Maria Ryan to the newly created role of head of institutional sales for the UK, Scandinavia and the Middle East. Ryan will be responsible for developing and growing client relationships across the firm's institutional businesses in the UK, Scandinavia and the Middle East. She will be based in London and report to Brian Heyworth, global head of institutional business.

MICHAEL KJELLER

The boards of Folksam Life and Folksam Sak have appointed Michael Kjeller as new deputy CEO of Folksam. He has worked for the company since 1988 and was previously head of asset management and sustainability. Folksam Group CEO, Ylva Wessén, said Kjeller is a "wise and very competent person". He stated Kjeller is respected in the organisation and the insurance industry.

ANN PRENDERGAST

The Irish Association of Pension Funds (IAPF) has appointed Ann Prendergast as its new vice-chairperson. She will work alongside IAPF chairperson, Eunice Dreelan, of Irish Life Financial Services. Prendergast had previously served on the IAPF Investment Committee and joined council at the 2017 AGM. Holding a business studies degree from the University of Limerick, her career began at the Bank of Ireland.

TORSTEN KOPKE

Redington has named Torsten Köpke as a director in its global assets team. An internationally trusted adviser, Köpke brings over 20 years' experience in investment strategy and governance structure to the role. He has previously held roles with Aon Hewitt, Willis Towers Watson and FERI, most recently being managing director at Silverfern. With an initial focus on Germany, his role will help strengthen the company's European presence.

MARINO VALENSISE

The Cardano Group has appointed Marino Valensise as group chief investment officer (CIO). Bringing over 20 years' experience to the team, he will be responsible for overseeing investment strategies and portfolio construction for clients across the group. Based in the UK offices, he will also work alongside the LDI team in the Netherlands, led by Rik Klerkx.

KRISTIN MAGNUSSON BERNARD

The board of directors of Första AP-fonden have appointed Kristin Magnusson Bernard as CEO, replacing acting CEO, Teresa Isele. With over 10 years' experience, she is expected to assume the role from 1 September 2020, at the latest. Previously, she was Nordea Markets Sweden country senior executive, and has also held a number of senior positions at the European Central Bank in Frankfurt.

MARCO SMELTER

BMO Global Asset Management has announced the appointment of Marco Smelter to its fiduciary team. Smelter will join the team as director, portfolio manager for multi management, and will report directly to managing director and head of fiduciary investment (Netherlands), Bart Kujpers. The role will see him hold co-responsibility for portfolio construction and research. Previously, he was based at Cornerstone Investment Managers.

ANNELIE HELSING

The SH Pension board of directors has appointed Annelie Helsing as CEO. Joining with more than 25 years' experience, Helsing has previously held senior positions within AMF pension and has experience in Länsförsäkringar. Helsing replaced Lena Schelin, who had been acting CEO since November 2019. Previously, she was PRI Pension Guarantee business and marketing manager.

Chinese equities focus:
GOOD FORTUNES

Chinese equities: Reasons to be cheerful

In these extraordinary times, with an unprecedented pandemic holding the world to ransom, we believe the investment potential in Chinese equities remains nevertheless... extraordinary

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China – a break in the clouds

Francesca Fabrizi looks at why China could offer some promising investment opportunities for European pension funds in the long term, despite all the current doom and gloom

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INVESTMENT

Chinese equities: Reasons to be cheerful

In these extraordinary times, with an unprecedented pandemic holding the world to ransom, we believe the investment potential in Chinese equities remains nevertheless… extraordinary

That might sound debatable not too long after reading headlines about China's Q1 2020 GDP growth slowing down sharply due to the outbreak. But in our view, the long-term growth prospects of the country's vast, diverse equity markets make a very attractive proposition for active investors seeking to enhance the risk-return profile of their global portfolios.

For Chinese equities, we see seven strategic reasons to be cheerful.

1. Untapped opportunity in China's long-term (quality) growth path

Once the pandemic has passed, we see powerful domestic tailwinds such as urbanisation and a growing middle class continuing to drive China's GDP growth and productivity. Underpinning this, the government has firmly refocused its economic growth strategy away from sheer volume and speed and towards stable, high quality, higher value development.

In addition, despite China's economy accounting for 19% of global GDP, 12.4% of global trade and 11% of global consumption, Chinese equities remain significantly under-represented in global indices, and foreign ownership of A-shares – so far – remains small.

2. Chinese equities: A vast, accessible market

The total market capitalisation of Greater China onshore (Shanghai and Shenzhen stock exchanges) and offshore equity markets (Hong Kong stock exchange) is some USD 12 trillion. China A-shares account for about USD 8.5 trillion of listed market capitalisation, across some 3,800 stocks, making the onshore market one of the world's largest after the New York Stock Exchange and Nasdaq.

Unlike China offshore equity market, China A-share market still presents a relatively high number of momentum-driven retail investors. Yet in recent years, the retail/institutional balance is changing. The increasing participation of foreign capital will create a more balanced investor structure in the market. A higher institutional presence will help to improve corporate governance at China A-shares companies, which should benefit shareholders over the long term.

3. A-shares and H-shares: Complementary markets bringing diverse opportunities

China's onshore and offshore equity markets are complementary, with China A-shares providing more diversified access to structural growth opportunities. There is a significant difference in sector weights between the different types of shares.

While Hong Kong-listed companies have tended to be dominated by large, state-owned financial and energy firms, China A-shares provide more exposure to privately-owned companies in consumption-driven industries. Unlike H-shares, A-shares offer unique access to growth opportunities such as Chinese pharmaceutical companies providing diabetes treatments for the ageing population.

So, by investing in both China's A- and H-shares, investors can benefit from risk management via sector diversification and a broader opportunity set for alpha generation.

4. Under-explored market offers mispricing opportunities

Importantly, there is a lack of coverage of Chinese stocks by sell-side analysts. The quality of domestic broker coverage in A-shares also tends to be weak. Only 7% of onshore stocks are audited by the 'Big 4' global auditing firms.

A focus on environmental, social and governance (ESG) criteria is critical when investing. This is especially true in China, and for A-shares, where ESG analyses are still complicated by low levels of data availability. Despite some risk factors related to investing in Chinese companies (e.g. corporate governance and stock suspensions), Chinese policymakers are now making efforts to address these concerns, as they seek to attract more foreign investor participation.

Active managers, equipped with the resources to undertake their own on-the-ground research in China and who have a long-term investment horizon to benefit from the low market efficiency, should be well-placed to take advantage of the investment opportunity in both China offshore and China onshore.

5. A-shares: Different can mean good

After being long-closed to global investors, China A-shares have some features that set them apart from typical China exposure in a global portfolio. Typically, more than 90% of China A-share companies' revenue is domestically driven, and thus less sensitive to global macroeconomic trends – and global shocks. A-shares also have a low correlation to other global equities and this, plus ample liquidity, means they can provide an effective means for foreign investors to diversify their portfolios.

While exposure to Chinese equities can appear challenging from a risk-return perspective, the diversification in the portfolio mitigates this to some extent, such that risk-adjusted returns may actually improve. As a result, adding China A-shares can potentially enhance the risk-return profile for an emerging market (EM) portfolio as well as a China offshore equity portfolio.

6. Further inclusion in indices

The decision of the key global index providers (MSCI, FTSE, S&P) to include more China onshore companies in their indices was a significant milestone in the mainstream acceptance of Chinese equities in international investors' portfolios.

In our view, this inclusion helps support the renminbi and improve the China A-shares market's investor structure from being retail-focused to a more balanced mix of institutional and retail investors. We believe that the inclusion will likely improve China's capital market liberalisation and regulations.

7. Attractively valued

China A- and H-shares markets are reasonably priced relative both to those of developed equity markets and to their historical average. The MSCI China (offshore) and CSI 300 (onshore) indices are attractively valued at around 12.2x P/E and 11.0x for the 12-month forward P/E, respectively (as of 1 April 2020) which represents a discount compared with MSCI US, MSCI Europe and MSCI World indices.

Three structural trends for long-term sustainable opportunities

Technology innovation: China has shifted from cheap labour-based manufacturing towards medium to high-end manufacturing. This is further supported by the size of the domestic market, higher R&D spending and a vast talent pool. Examples include not only information technology (hardware, software), but also sectors related to capital goods, industrial automation, new industrials (e.g. electric vehicles, high-speed train).

Consumption upgrading: We see significant long-term growth opportunities for leading companies, not only in goods but also in services. A number of these domestic winners are already emerging as multinational corporates, supported by rising household incomes, low household debt and more diversified consumer profiles. The current COVID-19 crisis notwithstanding, we believe this will likely only accelerate in the next five to 10 years. Examples include premium consumer brands, healthcare, education, insurance and travel.

Industry consolidation in China in recent years is being driven by regulatory tightening on new capacities, environmental cost pressures, higher financing costs and structural and consumption upgrading. We believe this trend has longer to run in a slowing macroeconomic environment, and the emergence of leading companies in various sub-sectors should provide attractive investment opportunities. Faster acceleration in industry consolidation should play favourably for industry leaders over the long term. Examples include: cement, property, machinery, mining and chemicals.

Globally-backed local expertise

BNPP AM believes there is a significant investment opportunity in Chinese markets, driven by the growing acceptance of Chinese equities in institutional investors' portfolios, and the changing nature of China's economy, prompting the emergence of globally recognised Chinese companies. We also believe it requires local expertise to navigate the Chinese markets successfully. Our Greater China Equities team, based 'on-the-ground' in Shanghai and Hong Kong, manages or advises on assets totalling more than USD 1.3 billion (as of 30 April 2020) for local and international investors. In addition, three of the 25-strong BNPP AM Sustainability Centre are based in Hong Kong to support ESG integration and engagement. ■

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INVESTMENT

China – a break in the clouds

Francesca Fabrizi looks at why China could offer some promising investment opportunities for European pension funds in the long term, despite all the current doom and gloom

WRITTEN BY FRANCESCA FABRIZI

It's hard to find ways to describe what's been happening in the global economy in recent months without focusing too much on the negative; and anyone managing a pension fund portfolio may be tempted to believe that it's all bad news.

However, despite the unsteady markets, there are still opportunities to be had across the globe for pension funds looking to enhance the risk-adjusted returns of their global portfolios, particularly in the long term – China being a prime example.

As outlined on page 20, there are several strong strategic reasons to invest in Chinese equities, as well as structural trends which back-up the long-term sustainable opportunities offered by this vast, dynamic and diverse country. For pension funds and other institutional investors, one of the key features of this market is that onshore equities (which include stocks that are traded on the mainland Shanghai or Shenzhen stock exchanges, as opposed to offshore, which are listed on the Hong Kong stock exchange) are so much more accessible to global investors than ever before.

But while that may be the case, it is, for many European pension fund investors at least, still early days for them to take advantage of these opportunities, according to Willis Towers Watson senior director of investments, Tom Brooke-Smith.

"It's important to note that we remain in the early stages of Chinese onshore asset integration within a global investor's opportunity set. Chinese onshore markets are large, either the second or third largest in the world, and so naturally offer a number of interesting opportunities.

"However, they also remain immature from a number of perspectives, such as the development of a consistent bankruptcy code. Therefore, whilst we have made steps towards integrating Chinese assets within our client portfolios, we have remained relatively cautious to date. We have participated in government/policy bank bonds and selectively within equity markets," says Brooke-Smith. Both allocations, he adds, have been made on an active basis as the firm sees value in skilled active management, given the idiosyncrasies of the markets in question.

Looking ahead, however, interest from Europe's pension funds is likely to increase significantly from hereon in. Redington senior vice president, manager research, Oliver Wayne – who has worked with several European pension funds, helping advise them on standalone allocations to Chinese equities as well as via emerging markets allocations – agrees that, while up until recently it was difficult for European and other foreign investors to access the onshore market, this has now changed dramatically, meaning more clients are likely to want to take advantage.

"With increased financial liberalisation, the majority of the onshore market capitalisation is now easily accessible to outside investors. As a result, we expect to see further traction with clients on a forward-looking basis," he predicts.

So, with the onshore market having opened-up, what can these new opportunities potentially bring to European pension fund portfolios?

Historically, Chinese onshore equities provided investors with a diversification benefit relative to their other asset holdings, Brooke-Smith explains: "We see benefits to holding an allocation to this market from a structural perspective, assuming returns are attractive enough. We think there is a strong economic underpinning for this diversification, and so believe equities are an attractive portfolio holding if purchased at the right price."

The Chinese market, he qualifies, has been through several valuation swings over the course of the last decade and so market timing is essential to success. "As importantly," he adds, "active stock selection is also key. This is true from both a risk management perspective, where we place significant weight on a strong environmental, social and governance (ESG) process, and also on return generation by finding companies that are focused on generating shareholder value."

generating shareholder value."

This argument for active management is backed-up by Wayne, who believes there to be a strong case for an active approach in China. He argues: "The market is far more inefficient and under-researched than developed counterparts and, as such, we believe this creates a fertile hunting ground for stock pickers with a long-term view."

Redington has completed extensive on-the-ground research in China and the potential for scalable alpha is, in his view, unparalleled. "This view is predicated on the high dispersion of returns created by the deep retail investor base and the low experience levels of the domestic mutual fund managers," he adds.

An all-encompassing solution

The arguments for European pension funds to invest in Chinese equities are, therefore, plentiful; what is less clear is what approach they should take to get the most out of China's prospects. BNPP AM head of greater China equities, Caroline Yu Maurer, argues that pension funds should opt for an all-China equity solution in order to get access to the full opportunity set in Chinese equities, thereby maximizing returns potential.

Maurer explains: "Access to A-shares has never been easier for global investors. Historically, access was limited to large Chinese companies listed on global equity markets (e.g. Hong Kong), or cumbersome through capital-controlled investment programmes (e.g. QFII/RQFI)."

However, with the Stock Connect programme launched in 2014 linking the Shanghai/Shenzhen to Hong Kong markets, there is no restriction on repatriation, capital can be deployed quickly, and the eligible investment universe gathers over 1,500 stocks listed in Shanghai and Shenzhen, "offering abundant alpha opportunities," she says.

Alongside this, H-shares and American Depositary Receipts (ADRs) also provide appealing features. "H-shares invariably trade at lower prices than their equivalent listings on mainland exchanges, while ADRs also present opportunities particularly for large-cap technology-related names," she continues.

Therefore, by opting for an All-China equity solution, pension funds can benefit from relatively stable returns from China offshore equities, coupled with diversified opportunities and higher dispersion of returns from China A-shares.

In addition to the large opportunity set, A-shares provide more diversified access to structural growth opportunities, a complement to the China offshore exposure.

Yet, A- and H-shares have shown performance divergence, warns Maurer. Between 2003 and 2019, the CSI 300 index (China onshore) outperformed the MSCI China index (offshore) only six years out of 17 years. "As A-shares tend to be less sensitive to global sentiment, its correlation with the rest of the world remains low. Therefore, adding China A-Shares can potentially enhance the risk/return profile for an emerging market equity portfolio and even for a China offshore equity portfolio," she confirms.

ESG gaining ground

A further positive for China as an investment opportunity is its growing recognition of the importance of strong ESG practices, something that all European pension funds were increasingly focusing on before the crisis and will likely continue to do so going forward.

Maurer explains: "China is serious on ESG reporting, with regulators requiring companies to improve communication and transparency on their ESG risks."

There is, however, some way to go and, for a number of Chinese firms, ESG reporting still remains a box-ticking, compliance-driven exercise – all the more reason why the right expertise is essential. Maurer continues: "ESG analysis in China is complicated given the low levels of data availability and data quality. As China A-shares have been partially included in mainstream international indices, it is becoming particularly critical for global investors to know how to quantify and measure ESG analysis in China."

Maurer believes, as do many investors today, that companies with sound or improving ESG practices are typically of a higher quality and more likely to generate sustainable earnings over the long term. "Integrating an analysis of relevant and material ESG issues alongside financial analysis of companies should help investors achieve long-term investment objectives.

"Meanwhile, company engagement can help bridge data gaps, with a focus on material issues. Therefore, this stresses the importance of having the right resources to support the investment decisions," she concludes.

All in all, while in the short term the challenges are abundant for institutional investors today, a look into the longer term does offer some hope. As Brooke-Smith concludes: "We remain in the opening plays of Chinese capital market integration, but we believe this trend will continue over the coming years. China may not be linear in its opening up process, but the long-term direction is clear. As market access expands, new opportunities will arise for global investors." ■

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EIOPA

PEPP talk:

Designing a good product for EU citizens

European Insurance and Occupational Pensions Authority (EIOPA) coordinator for pensions policy, Sandra Hack, reflects on the continual evolution of the Pan-European Personal Pension Product (PEPP)

WRITTEN BY EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY (EIOPA) COORDINATOR FOR PENSIONS POLICY, SANDRA HACK

Modern, mobile European careers ask for innovative solutions to address the ever-growing pension gap. New forms of labour, part-time work and times of unemployment, often resulting in low disposable income and small savings, challenge current pension systems and risk inadequate retirement income for an increasing number of European citizens. Private pension savings are adaptable to non-standard, mobile types of labour and can enable reaching the individual's retirement objective.

The macro-economic environment with persistently low and negative yields in Europe requires re-thinking long-term savings and investments for retirement, in order to deliver on the individual's needs for retirement income. This entails outperforming inflation and providing adequate returns for stable future pensions. Long-term pension savings can finance the real economy and so the pension saver can participate in sustainable, long-term economic growth.

For building a Capital Markets Union for Europe, the European co-legislators put at the heart of the initiative the idea of a 'Pan-European Personal Pension Product' (PEPP), which is designed as a standard 'default' personal pension product for the European careers. The market potential of the PEPP had been estimated to reach up to €1 trillion.

What is needed to design a default pension product for Europe?

Standardising key features of pension solutions can have three benefits. Firstly, it can ensure that basic components are designed in a way to safeguard good pension outcomes; secondly, it helps consumers to better understand and to compare and benchmark pension solutions offered to them; and thirdly, it brings efficiency gains and cost savings to pension providers.

Standardised quality features of private pensions benefit both consumers and providers through the realisation of economies of scale, lower costs and an environment fostering both open and fair competition as well as innovation. Eventually, this is about reaching the right balance in a way that the mandatory standardised elements protect the interest of savers and lower information costs for providers, yet leaving sufficient flexibility and room for innovation.

Cost-effective pension solutions are in high demand in Europe, as the disposable income in many member states is limited and it needs to pay off to save even small amounts. Determinants of high costs in pension products are, in particular, distribution costs, as well as information and manufacturing costs, which are intrinsically linked to the complexity of products - and the lack of standardisation.

Providing relevant information to consumers, embracing the opportunities of digitalisation, and designing high-quality, enforceable standard product features level out information asymmetries and support the marketing of those products. Efficiency gains are needed, particularly at a time of low asset returns, to build a stronger market for private pensions. Economies of scale and risk diversification contribute to lowering costs and reaping efficiency gains.

Can private pension savings finance sustainable growth in Europe?

Pension providers have the potential to play a central role as drivers of efficient capital markets – as providing genuinely long-term financing, based on long-term savings of their customers. Incentivising long-term financing and investing, so called 'sustainable investments' – and their promotion amongst institutional investors – are at the centre of current policy considerations, with the appreciation of environmental, social and governance (ESG) factors as one of the European Commission's flagship initiatives.

Private household savings rates in the EU have remained at a stable level of 11-12 per cent of disposable income in recent years – and equally stable has been the allocation of household saving to one third to cash and deposits, and another third to insurance and pension products. In order to increase consumers' participation in economic growth, indirect investments in equity exposures, mitigating the risks of financial loss and establishing consumer trust could be one of the key elements of the solution.

Due to the long-term perspective on investments and retirement obligations, pension providers have developed different approaches to manage the risks for the individual saver to reach good returns and to stabilise the future retirement income. Approaches, such as life cycling or building reserves for a group of savers, mitigate the risks and the effects of market volatility, and therewith enable riskier illiquid and equity-type investments.

Using such risk-mitigation techniques let pension savers participate in the long-term returns of a wide range of asset classes, including, for example, infrastructure or private equity, overcoming individuals' risk aversion or biases towards avoiding the risk of financial loss. Promoting an inclusive approach to individuals' investments in the European financial markets may contribute to furthering the efficiencies of those financial markets and to financial stability in Europe.

How to enforce the PEPP's high quality features

Private pensions often are regarded as an inefficient market, where consumers' demand is not matched by adequate supply of suitable solutions. Regulation has to address agency conflicts and information asymmetry as shortcomings of an inefficient market. Conflicts of interests need to be acknowledged and the right incentives need to be put in place to facilitate optimised results for consumers. The main tools for enforcing these considerations are a robust regulatory framework, addressing the provider's governance, conduct and distribution rules, and establishing the necessary supervisory powers to monitor the market and intervene where necessary.

Designing a good product for the European consumer means enabling long-term good performance and pension outcomes whilst setting enforceable rules to monitor the effectiveness. Supervisors need to have in place an appropriate tool set to act swiftly and to – temporarily – restrict or prohibit the marketing, distribution or sale of deficient pension products or schemes. That is particularly sensitive – yet essential – in the financial sectors, and specifically in the pension sector, which is challenged by low consumer trust and high risk of significant negative effects on individuals and their standard of living in retirement – and eventually the financial stability of the sector.

Looking ahead

The growing pension gap creates two challenges for policymakers: making consumers aware of the need and providing for an appropriate framework for valuable and effective private pension products and schemes. To boost the take-up of a private pension product, tax incentives are a powerful tool to encourage consumers to save and to engage with their own retirement objective.

Private pension savings can positively contribute and enable adequate replacement rates in the future, only if the products and schemes are fair and when savings are indeed safe. Safety here is meant as trust enhancing, fair, cost-effective and transparently designed with the objective of ensuring stable and superior pension outcomes. At the same time, the pension solutions needs to be sufficiently flexible to cater for a European labour market that is characterised by increasing unconventional careers and heightened mobility of workers. For a European product, it is essential to ensure a level playing field for providers and products, with consistent and transparent enforcement mechanisms at a European level.

Private pension products have to be cost efficient, which can be achieved by reaching economies of scale, and should be attractive to the consumer, addressing behavioural biases like loss aversion. This leads to the need for smart 'default solutions', where a standardised set of high quality features is complemented by a few flexible components. Leaving room for innovation and flexibility is needed to help consumers make beneficial life choices and for providers to find superior solutions. Policy and prudential frameworks have to be capable of enforcing such high quality private pension solutions, building on the effective regulation and the provider's strong governance structures, enabling sustainable private pensions. ■

COUNTRY SPOTLIGHT GERMANY

Reform in a time of crisis

Whilst the German Pensions Commission's report is still warm from the press, its recommendations have provided less of a splash than many had hoped and could face further limits in the midst of Covid-19

WRITTEN BY SOPHIE SMITH

Pension systems around the world have been progressively adapting to suit growing and diverse member needs, and Germany is no exception, kicking off the decade with its final Pensions Commission report (GPC), published in March. But whilst the GPC's report is still warm from the press, its recommendations have provided less of a splash than many would have hoped, with DGB board member, Annelie Buntenbach, stating that the report had been "neither a blessing or a curse" for many workers. Fairr by Raisin head of pension products, Dr Alexander Kihm, also notes that "concrete recommendations" were generally sparse within the report.

Kihm clarifies that where there are recommendations, these were to be expected, and are generally aligned with the existing German pension system and policy. He highlights, however, that many of the more controversial topics have been postponed to a new commission in the future, the creation of which was a central recommendation of the report.

Primarily though, the report and commission have focused on statutory pension schemes, with many passages reading like a "keep it up," according to Mercer Germany chief actuary, Thomas Hagemann.

"In fact, the recommendations are too limited," he adds, "they do not include specific proposals or major drivers, and do not represent a boost for the pension system.

"On many points, the commission has not passed beyond considerations. Considerations on the different ways of adjusting entitlements and current benefits, and considerations on the standard age limit are presented, but these did not result in a specific recommendation."

This neglect for occupational schemes has been highlighted by a number of industry experts with ABA general secretary and CEO, Klaus Stiefermann, also stating that the report deals with such pension schemes "only marginally".

"As far as occupational pension schemes are concerned," he notes, "it is merely stated that their expansion is still unsatisfactory."

Reform in a time of crisis?

However, Deutsche Rentenversicherung Bund spokesperson, Dirk von der Heide, argues that in light of the current crisis, the commission's decision not to include concrete measures may be more "far-sighted than limited". And whilst the report itself was not delayed due to the ongoing Covid-19 pandemic, it seems likely that the creation of another commission, and many of the, albeit limited, recommendations, could face more delays and limitations, as a result of the crisis.

"The pandemic naturally affects all areas, including pension provision and thus also occupational pension schemes," emphasises Stiefermann. "As a funded system, it naturally also suffers from the current developments on the capital markets."

Adding to this, Hagemann clarifies that proposals requiring an additional financial effort could be "significantly delayed", also stating that whether there will be any significant development for the pension system in this legislative period "remains to be seen".

Some see the pandemic as less of an obstacle for the proposals however, with Willis Towers Watson Germany director of legal, tax and accounting, Dr Michael Karst, arguing that there should not be "substantial impact" on the GPC proposals.

"It is likely that the pandemic will accelerate e.g.

the implementation of a digital platform," he explains, acknowledging that it is not yet clear whether the pandemic will lead to changes to raise the first pillar pensions, with respect to the economic consequences of the crisis.

The pandemic also appears to have sped up discussions about how the industry calculates and underlies guarantees, especially for long-term commitments, adds Kihm, also highlighting the development of the Pan-European Personal Pension Product (Pepp) as another area to be monitored closely over the coming period.

A change already underway?

Of course, the GPC report is not the only driving force for change in the German pension system and, in fact, the report itself has highlighted much of the existing policy work and reform already in the pipeline.

"The main legislative initiative is a change for the insolvency protection of 'Pensionskassen' according to a decision of the Court of the European Union," adds Karst.

"This legislation is on track and will oblige employers to pay contributions to the insolvency protection agency (PSV) from 2020 or 2021 onwards. The coronavirus has so far had no impact on the introduction of this legislative change," he states.

However, Hagemann highlights discussions around the introduction of a basic pension as a crucial ongoing reform, adding that while the federal government has stood by the existing timeline, which would see this introduced before the end of this legislative period, it remains to be seen whether this will happen in practice considering the crisis.

"At the moment," he clarifies, "immediate supervisory measures to mitigate the consequences of the coronavirus crisis can be observed; for example, with regard to deadlines for reports and funding obligations."

Indeed, von der Heide also highlights the pressing issues that have arisen in the German pension system as a result of the current crisis, such as concerns around the impact on those returning to work to support medical, or food collection efforts. Diverting attention and resources to deal with these concerns, and the broader impact of the Covid-19 pandemic, could mean that other ongoing plans, such as those for a European or German tracking system, could be delayed, Stiefermann warns, also stressing that financing could become more difficult in view of the "enormous challenges" facing national budgets.

"AS FAR AS OCCUPATIONAL PENSION SCHEMES ARE CONCERNED, IT IS MERELY STATED THAT THEIR EXPANSION IS STILL UNSATISFACTORY"

"In the crisis, other issues have higher priorities," agrees Hagemann. "This will lead to delays in all projects, especially when they require an additional financial effort."

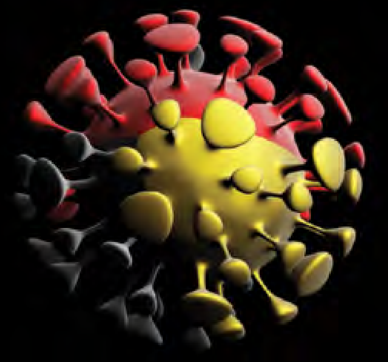
Although, Hagemann argues that the general cross-pillar pension information is "necessary" and will "certainly be introduced" despite the current crisis. However, he acknowledges that the European Tracking Service is not so important as only a few employees work abroad, and therefore may face more limitations.

Navigating the long grass

Despite any limitations or diverted resources stemming from the current crisis, there is a clear need for greater reform in the occupational pensions space in the German pension system. And while the GPC report may have been relatively limited in its recommendations, industry experts are less restrained.

"The headline should be: 'Stability for the first pillar system, simplifying the occupational pension system with respecting support for employers and employees to raise participation'," argues Karst, highlighting the careful balance that must be achieved in the cross pillar system. Adding to this, Stiefermann also acknowledges that the pay-as-you-go state pension will continue to be the "mainstay of the German pension system".

"However," he clarifies, "occupational pension provision



"CHANGE THEN, IS CLEARLY NEEDED, NOT ONLY IN THE SPECIFIC TECHNICAL ISSUES, BUT ALSO PERHAPS IN TERMS OF BROADER PRIORITIES AND POLICY"

as a second pillar with its great efficiency and collective approach should, wherever possible, be the first choice for supplementary provision. It should therefore be promoted more strongly than private pension provision. It also deserves greater commitment from the social partners."

Change then, is clearly needed, not only in the specific technical issues, but also perhaps in terms of broader priorities and policy. But with focuses split between a number of broader goals, and no unanimous verdict on the most vital change to be made, just what form any future changes could take, especially amid so many other pressing priorities, remains to be seen. ■

A Ripple not a splash

The start of the year had been expected to bring with it some of the first social partner pension (SPP) models, with Talanx AG and Vereinte Dienstleistungsgewerkschaft (Ver.Di) expected to have its agreement for one finalised in January 2020.

Yet, progress remains limited according to Karst, who emphasises that no social partner pension model has been implemented in the market so far. "Nevertheless," he adds, there is interest in the market, and we expect first social partner models in the market in the second half of 2020 or the first half of 2021."

However, Kihm warns that while there have been various initiatives published and 'live', this has been limited to a website level, with no "concrete financial products" yet in place.

"So there's no uptake visible, lots of talk, but not much action," Kihm explains. "It's remarkable that there is only one concrete SPP in Germany by Talanx (insurance company) and Ver.Di (services union).

"As a limitation, the mandatory parity of investment committees between employers and trade unions is perceived as a main barrier; and the unions are not especially keen on guarantee-free products."

This is echoed by Stiefermann, who emphasises that the SPP is "uncharted territory", arguing that social partners must participate in the steering process, and must also agree to use part of the financial mass of a collective bargaining round to finance the SPP.

This means that an SPP takes time, and while Stiefermann acknodwledges there are technical changes still needed, he emphasises that "what is really crucial", is that the social partners actually want an SPP, as they are the ones to organise financing, management and administration.

According to Kihm though, there is a low level of interest in SPP models from trade unions, thanks to the complex structure, which can raise barriers for market entrants. He explains: "To establish new products and providers, preceding commitments are required from both collective bargaining parties… the portability of current collective parties into SPP would greatly enhance uptake and yet, at the same time, it could create moral hazard by taking away the guarantees."

However, Karst notes that the current legislative framework has to be applied in first cases to identify where potential changes could make sense. "Therefore this model does not need changes," he explains, "but time for negotiations and implementation."

Karst continues: "Due to the complexity, politicians should give more time to implement this type of occupational systems. The GPC is heading very clearly in this direction by stating the year 2025 for the evaluation of participation rates, but it is likely that even these five years may not be enough to see a substantial raise of participation rates in the market due to SPP models.

"To raise the participation rates, it would be much more important to promote and support the existing occupational system with necessary adaptations."

However, as Hagemann points out, the GPC has not touched upon the SPP at all, instead choosing to introduce the Deutschlandrente as a "totally new model".

"If a model which has just been introduced does not develop, should a new one be introduced immediately, or should we first analyse what is lacking in the first model? The Commission has obviously not asked itself this question."

INTERVIEW

Adapting amid a crisis

Deutsche Rentenversicherung Bund spokesperson, Dirk von der Heide**, sits down with** *European Pensions* **reporter,** Sophie Smith**, to discuss the recent German Pensions Commission's report, and how the system's adaptability and long-term outlook can help it see past the current crisis**

WRITTEN BY SOPHIE SMITH

The Pensions Commission recently published a report on the German pension system. What were the key points and recommendations from within this report, and what could they mean for the future of pensions in Germany?

The commission has emphasised, with the consensus of all its members, that the statutory pension scheme is the core of old-age provision in Germany, and also that it is future-proof, thanks to the pay-as-you-go system and its adaptability.

This unanimous assessment by the politicians, academics and social partners in the commission is a positive signal to pensioners – but also to young people, who can be confident that the pension insurance system will be stable in the long term.

The recommendations are, above all, proposals for the framework and procedure in which politicians should take decisions on the future of old-age provision.

How has the current pandemic impacted the recommendations and next steps for the report and pension policy in Germany?

First of all, it is important to realise that the pandemic could change many of the parameters that are decisive for old-age provision; this makes it clear just how forward-looking the Pensions Commission was.

It did not call for concrete political measures for the next two or three decades against a background of economic forecasts presented six months ago, but rather, said that policymakers should decide on this in a timely manner a few years in advance.

If six months ago the commission had proposed specifications for the contribution rate or the age limit for 2030, these recommendations would probably already be obsolete today, in view of the coronavirus pandemic.

It is highly probable that the current crisis will also have long-term effects on wage trends, labour markets and capital markets – in other words, on the essential framework conditions for both the pay-as-you-go and the funded old-age provision.

In contrast, however, the commission's proposals on the procedure for how the necessary decisions on the further development of old-age provision should be taken by policymakers are likely to be helpful, regardless of the pandemic.

What direction should German pension policy be heading in after the pandemic?

The most important prerequisite for the pension system to remain functional and thus sustainable in the long term is the system's ability to adapt to changing conditions.

This applies to all old-age security systems, e.g. both the statutory pension insurance and the other first-pillar systems, as well as the funded supplementary pension schemes in the second and third pillars.

For the statutory pension insurance, there is a need for adaptation, especially in view of demographic change. Much has already been done here in recent decades as part of several major pension reforms, such as raising the age limits or taking account of the demographic situation in the pension adjustment formula. These reform approaches have been quite successful.

This has prevented a stronger increase in contribution rates due to demographic change, and should politicians see a need for further action in the future, it would be possible to build on this or use other adjusting screws in pension law.

However, from the point of view of occupational pension schemes and private provision, the most important change in the general environment at present is probably the ongoing phase of low interest rates. Whether the funded pillars of old-age provision can successfully adapt to this change remains to be seen.

More broadly though, all three pillars are also faced with the need to adapt to changes in the world of work, which is sometimes discussed in a shortened form under the heading of "platform economy". Here, too, the statutory pension scheme, as well as a funded old-age provision, must adapt to the changed conditions to ensure they can continue to play their part in providing for people. ■

INVESTMENT

Francesca Fabrizi **explores how Nordic pension funds, often regarded as leading lights in the European pensions space, are handling the current crisis**

WRITTEN BY FRANCESCA FABRIZI

Nordic pension funds – business as (un)usual

Nordic pension funds are some of the most sophisticated in the world, setting the bar high when it comes to pension fund management and investment expertise. But the Covid-19 pandemic has had a far-reaching impact across the globe, and even the most proficient and forward-looking of institutional investors are unlikely to come out of these difficult months unscathed.

So how have these most revered pension fund markets coped with the coronavirus outbreak, and what is the general feeling in the Nordic pensions space?

"Most Nordic funds seem to just weather the storm, making little changes," says BNP Paribas Asset Management client relationship manager, Johan Skoglund.

"Appetite for new investments seems quite low and most are focused on monitoring existing investments and managers."

There have been occasions of funds taking advantage of the sell-off, he continues, but this is more of an exception. "Given the fairly good solvency situation for most pension funds, they haven´t been forced to sell for most parts," he says.

This positive sentiment is echoed by PensionsEurope secretary general/CEO, Matti Leppälä. He believes that Nordic pension funds are in a much better place than most to deal with this crisis.

"Their solvency and funding levels have been high; they had excellent returns in 2019; their investment teams are sophisticated; and their governance models support long-term views that enable dealing with difficult situations, as does their role in the Nordic welfare societies," he argues.

But, while the overall sentiment may be positive, that's not to say Nordic pension funds haven't been impacted. In Finland, for example, the total amount of pension fund assets at the end of 2019 was €215 billion and half of them were in equities. The crisis had wiped out about €20 billion by April.

But due to the set-up of the Finnish pension system, the main focus for pension funds now is business continuity and securing funding in the long term, explains Leppälä."The Finnish pension system is a mix of pay-as-you-go (PAYG) and funded, and the PAYG part is and remains much bigger." Thus, he adds, the role of contributions is more important than the investment returns, and it is crucial that the real economy recovers and supports a high level of employment as quickly as possible.

The role of investments is important too, he qualifies. "In 2019, about one-fifth of the annual pension expenditure was covered from them and it is planned that this portion will grow into one quarter in the future," he says.

At the time of writing, the Q1 results for Finland were coming in and they were showing losses of between -7.5 per cent and -10.4 per cent. Leppälä comments: "Private-sector funds that have solvency requirements still have a healthy solvency situation due to the excellent investment returns in 2019. Pension funds have been able to manage the liquidity they need." So, all in all, while the Finnish pension funds have concerns, they are confident that they and the Finnish pension system will remain resilient, and weather this crisis well.

As for other countries in the Nordic space, they are similarly working hard to keep things on track. Every pension fund in Europe has been rocked and, as Willis Towers Watson Denmark leader of the investment practice, Morten Linde, accurately puts it, "it's business as usual – although nothing is as usual".

In Denmark, for example, while strategies haven't necessarily changed, tactical asset allocation has been adapted to the situation and rebalancing is taking place. "There are more clients changing their risk profiles, but it's difficult to say whether it's towards higher or lower risk profiles – since some of them see the situation as a threat and want to de-risk and others see it as a possibility to add risk. Our advice is to stick with the long-term investment strategy and not to time markets, which is what the majority do," says Linde.

Battling low interest rates

One of the biggest challenges facing pension funds in the Nordic region and further afield, before the coronavirus took hold, was the search for returns in the low interest rate environment. This, says Skoglund, made funds abandon government bonds for more high-yielding bonds, invest more in alternatives and real estate, and also uphold a substantial equity allocation, even at quite high valuations. That battle against low interest rates continues, but how the crisis will affect things in terms of asset allocation going forward, he argues, remains to be seen.

"So far, Nordic pension funds have not, in general, made any major changes and the underlying challenge of finding returns prevails. Interest rates are as low as ever, but equity risk premia and credit spreads have widened. Whether this will prompt any long-lasting changes to their investment strategies is too early to say," he adds.

The effect of the crisis on illiquid investments, which is a part of the portfolios that has increased over recent years, is also yet to be seen.

Max Matthiesen (part of Willis Towers Watson in Sweden) head of investments, Jon Arnell, agrees that one of the biggest challenges facing pension funds pre-crisis was the low interest rates, "and one way to deal with that has been to diversify into more alternatives like private debt and direct investing".

Going forward, he says, they will not change their investment approach, but more adapt to the markets. "You should stick to your long-term focus and continue to work with the portfolio in terms of diversifying between and within different asset classes," he advises.

In Denmark specifically, Linde concurs that the low interest rates pre-crisis created significant challenges for pension funds, causing a general move from guaranteed to market-rate products.

"The continued dropping of interest rates has caused pension funds to look elsewhere and invest in alternative non-public traded actives. Real estate is one that has always been a part of the portfolio but is now a bigger part. Infrastructure, private equity and direct lending are now also a larger part of the portfolios," says Linde.

For some time, there has been discussion about the pricing of these alternatives and the problem with the delay of pricing due to them not being publicly traded. "The coronavirus crisis and its larger volatility has heightened this discussion," he adds.

Even in Finland where, although 2019 was a record investment return year, there have been debates about how to enable the pension system to increase returns going forward given the low interest rate dilemma.

Finnish Centre for Pensions former managing director, Jukka Rantala, produced a study in January that pointed out the conflict between the prevalent low interest rate environment and the expected returns, and the legal framework that restricts pension fund investments in assets with higher expected returns than in fixed income.

The report presented three possible options: increasing solvency capitals; introducing more flexibility in funding requirements; and easing solvency requirements. The ongoing crisis will undoubtedly have an impact on how and when this type of reform progresses.

ESG

Another pre-crisis trend prevalent in the Nordic pension space was the spotlight on sustainability and ESG-focused investing which, says Arnell, will continue to take market share in Sweden and become an even more integrated part of investment strategies: "It was a strong trend before the market turmoil, and it will continue to be one going forward."

Similarly, in Denmark, there was a focus on the development of climate and green lifecycle products. "Two pension funds introduced products before the coronavirus crisis and three are coming with products this summer. The coronavirus crisis hasn't changed this, but whether the demand has changed is yet to show," says Linde.

Learning lessons

Looking ahead, it remains to be seen how significantly the crisis will impact the Nordic space, but even if these pensions funds are fit to weather the storm, Arnell believes lessons can still be learned from these uncertain times.

"One challenge has been the long bull market, which has led to too many investors taking on too much risk. Or in other words, taking on risks they didn't see or believed to be risks. A downturn is healthy that way as it shakes out the weak cards," he argues.

Also, Arnell says, many investors have had too much equity-like exposure, given the low rate environment, which in hindsight was too risky. "Going forward, at least we will dig deeper into this topic."

In addition to forcing some investors to re-think their behaviour, Skoglund argues that there may be opportunities for Nordic pension funds going forward: "To quote Winston Churchill – 'never waste a good crisis'. Depending on the solvency situation, it may be wise to make use of the situation and look for undervalued long-term investments. This can be in terms of assets that have sold off too much but also asset classes with superior long-term growth prospects that are not fully priced." ■

Currency management focus:
LOOKING THROUGH A NEW LENS

ESG risk factors – can they help forecast exchange rates?

Over the past decade, 'socially responsible' investing has become a key objective for pension funds globally. Mesirow Financial looks at whether a company's ESG risk rating can help forecast exchange rates

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In a class of its own?

Whether welcome or not, currency exposure is a guarantee for any pension scheme with international investment exposure. Natalie Tuck looks at how Europe's pension funds can take advantage of it and minimise the risks associated with such exposure

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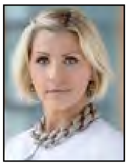
INVESTMENT

ESG Risk Factors – Can they help forecast exchange rates?

Over the past decade, 'socially responsible' investing has become a key objective of pension funds globally. Environmental, social and governance (ESG) risk ratings have enabled investors to incorporate 'non-tangible' information about a company, such as their environmental and employee welfare policies, into their investment decisions



WRITTEN BY MESIROW FINANCIAL SENIOR VICE PRESIDENT, CURRENCY SPECIALIST, AMY MIDDLETON

ESG and the currency markets:

Traditionally, ESG ratings have only been published at a corporate-level. However, ESG ratings at a country-by-country level are now available. In this article we take a preliminary look at whether this data could be useful in predicting the path of a country's currency.

First, let's conjecture how a country's standing in terms of ESG matters could potentially impact the price of its currency:

1. Countries that have healthy, productive and stable workforces are more likely to have a societal framework conducive to a flourishing economy versus countries whose workforce is the opposite. A corollary to this are countries with higher ESG scores may be more competitive (and have stronger currencies) longer term than countries with lower ESG scores.
2. Countries with good environmental standards and/or stable governance in terms of financial, judicial and political systems, are often classified by investors as lower risk than countries with the contrary. Therefore, countries that score higher on ESG factors may attract more investment and have stronger currencies than those countries who score poorly.

ESG and currency: Research so far

As country-level ESG factors are relatively new, there is limited research of the use of ESG country factors in the currency markets. However, in 2019 a paper by Baker, Alves and Morey (2020) found evidence supporting the hypothesis that the currencies of countries with high ESG country-ratings performed significantly better than the currencies of countries with low ESG country-ratings.

Is there a link between a country's ESG rating and its currency?

Creating an ESG currency basket:

Like Baker et al (2020), we used the MSCI ESG Government ratings but concentrated our efforts on the developed currencies of: AUD, CAD, CHF, EUR, GBP, JPY, NZD. We created a systematic strategy which, on an individual country basis, creates a buy signal for that country's currency if the most recent ESG value has increased the previous year and a sell signal if its most recent ESG value has decreased since the prior year. We effectively tested the hypothesis that a country that has an increasing (decreasing) ESG country-value will, over the following year, see an appreciation (depreciation) in its exchange rate.

The period under study is January 2009 to December 2019. All trades are versus the US Dollar; the returns

Figure 1. Hypothetical Performance of an ESG Currency Basket and a Multi-Strategy Currency Factor Portfolio.

		Multi-Strategy Currency Factor	
	ESG Strategy Currency Basket	Original Weights	Weights adjusted to include allocation to the ESG Basket
Annualised Return	1.90%	2.52%	2.37%
Annualised Standard Deviation	5.59%	2.85%	2.77%
Return/Risk	0.34	0.89	0.85
Max Drawdown	-8.52%	-4.15%	-3.18%
Best month	7.01%	3.68%	3.74%
Worst month	-5.50%	-1.54%	-2.49%
Annualised Return	1.90%	2.52%	2.37%

Figure 2. Hypothetical Net Asset Value of an ESG Currency Basket and a Multi-Strategy Currency Factor Portfolio.

of the strategy are calculated individually on each of the seven currencies (against the USD) and then equally-weighted to create the basket return.

The results of this analysis can be seen in the second column of Figure 1. Over the period in question, the ESG currency strategy basket achieved a positive annualized return of 1.90%. The progression of the net asset value of the strategy can be seen in Figure 2.

The signal in an ESG currency strategy emanates from a source which is very different to the most popular currency trading styles of carry, value and trend. As such, adding an ESG strategy to a multi-strategy currency portfolio may result in diversification benefits.

Using the single style currency factors from Middleton (2019) namely carry, value and momentum, we calculated the correlation coefficients with the ESG currency basket over the period in question. It was not unexpected to see that the correlation between the ESG strategy was low at 0.19 and 0.25 with the carry and value factors respectively, and negative with respect to the momentum factor at -0.23.

In Middleton (2019) the three styles of carry, value and momentum were equally-weighted to produce a multi-strategy factor and the performance of this can be seen in column 3 of Figure 1 with the progression of the net asset value shown in Figure 2.

To assess whether adding the ESG strategy would have a beneficial effect on diversification, the multi-strategy was reweighted to 25% on carry, value and momentum and the additional 25% allocated to the ESG strategy. The results of this can be seen in the fourth column of Figure 1 and also in the net asset value chart in Figure 2.

Overall, adding the ESG strategy did little to change the overall performance of the multi-strategy currency factor portfolio with the return to risk of the original weighting being roughly in line with that of the re-weighted one, 0.89 versus 0.85. However, the maximum drawdown of the re-weighted multi-strategy did decrease by approximately a quarter to -3.18%.

In addition, Figure 2 shows that the value-add of including an allocation to the ESG strategy varied: between 2009 to 2012 it detracted performance versus the original multi-strategy factor, through 2011 to 2014 it enhanced performance but has detracted performance since. This suggests that if an allocation to an ESG currency basket could be varied strategically within an already diversified currency strategy portfolio, it may prove beneficial to overall returns.

Traditionally it has been difficult for investors to include ESG information into their currency investment approaches. This has changed over recent times though with the advent of country-wide ESG ratings.

Whilst an ESG strategy currency basket may not produce enough return-to-risk characteristics to warrant an investment in insolation, it may have diversification benefits.

In the case of ESG applied to traditional asset classes, it is unusual for an investor to demand a strategy that is entirely ESG-orientated. Instead, the importance is more about integrating ESG considerations into the overall investment process.

There is no reason to believe investors in currency would think any differently and we have seen how an ESG currency basket exhibits low or negative correlation with the mainstream currency strategies of carry, value and trend. This suggests, therefore, that a framework to incorporate an ESG currency strategy into an already diversified currency portfolio could be of interest to investors and therefore an interesting area for future research. ■

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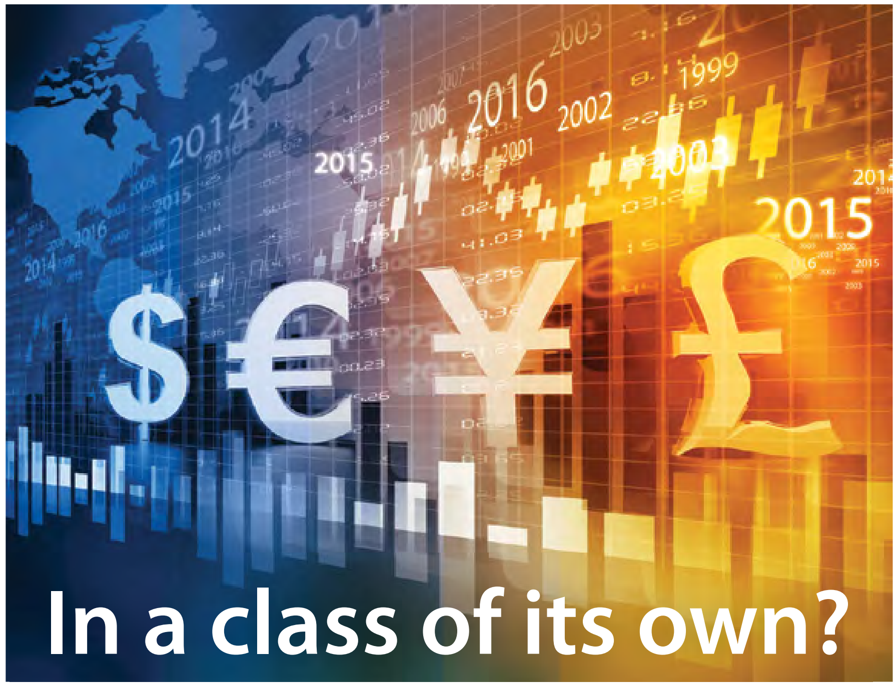

In a class of its own?

INVESTMENT

Whether welcome or not, currency exposure is a guarantee for any pension scheme with international investment exposure. Natalie Tuck **looks at how Europe's pension funds can take advantage of it and minimise the risks associated with such exposure**

WRITTEN BY NATALIE TUCK

Currency exposure. For pension funds, or any investor with international investments, it's always going to be there. It's by no means insignificant either; with an increasingly global outlook, many pension fund portfolios will have a large percentage of international holdings. It's what pension funds choose to do about this exposure that matters.

As Mesirow Financial, head of portfolio management and research, currency management, Uto Shinohara, CFA, notes: "As the world has become more interconnected, pension funds have increased their allocations towards international investments in search of more opportunity and to diversify their portfolios."

These foreign investments, he says, include a currency component as a by-product, as performance is comprised of both the asset return and the currency return. Of course, as Shinohara says, there are risks associated with currency exposure, which sees funds employing various hedging strategies to manage such risk. "Currency risk management strategies span the risk spectrum, from passive hedging to dynamic hedging, depending upon the risk appetite and return goals of the pension fund," he adds.

However, pension funds should not just look at currency as a risk that needs to be managed, and many don't. Shinohara says that funds will often include return-seeking currency strategies in their alternatives sleeve, as currency has shown to be uncorrelated to the major asset classes.

An age-old debate

It's an age-old debate; is currency an asset class in its own right? Sweden's Sjunde AP-fonden (AP7) head of fixed income, FX and alpha, Pontus von Essen, says his fund does see it as a standalone asset class, "in the sense that it can contribute to the building of a portfolio".

"If you compare currency to other asset classes it stands out in several ways. For example, compared to equities or bonds there are much fewer individual components to take positions in which is a negative. On the other hand it is very liquid, which is a positive since it makes large position sizes possible," he explains.

In contrast, Aon Netherlands senior investment consultant, Thierry Rozier, does not think Dutch pension schemes see currency as an asset class in its own right. This is because in general, he says, Dutch pension funds see currency risk as unrewarded risk. However, this does not mean that schemes do not have any currency management strategies.

Risk management strategies

"As you would imagine, pension funds are involved in currency management to varying degrees," Record Currency Management CEO, Leslie Hill, notes. "On the risk management side there are those at one end of the spectrum who believe that currency will 'come out in the wash' in the long term and so they choose not to hedge their foreign currency exposures."

"Others see the short- and medium-term volatility that currency introduces into their portfolio as highly undesirable and therefore choose to hedge some (or all) of their risk, either passively or actively," she adds.

Rozier says that many Dutch pension funds choose to hedge fully or part of the risk caused by currency exposure. "It is a strategy for risk management and a lot of pension funds with low funding levels choose to fully hedge the exposure. This is mainly on the US dollar, British pound and the Japanese yen," he notes.

Whereas, von Essen says AP7 does not see the need to apply a static currency hedge to its investments as the fund is a long-term owner and its assets are highly yielding, he says.

"AP7 monitors currency exposure derived from investments but does not apply a static currency hedging programme since we believe that, over the longer term, that will cost more than it will give in return. We therefore normally run 100 per cent open currency risk in our fund. If we think a particular currency exposure warrants hedging due to mispricing or other issues such as political risk, we can do that."

Whatever a pension fund's opinion, however, in the current economic climate with the effects of the Covid-19 pandemic weighing down on schemes, it may be useful to have some kind of currency risk management strategy.

Shinohara states: "As with equities, the Covid-19 pandemic has elevated foreign exchange (FX) volatility to high levels at great speed. International equity portfolios have been especially susceptible to this elevated risk as both the equity and currency components have been extremely volatile.

"In times of crisis, correlations can break down and relationships can become uncertain, highlighting the need for having a currency risk policy in place before such an event occurs."

Return-seeking strategies

When it comes to return-seeking strategies, Hill says that it is many of the larger and sophisticated pension funds that adopt such approaches. "These funds either have an explicit allocation to currency strategies within their strategic asset allocation, or they incorporate currency into portfolios such as a larger multi-asset risk factor portfolio, or absolute-return portfolios."

When it comes to searching for alpha, Rozier believes currency has a limited role within actively-managed bond or equity portfolios with currency management as an overlay. Using overlays is something that AP7 has been doing for more than a decade, von Essen adds.

"At AP7 we have been implementing unfunded strategies, as overlays to our long-only portfolio, for more than 10 years and currency has always been a part of that. We see currency exposure as a risk that we need to monitor, as well as a space where we can earn alpha from the markets."

Explaining in more detail how pension funds can use currency as part of a return-seeking function, Shinohara says: "Currency factor strategies and currency alpha strategies can add return while helping to diversify the fund's portfolio. Factor strategies typically exploit the well-known factors of carry, value, and momentum to represent currency.

"Currency alpha strategies cover a wide range of styles, from fundamental to technical to discretionary, where skilled managers can exploit opportunities in a market predominantly made up of passive price-takers. Currency-return strategies are highly liquid and tend to be uncorrelated to the major asset classes, making them an effective diversifier within a fund's portfolio."

Costs

In terms of cost, Record Currency Management global head of sales and head of client team, Sally Francis-Cole, says trading costs are typically the main type associated with running a currency programme.

"If not well-managed and monitored, the cost of poor execution can quickly become disproportionately high. As such, it is important for pension funds to have clarity and transparency around costs and charges across their entire portfolio. This is particularly true in currency as the main costs are often implicit in the rate at which a transaction is carried out, as opposed to explicit commissions or charges, and can be hidden away in obscure benchmarks and difficult to pinpoint easily," she adds.

For example, while the overall transaction costs of a currency hedging portfolio should be in the low single digit basis points, small slippage in execution (eg 2 bps) can quickly accumulate in a programme that rolls 12 times a year using monthly contracts (eg 12 x 2 bps = 24 bps p.a.).

"Another cost is obviously the management fees paid directly to the asset manager. Here it is important to look for managers who offer value for their service, and this doesn't always mean the managers who will perform the service at the lowest fee. Often this means finding managers who focus on minimising costs and maximising value; these managers are often the most innovative and the quickest to respond to and exploit the ever-changing landscape of the FX markets," Francis-Cole adds. ■

INTERVIEW

Turning the tide

Duncan Ferris speaks to Finnish Pension Alliance (Tela) senior adviser, Janne Pelkonen, about the organisation's aims, coronavirus and dealing with demographic change

WRITTEN BY DUNCAN FERRIS

What are Tela's objectives and how successful has it been in implementing its strategy?

We're now in the midst of creating a new strategy for the next few years but I would have to say that the main goal is to strive for not just financial, but also social stability of the pension system. We are in close contact with those who design the pension legislation, our social partners, but also with parliament and the various political parties, as well as the Social and Health Ministry, and the Financial Ministry.

I guess you could call us a lobbying organisation, we create information for the decision-makers and we try to create valid topical information that's also trustworthy. I think we've been quite successful in this and we have been given all kinds of reporting duties concerning how to develop the pension model by the social partners.

The second part of what we do, aside from affecting future legislation, is taking part in public discourse about pensions. We've been quite brave by bringing topics that are usually considered tough or difficult for pension institutions into the public conversation, such as generational equality. We've also engaged youth organisations and pensioner organisations in public discussions, and so have managed to accumulate quite a bit of social capital.

We were also one of the first in Finland to bring into the public discourse that we are in the midst of a demographic revolution, a quiet revolution. Within the past 10 years, especially during the past five years, our fertility rate has dropped dramatically, and it went unnoticed for a long time. We have tried to revive a discussion of population policies on birth rates, immigration and other things that affect the demographic situation.

If, in the long run, our main goal and priority is to keep our pension model stable then the demographic issue is the most important. This is something we have tried to discus with all kinds of different stakeholders, so we don't just talk about pensions but also the underlying societal developments.

How much has Tela's work been affected by the coronavirus crisis?

There are all kinds of procedures still going on regarding preparing future legislation. One of the major things is a project that started in 2017 and is going to be complete in approximately 10 years. This is the consolidation of public and private earnings-related pension systems in Finland.

The benefits of the insured beneficiaries are largely the same between the public and private sectors, but the funding is different. We have company-based and industry-wide pension plans with private-sector pension insurance companies and then there is the state, the church and the municipalities at the public level.

These two sectors are going to be married. They are already engaged in the sense that this process started back in 2017 and now it's all talk about actuarial factors, how the funds are going to be transferred and whether there will be any subsidies to the private sector.

This last factor is because 80 per cent of the public sector workers are female and the have longer life expectancies. There is also the issue of legacy, in that there used to be better benefits within the public sector. All kinds of things are going to have to be examined and researched, even during this coronavirus crisis!

What pension-related measures have been put in place during the coronavirus crisis?

Measures have been prepared and implemented extremely rapidly in just a few weeks. The social partners agreed to a contract that included labour laws and a lowering of contribution levels by 2.6 percentage points until the end of the year, starting from May. These will be collected back afterwards.

Around 10 per cent of our members' assets under management, which stood at approximately €215 billion at the end of 2019, will not collect rent from restaurant owners for the real estate they own during April and May due to the government's shutdown of these businesses. It's also permitted for entrepreneurs or corporations to postpone their mandatory pension insurance contributions for three months. These have been the most urgent measures.

What approach is Tela taking to solve Finland's demographic issues?

We have cooperated with a research agency called the Family Federation of Finland, which is preparing a population policy programme for Finland, and is probably going to be published next September. We have tried to raise awareness on the effects of demographic issues, not just on our pensions but on our labour markets. We're going to lose close to 1 per cent of our economic growth every year during the next decades.

We are also examining how it affects our social security system because the demographic developments are going to leave us with fewer working age people and more pensionable age people. This involves examining different age cohorts and how different generations contribute to society through taxes or tax-like contributions, and what they get in return.

We're looking at what we can learn from other countries, such as Japan, and how they have managed to adapt to different demographic situations. Regional effects are also being considered, because in Finland the population is packing into cities, and the countryside is going to look like an episode of *The Walking Dead* in a couple of decades, though with slightly fewer zombies.

Last year the government changed, and we tried to bring this demographic issue into politics, but it's a hard thing to do. Social policies and discussions to do with birth rates are difficult because some people perceive it as such a private issue. Millennials can feel like they are being blamed for not bringing enough children into this world and paying pension contributions, so we have tried to avoid a blame game and use other kinds of discussion.

Finland's fertility rate used to be 1.8, among the highest birth rates in Europe; still not enough to sustain a population but we also had immigration, which meant our population rose steadily. Now it's 1.4 and one quarter of our age cohorts are 24 per cent lower than they were 10 years ago. In time, these small generations will enter working life, so in 15 to 25 years we are going to have lots of problems.

It's a quiet revolution because it has happened over a long period of time. The falling doesn't hurt but the impact will.

Has geographic diversification of investments among Finnish pension funds affected investment returns?

Diversification has increased the real rate of return and also, in the hypothetical situation that we invested more within Finland, we would also sacrifice part of the potential returns. That's because the OMX Helsinki index's growth potential is not as high as in developing markets or outside of the euro area.

This is one of those eternal issues of pension policy, how much should be invested domestically and what is the real purpose of the pension funding. For us that works in the industry, our job is to safeguard and make sure we can deal with our pension liabilities, but politicians might want pension funds to support the economy and employment.

Of course, there are European Union rules on state aid and other things that also affect how much could be invested domestically so that we don't distort the markets.

The funds stood at €215 billion at the end of 2019. They used to be down €30 billion and now they're probably down by just €20 billion, though these are just first quarter estimates. Nevertheless, that's still over 90 per cent of Finnish gross domestic product.

Asset classes have also changed. It used to be in the 80s and 90s that the pension system borrowed everything and used government bonds, it was all fixed income. Now it's changed after the liberalisation of the Finnish financial markets in the late 80s and there's about 10 per cent in real estate, 40 per cent in fixed income and around 50 per cent in equities. ■

ESG

Many view Europe as the forerunner in adopting environmental, social and governance (ESG) principles into the pension and investment industries. Jack Gray **investigates what can still be improved despite recent progress**

WRITTEN BY JACK GRAY

Room for improvement

The European pensions sector has seen a transformation that few could have predicted 15 years ago. With public and industry focus moving to climate and ethics-related issues in pension scheme investments, the continent has become the trailblazer for a more environmental, social and governance (ESG) aware model.

Regulation in this area has stepped up, with the European Union's (EU) IORP II Directive introducing new provisions requiring schemes and funds to consider ESG factors and risks in their system of governance, investment policy, risk management and member communication.

In 2019, the European Insurance and Occupational Pensions Authority (EIOPA) carried out an IORP stress test on how ESG risks were incorporated into risk management and investment policies.

"The reference date of the stress test was end-2018, at which time the IORP II Directive had not been transposed, and furthermore transposition had been delayed in a number of member states, so that it was expected that IORPs in a few member states would integrate ESG factors," states an EIOPA spokesperson.

"However, the vast majority of IORPs indicated to integrate all three 'E', 'S' and 'G' factors. This seems to be linked to national requirements and the push from members and beneficiaries of the IORPs."

Furthermore, KPMG's *European responsible investing fund market survey 2019*, which took place prior to the IORP II Directive's enforcement, found that the number of responsible investment funds increased by 27 per cent between 2016 and 2018, while assets rose by 12.5 per cent to reach €500 billion.

"Perhaps more important than figures, there are some qualitative trends of interest," comments Association of the Luxembourg Fund Industry (Alfi) deputy director general, Marc-Andre Bechet.

"Asset managers report that requests for a proposal from institutional investors, pension funds or insurance companies nowadays invariably require the provider to set out in detail its credentials in ESG and sustainable investing."

Beyond regulation

Despite these positive findings, KPMG's research also shows that the €500 billion in responsible investment fund assets represented just 3-4 per cent of the assets across all European funds.

"We are still on the journey towards having the financial sector better understand ESG issues," says Robeco head of sustainability integration, Masja Zandbergen.

"Regulation really helps because they have to think about the topic, but that is the first step. I'm very much in favour of getting knowledge and understanding rather than checking a box, so we need more than regulation."

Regulation can also pose challenges if it is not a Europe- or EU-wide initiative. Willis Towers Watson head of sustainable investment manager research, Amandeep Shihn, explains that differing legislation can add a "layer of complexity" to an already complex topic.

"The challenge with regulation is

that it is geographically different, and global investors may find it challenging to navigate different legal requirements when thinking about how to act in the best interests of investors.” However, he says the challenges are not “insurmountable”, as differing geographical regulations affect every part of businesses.

Education, education, education

One of the ways to go above and beyond the regulations set by governments and organisations could be to improve education for industry members and investors.

“The financial industry needs to understand what ESG issues there are and how they can implement them into thinking about businesses, which is all aimed at how you can make better investment decisions,” Zandbergen adds.

“It should be a standard course in the financial and economic curriculum, for example at universities.”

Alfi Responsible Investing Legal and Policy Committee chair, Nathalie Dogniez, believes that determining the sustainability of products will “remain a critical challenge” that the taxonomy and disclosure regulations are aiming to address.

She continues: “In order to properly implement these measures, intensive investors’ education and up-skilling of sales forces will be required - not just demonstrating that, in fact, ESG integration brings additional performance, but also in order to assist investors in expressing their sustainability preferences.”

Further education may help pension schemes position themselves in the rapidly changing market to ensure that outcomes for members and schemes are the best that they can be.

“We believe it’s important asset owners evaluate their starting position to be able to facilitate their next steps for asset allocation, benchmark selection and manager oversight,” notes MSCI executive director, asset owner and consultant coverage, Mark Guirey.

“To date, only a handful of pension schemes have reported on a Task Force on Climate-related Financial Disclosures (TCFD) basis and have done the analysis of the risks their portfolios face with the transition to a low carbon economy.”

Reporting responsibility

Some argue that the key to increasing the implementation of ESG principles in European pension schemes is industry members taking responsibility in pushing for change and meeting sustainability targets. This could take the form of reporting on ESG-related activity, adapting investment strategies, or voting for or against management practises that support or ignore ESG issues.

“This systemic risk needs to be addressed by the whole system, not just the regulators, but everyone working together,” says Zandbergen.

“Active ownership is an extremely important tool. You must also be ready to vote against management recommendations if you are serious about certain issues. If engagement does not work, then you need to be ready to show what you are serious about. If you are serious about creating wellbeing, you need to create non-financial goals next to your financial goals.”

BNY Mellon Investment Management head of European institutional distribution, Olivier Cassin, agrees, saying: “The investment industry can still improve on ESG reporting and performance attribution. Active managers have a unique role to play here in focusing on bottom-up security or bond selection to demonstrate that ESG integration and sustainability are not labels, but a way to view the world that adds value to client portfolios.”

Data and transparency

Commitment to ESG can naturally lead to more ethical management of pension schemes, with transparency at the heart of ethical improvements.

“Transparency is key, and the upcoming sustainability disclosure will impose demanding disclosure on all financial market participants and financial products, ranging from sustainability risks, to impact reporting and taxonomy alignment,” explains Dogniez.

“Complete and reliable sets of data on the investment universe and investee companies will be required to prepare these disclosures. As of today, the main source of information remains the investee companies themselves, through their non-financial reporting.

“But very few companies are required to do such reporting and the information is not standardised nor subject to independent verification mandatory requirements.”

Invesco global head of ESG, Cathrine De Coninck-Lopez, adds that communicating with members and adapting investment options can improve schemes’ sustainability.

“ESG investment principles are founded on long-term sustainable value creation and therefore ESG investing is naturally aligned with the objectives of pension savings,” she states.

“Studies have shown that pension savers put a high priority on aligning their pension savings with ESG principles, in some cases above returns. Pension investors are often not informed on how their pension savings are invested and default funds continue to be non-ESG options. In future, we would hope and expect to see default options increasingly moving towards ESG strategies.” ■

Tobacco Free Portfolios

No ifs, no butts

TOBACCO FREE PORTFOLIOS DISCUSSES THE RISKS ASSOCIATED WITH PENSION FUNDS INVESTING IN TOBACCO

Written by Tobacco Free Portfolios director UK and Europe, Dr Rachel Melsom, MBBS, BSc, and Tobacco Free Portfolios director of communications, Clare Payne

When risks are about more than losses

Covid-19 calls on us all to prioritise the common good over self and private interests; this also applies to the way we invest and think about money.

Whilst Covid-19 was at first deemed a health problem and a health crisis, we have quickly seen the interrelated nature of our societies and an expanded notion of risk to include other factors such as the risk of losing the social licence to operate and the risk of breaching public trust.

As financial institutions and providers turn their attention to coping with Covid-19, they should be mindful to ensure existing investments aren't contributing to the problem. The World Health Organization director-general, Dr Tedros Adhanom Ghebreyesus, has highlighted the growing number of studies and reports linking severe and fatal impacts of Covid-19 with those who smoke.

The role of finance in society

It is now commonly accepted that investing for good does not have to mean financial sacrifice. AP4's annual report has recently published the return contribution of their sustainability decisions 2015-2019. The business-based decision to remove tobacco made the largest positive return contribution.

Regardless, it's not just about the bottom line, making good investment decisions can save lives.

The UN Tobacco Control Treaty highlights in Article 5.3, that governments should cease financial support of and investment in tobacco companies as a crucial piece of tobacco control. This directive matters as tobacco is the world's number one cause of preventable death, and the single most deadly consumer product in history.

Individuals with everyday financial products, and in particular through their pensions, have found themselves unwittingly contributing to this problem.

The range of risks associated with tobacco

Risks associated with ongoing financing of tobacco are multiple, including: Regulatory risk: 181 countries are actively implementing the UN Tobacco Control Treaty; Litigation risk: In 2019 Quebec's Court of Appeal upheld the award for damages of CA$15 billion health-related costs and Brazil announced its case against Big Tobacco in May 2019; Supply chain risk: Practically no cigarette can be guaranteed to be free of child labour. In addition, children get Green Tobacco Sickness causing ill health and nicotine addiction; Reputational risk and Human Rights: The Danish Institute for Human Rights has stated: "Tobacco is deeply harmful to human health, and there can be no doubt that the production and marketing of tobacco is irreconcilable with the human right to health"; Environmental Risk: The European Parliament paved the way for a ban on single use plastic, to reduce pollution in the oceans in accordance with Sustainable Development Goal (SDG) 14 'Life below water'. Less well known is that cigarette butts are the biggest man-made contaminant of the ocean and can take over a decade to decompose. Over 4.5 trillion cigarette butts are discarded every year. Detritus from vaping products also adds to the increasing volume of environmentally damaging waste.

Tobacco-free finance

The good news is that momentum around tobacco-free finance has grown steadily. The Tobacco-Free Finance Pledge, launched in September 2018 at the United Nations, was developed by Tobacco Free Portfolios in collaboration with the UN Principles for Sustainable Insurance, UNEP Finance Initiative, the UN-backed Principles for Responsible Investment, AXA, BNP Paribas, Natixis and AMP Capital.

The pledge currently has 129 signatories - leaders in insurance, banking, pension funds and asset management, representing over US$8 trillion in asset under management and over US$2 trillion in corporate loan book. They are guiding us all to a healthier, more sustainable and more financially secure future. ■

CASE STUDY

A game of skill

Jens van Egmond, **board member and member of the investment committee at Netherlands' Sportfondsen pension fund, talks Covid-19, portfolio strategy and the future of pensions with** Francesca Fabrizi

WRITTEN BY FRANCESCA FABRIZI

How long have you been involved in the world of pensions?

Around nine years ago I completed my Master of Science on the Economic and Finance of Aging by writing my thesis during an internship at APG. I also got involved in the youth labour unions´ efforts on pensions at around the same time.

What is the current set-up of the Sportfondsen pension fund that you currently work with?

Sportfondsen pension fund has around €300 million in assets under management on behalf of more than 6,000 members who work or have worked to operate swimming pools and other sports facilities in the Netherlands.

Sportfondsen pension fund is partially reinsured, with current employees of the company accruing pension in the non-reinsured section. The reinsurance has proven to be of great value given the fall in interest rates and increase in longevity in the past decade. As a result, the funding ratio is among the highest in the Netherlands and was high enough to increase the pension benefits with inflation indexation last year.

The fact that the pension fund consists of two parts but is managed as one does deliver some complexities that require attention from the board. It isn´t always straightforward to establish what fairness means if some members have a largely reinsured pension while other members are more exposed to economic risks.

What are your duties in your current role?

The most important duty of the board is to ensure the ongoing management of the investments, member administration and communication such that the agreed pension arrangement is delivered.

As a member of the investment committee, my duties gravitate towards the investment side. The investment committee monitors the different investments and interacts with the asset manager and investment consultant on the management of the dynamic interest rate hedge and rebalancing of the portfolio. The committee also takes the lead in drafting the investment policy and the triannual ALM study.

What have you enjoyed in the role to date?

I have mainly enjoyed the breadth of the responsibilities and the interaction with my intelligent fellow board members. It is quite remarkable how complicated the interaction between economic uncertainty, regulation, governance and operational robustness can become. Yet we have been able to establish a degree of control.

How are you managing the current situation we are in?

There are two sides of the story. On the one hand, we feel comfortable that the pension fund is in a relatively good position compared to many other pension funds.

However, the uncertainty around the impact of the Covid-19 crisis on the fund, the company and our members is currently our highest priority. We have more frequent calls with the investment committee to oversee the rebalancing of the portfolio in the currently volatile and illiquid markets.

There is also a discussion in the Netherlands around potential pension premium holidays to relieve liquidity pressures on companies and that is something we may consider.

What do you anticipate as being the hot topics for pension funds in the coming months?

Although there are many long-term concerns and ambitions for the pensions industry, the focus will be on the economic consequences of the unprecedented crisis we find ourselves in.

Personally, I have been concerned with gaps in dependents' pensions for a while. For example, if a person is between two jobs, it is not always the case that the dependent's pension would be paid out if the person were to decease. This was already an issue that needed solving to prevent the tragedy of a widow finding out that there is no financial safeguard in place after a loved one passes away.

The Covid-19 crisis makes even clearer that, as a society, we cannot allow such a situation to exist. In the UK it turned out that not all medical staff were entitled to death-in-service benefits, while these people were risking their lives to save others. That is simply not acceptable. ■

RISKS

Ask the industry:
What is the biggest risk facing pension schemes in Europe?

***European Pensions* asks pensions industry members for their thoughts on what they see as the greatest risk schemes in Europe are currently facing, excluding the ongoing coronavirus pandemic**

"The single biggest risk facing European pension schemes is lack of financial education. The fundamental aim of pension schemes is to enable members to live in retirement with dignity. As the trend to DC in Europe intensifies, more and more individuals will have to make individual financial decisions within European pension schemes, which determine their own retirement outcomes. Most individuals in European DC pension schemes are simply not equipped to take those fundamental decisions.

All stakeholders have a role to play. Governments should teach children about financial education. Pension regulators should require European pension schemes to provide simple understandable information. Companies should educate their workforce. Pension schemes should focus on member education, and most importantly members should care about their own future as they will still probably live to see their retirement."

PAUL BONSER

Aon UK head of International Retirement Practice and senior partner

"For DB schemes the key risk and challenge is that interest rates remain 'lower for longer'. Ongoing record low and negative interest rates will continue to adversely affect the funding ratios of most plans. At the same time, many corporate sponsors face challenging economic conditions, weakening the employer covenant of the scheme and the ability to fund deficits.

For DC plans, the key risk is member behaviour – that the recent market volatility and losses cause members to lose confidence. Decisions to opt out of the plan or switch to cash and other low risk investments can have a very negative impact on the retirement income prospects of members. Trustees need to reassure members to stay the course."

ALISTAIR BYRNE

State Street Global Advisors head of pensions and retirement strategy

"It is not the Covid-19 crisis or even the predicted aftermath in the long term, I would say it would be demographic ageing. It consists of two topics: people's increasing life expectancy and the diminishing rate of the working age population. Regarding longevity risk, pension schemes have done quite a lot. There are products that corporations can use to protect their pension schemes.

The diminishing working age population is due to the fact that the total fertility rate is not keeping up with the population. We have a much smaller working age population even now, let alone looking forward a couple of decades. It has been handled by lifting the retirement age, and other sorts of tricks in the labour markets, but there are limits to this. This has not been handled and there are no major solutions. Population policy is hard; it takes a couple of decades for the effects to show, which is one of the reasons why it is so hard to tackle because people don't believe it will have a major effect as they can't see it now."

JANNE PELKONEN

Tela senior specialist

"Pension schemes cannot allow the need to recover from Covid-19 mask the planet's biggest tail risk - that of the impending climate emergency. This systemic risk has not gone away, and the effects of climate change pose a significantly greater risk to economies and our investments if we do not ensure they are sustainable.

"Based on our portfolio performance, we believe this provides evidence that pension funds that follow a sustainable investment strategy will have seen a stronger resilience to the shocks seen in other parts of the market. This is further evidenced by the latest MSCI figures that show that over 60 per cent of ethical and ESG investment funds have outperformed the wider global stock index during this market downturn. Policy-makers and investors must ensure that we have a green recovery, not a recovery at any cost."

GORDON POWER

Earth Capital chief investment officer

"While there are a wide variety of risks facing European pension schemes including how investment can positively impact on our planet and society, the old chestnut of retirement adequacy has come to the fore again. We find central bank buying of bonds pushing yields into negative territory while economic stimulus packages come with risk of inflation. To address this risk and its intergenerational consequences, pension schemes and their regulators need to consider whether approaches that excessively reward certainty in nominal terms can realistically provide for members in future purchasing power terms. Rather than locking in negative real yields, schemes might reasonably seek to build portfolios that are diversified and sustainable while seeking to support post-retirement incomes that are likely adequate in a range of inflation scenarios."

JOHN O'BRIEN

Mercer strategic risk management in Europe leader

"While pension systems face several challenges, including increased unemployment rates, financial market downturns and falling contributions, many of these are cyclical. In our view, the key challenge facing European pension systems is structural and is the growing old-age dependency ratio. The ratio in the EU-27 has already pushed past 30 and is expected to reach 40 within the next 10 years. Going hand-in-hand with this is increased longevity. Due to these structural challenges, pension policy reforms have been triggered in many economies, however pressure remains high. Old-age support ratios have dropped dramatically, leading to financial imbalances and increased contributions."

DARIUSH YAZDANI

PwC Global AWM Research Centre head

"Unprecedented monetary and fiscal policy, used to counter recent crises and cyclical downtrends to keep the economy afloat, leave governments and central banks with inflated balance sheets. Notwithstanding these draconian measures, we are experiencing a demand shock, and as a result we do not foresee inflationary pressures in the near future. We may well be able to cope with these debt levels, as evidenced by Japan and the period since the global financial crisis. On the other hand, if these measures prove insufficient, a scenario of low growth, low rates and a credit squeeze may give rise to disinflationary pressures. For some pension systems, like in the Netherlands, lower rates and falling expected returns may lead to further deterioration of funding ratios and benefit cuts for their DB pensions. And that could prove an existential threat."

JACCO HEEMSKERK

Willis Towers Watson Netherlands head of investment

CYBERCRIME

In the wrong hands

Whilst the reporting of cyber security attacks remains low amongst pension schemes, the risks are increasing. Natalie Tuck reports on how pension schemes can protect against this threat

WRITTEN BY NATALIE TUCK

In a time when Europe appears to have become divided, the Covid-19 pandemic has shown the sense of community and unity amongst citizens across the continent.

Although borders have been shut, and national efforts have taken over, the global science community is working together to help discover a vaccine for the world's citizens.

That's why it was such a shock to hear of cyber attacks on labs involved in Covid-19 research. But, it is also a stark reminder that valuable information serves as a hook that draws in cyber criminals. In a report last year, the Thinking Ahead Institute labelled cyber warfare as one of the world's top 30 risks.

Pension funds, with masses of personal data about their members, are not exempt from this risk. Redington chief technology officer, Adam Jones, notes that the biggest risk areas for pension funds are through data loss and theft, as well as the onward sale of member details.

"This is a risk for data held by the scheme, but also processes being carried out by third party administrators, actuaries and consultants on their behalf. Where data is personally identifiable, there is also a GDPR risk. Furthermore, there is a threat to assets and cash, however this isn't held directly by the pension scheme, but rather custodians and banking partners," he says.

Most recently, the European Insurance and Occupational Pensions Authority (EIOPA) warned that since the outbreak of Covid-19, schemes are at an increased risk of exposure to fraud. "This includes cyber security and data protection, in particular, relating to staff working remotely," it stated.

Prior to the outbreak, pension schemes had not reported any significant cyber attacks. Aon's *Global Pension Risks Survey 2019* found that in the UK, over 95 per cent of respondents have not been affected by cybercrime. This does, however, mean that 5 per cent of schemes have been affected, and as Aon warned, a figure that is unfortunately likely to increase.

In other countries surveyed, Aon found that no schemes, so far, have reported any cyber incidents, but the risk of an attack is on their radars. So what are schemes doing to prepare and protect against potential cyber attacks?

According to Aon's survey, in Switzerland, half of the respondents have documentation in place and policies and emergency procedures. The remaining schemes plan to put this in place during the next 12 months (by September 2020). However, only one third have carried out a stress test of their organisation/infrastructure, or a simulation type 'war game'.

In Germany, attention has mainly focussed on the secure data transfer to service providers, such as the actuaries, according to Aon. Companies have also started to implement additional measures for risk management such as cyber training for those responsible or comprehensive assessments of the threat risk.

Insurance is another option; in Germany, two thirds of respondents have already assessed their existing cyber risk and taken out respective insurance policies. However, it is not yet possible to take out specific cyber insurance policies for occupational pension schemes in Germany. Aon suggests schemes should verify whether it is possible to include a certain cyber protection in existing insurance policies.

More generally, Jones adds that good governance is key in mitigating cybercrime risks. "Forward-looking pension schemes will have information security and associated issues forming part of their governance framework," he says.

"As with any risk-based framework, it's important to understand the current risk exposure. This can be done via a top down review of your business structure and third-party relationships, or equally with a bottom up review of processes. Once you have a good understanding of the risks, it's important to understand mitigants and implement these wherever possible." ■

Irish Association of Pension Funds (IAPF)

Pensions in a time of Covid-19

IRISH ASSOCIATION OF PENSION FUNDS (IAPF) CEO, JERRY MORIARTY, DISCUSSES THE CHALLENGES FOR THE PENSIONS INDUSTRY IN IRELAND AT A TIME OF A GLOBAL HEALTH AND ECONOMIC CRISIS

At the beginning of 2020 in Ireland, all the focus was on a general election, which was called on 14 January and took place on 8 February. Pensions became an early area of focus, as the proposed increase to the state pension age from 66 to 67 on 1 January 2021 came under the spotlight.

There was considerable pushback, mainly due to the lack of transition arrangements when many people still expect to retire from work at age 65. Most of the political parties promised to stop the increases or even revert to age 65. The election result was indecisive, and a new government still hasn't been formed.

Like everywhere else in the world, the arrival of Covid-19 has pushed everything else into the background. When the country practically shut down in March, the impact was sudden and severe.

By the week commencing 11 May, around 589,000 people were receiving the Covid-19 Pandemic Unemployment Payment of €350 per week for those unemployed as a result of the economic shutdown.

A further 456,200 people were receiving income support through the Temporary Wage Subsidy Scheme, for which over 53,000 employers have now registered. 214,700 people were receiving the standard Jobseeker's Benefit of €203 per week, which was in place before the Covid-19 crisis. This means that in total around 1.3 million people are now fully or partially dependent on the state for income support out of a workforce of 2.3 million; this has naturally pushed long-term pension issues down the priority order.

It is encouraging though that progressing auto-enrolment has been agreed by the two parties most likely to form a new government.

In the meantime, schemes and administrators are focused on dealing with the day-to-day impact of Covid-19. The IAPF surveyed our members in April and most schemes reported an increase in member queries, requests for transfer values, retirement quotes and fund switches. Third party administrators have switched to all or most of their employees working from home. That doesn't seem to have caused too many issues and, interestingly, all schemes that had a business continuity plan in place have said that it was fit for purpose.

While the regulator has identified some of the priorities schemes should deal with, such as paying benefits, none of the statutory duties have been relaxed. The areas that are causing most concern for schemes relate to employer contributions where the employer is struggling with cashflow. The Irish Wage Subsidy Scheme also does not allow for employee contributions to be deducted. The regulator also requires some documentation to be provided to members in paper format and this can be logistically difficult at the moment, with access to printing facilities being an issue.

Defined benefit schemes will be anxiously considering their funding position and the strength of the employer covenant. With legislation to introduce employer debt not having survived the previous parliament, this leaves trustees and members in a vulnerable position.

Hopefully as the country eventually begins to reopen, some of these issues will resolve themselves. In the meantime, there will need to be a pragmatic and practical approach as suggested by the European Insurance and Occupational Pensions Authority (EIOPA), "in order to mitigate the impact on pension schemes and their members and beneficiaries, as well as to avoid pro-cyclical effects on the real economy and financial system, using a risk-based and proportionate approach". ■

"ALL SCHEMES THAT HAD A BUSINESS CONTINUITY PLAN IN PLACE HAVE SAID THAT IT WAS FIT FOR PURPOSE"

Written by Irish Association of Pension Funds (IAPF) CEO, Jerry Moriarty

PENSION SCAMS

Duncan Ferris **examines pension scams, looking at how scams can affect the industry, what professionals can do to prepare, and whether the global pandemic is being exploited by criminals looking to pilfer pension pots**

WRITTEN BY DUNCAN FERRIS

The art of the scam

Crime is a fascinating subject. Whether it's the exploits of the stunningly corrupt Detective Alonzo Harris in *Training Day* or the rise and fall of Henry Hill in *Goodfellas*, some of cinema's most enthralling stories centre around criminals. While stories of pension scams have yet to grace the big screen, the subject is of the utmost importance for industry professionals everywhere.

Perhaps the most important thing to remember is that pension professionals have a responsibility to ensure that scheme members' retirement savings are secure. Let's begin our examination of scams with a look at the ways in which savers' pots can be placed in jeopardy.

Common scams

There are two primary ways in which pension funds can be affected by fraud. The first of these is through members being persuaded into transferring their pots to fraudulent investments, only to find their hard-earned savings depleted or gone entirely.

The Pensions Regulator executive director of frontline regulation, Nicola Parish, says: "Pension scams can be extremely difficult to spot and even the most savvy of us can fall victim. Our research shows there are five million people in the UK who would fall for one of the six common scam tactics.

"All scams are different, but there are a number of warning signs that should raise alarm bells. These include being contacted out of the blue, offers of a free pension review, or unusual investment opportunities – things like overseas forestry or storage pods."

In one example of this, Alistair Greig, owner of Midas Financial Solutions (Aberdeen), persuaded more than 140 investors to place over £13 million into a non-existent, guaranteed, short-term deposit scheme.

He was sentenced to 14 years in prison after siphoning off £6 million of the investors' savings and pensions into his personal accounts, which had allowed him to lead a lavish lifestyle full of expensive cars and trips to Ascot.

This might seem like an enormous amount of money, but it is far from atypical, as Parish explains that "the latest available figures show that victims lost on average £82,000 each", demonstrating that the issue is not trivial.

Schemes themselves can also be vulnerable to tricksters' charms, as was the case in a long-running criminal case in Sweden, which saw four defendants jailed by a Stockholm court after their fraudulent activities cost around 20,000 pension savers SEK 308 million.

The case saw Maltese private pension provider Falcon Funds ordered to return all payments to savers after cash was sunk into investments that the funds were not eligible to be allocated to.

Resilience

So, how can schemes defend themselves, and their members, from such criminal activity?

One essential measure needed in order to fight against fraud is to ensure that staff are prepared to face the challenges posed by criminals.

Aviva group fraud risk director, Matt Chapman, says company staff have been given "fraud prevention training and regular reminders to be vigilant for scams", which includes "targeted guidance for our people when working from home as well as dedicating a section of our employee website to coronavirus scams".

He adds: "Pension funds and providers can help themselves by working with the industry and law enforcement agencies to stay up-to-date on emerging threats and types of scams as this dynamic situation evolves, and then using this intelligence to train front-line employees."

Technology is also a key issue, with Mercer principal, Lorraine Harper, explaining that Mercer has investigated ways to "reduce the need for email traffic in the future whilst enabling members to continue making online requests".

She says Mercer offers online scheme specific member portals and has rolled out "a central online portal, which is secure for members to provide information directly to us".

Measures like these can ensure that information is more secure and less likely to fall into the wrong hands, while reducing email flow will help make communications from scammers stand out more.

Harper says: "We are conscious that online requests so necessary in the current pandemic will become the norm in the future, therefore, we have implemented online verification processes designed to cut down the need for members to provide certificates but also to ensure that the members with whom we are speaking are who they say they are."

While Harper's point touches on the technological improvements that can combat scammers, it also brings into sharp relief the need for schemes' communication to be up to scratch.

Parish argues that schemes need to "alert members to the risks of scammers through their communications", as well as highlighting "the free, impartial pensions guidance" offered by industry bodies.

Chapman concurs, stating: "With the number of people now working from home, delivering targeted security guidance is crucial. Simple stuff like adding scam awareness tips to desktop wallpaper can help ensure people have the threat of scams front of mind."

Indeed, the current circumstances have created a particular challenge, not just because of the difficulties of remote working, but also because of how happy some people are to exploit an emergency.

Coronavirus

With the world currently experiencing a crisis over Covid-19, it seems that now is a crucial time to exercise caution and be aware of the dangers posed by devious criminals.

The onus is on schemes to be vigilant against these actors, with an April statement from the European Insurance and Occupational Pensions Authority warning that authorities should "expect institutions for occupational retirement provision (IORPs) to carefully consider and effectively manage the increased risk exposure to fraud, other criminal activity, cyber security and data protection" because of "the disruption of society and, in particular, staff working remotely".

Chapman points out that one facet of this disruption to society, which has left investors "much more vulnerable to falling victim to scammers offering unrealistically high rates of return", is the sharp falls experienced by global markets.

Harper notes that there are also more and more members "under financial pressure and needing to replace lost jobs and income", as well as an increased amount of "information being shared electronically across all sectors due to lockdown".

Chapman comments: "Unscrupulous individuals are using coronavirus as the hook to take advantage of unprecedented levels of uncertainty for pension scheme members and operational change for pension schemes."

"The type of fraud is the same, but the vehicle is coronavirus. [*In the UK*] Action Fraud has indicated that thousands of web domains have been registered with the name Covid-19. Our intelligence gathering also leads us to believe Covid-19 is being used as a pretext by scammers to persuade investors to transfer their investments into a safer investment," he adds.

While there might already be early warning signs of coronavirus-related scams, Parish comments: "We have seen no evidence of an increase in pension scams because of Covid-19 yet. However, criminals always seek to capitalise on uncertainty. Fears about the pandemic's impact on markets could make people more susceptible to scammers tactics."

Harper agrees that there has not been an observed increase in scam activity but warns that this could only be "because of the time taken to transfer benefits from defined benefit pension schemes".

It seems that while we have yet to see a spike in coronavirus-related pension fraud, the industry needs to prepare for a potential wave of cases. This makes it essential for pension professionals to use the current window of opportunity to prepare for the worst.

This will ensure that, when Hollywood finally gets round to making a summer blockbuster about pension scams, the good guys will come out on top. ■

In their own words...

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

On the measures that should be taken to mitagate the impact of Covid-19 on pension schemes

"PensionsEurope and its member associations ask EU level and national regulators and supervisors for close collaboration and support to ensure that pension funds can overcome the challenges posed by the current situation in the financial markets and the severe consequences of the threatening imminent economic downturn. Workplace and personal pensions need to preserve their operational capacities as well as their role to complement public social security pensions and provide adequate and sustainable retirement income."

A PensionsEurope spokesperson

On the British MPs' pension scheme cutting fossil fuel investments

"Investing in clean energy is clearly the right thing to do, financially and for the future of our planet… parliament declared a climate emergency nearly a year ago, and the Parliamentary Contributory Pension Fund needs to fall into line with this by ending the support for fossil fuels. These investments cannot be justified on ethical, environmental or financial grounds, and they undermine MPs' credibility in addressing the climate emergency. They have to stop."

Green Party MP for Brighton Pavilion, Caroline Lucas

On Danica Pension's decision to give self-employed members an optional contribution break amid Covid-19

OLE KROGH PETERSON
Danica Pension CEO
"Self-employed people are a very special group, that are extra vulnerable in this situation. Through our close cooperation with Pensions for Self-employed (PfS)... we are now ready to give an extra helping hand so that we can get through this crisis together."

On the German government's Sustainable Finance Committee's proposal to develop sustainability indicators for corporate disclosures in Germany

NBIM chief corporate governance officer, CARINE SMITH IBENACHO, and NBIM corporate governance senior analyst, SÉVERINE NEERVOORT
"We believe that developing country-specific indicators could have the unintended consequence of preventing comparability of companies' disclosures across markets… As a financial investor, we rely on good corporate governance and board accountability. We expect company boards to ensure that company reporting reflects all material sustainability risks and opportunities."

On Dutch schemes uniting to fight against Covid-19

CHRISTINE LINDEBOOM
SPH board member
"As doctors, we are urgently calling on the pharmaceutical industry to make society their principal consideration at this time in particular. The highest priorities at this moment must be the development of a vaccine and the availability of medication directly and indirectly related to the coronavirus, and these must be put ahead of the interests of individual companies."

On the UK pensions regulator's Annual Funding Statement (AFS)

LESLEY CARLINE
Pensions Management Institute president
"We are encouraged that TPR has had the pragmatism to acknowledge the particular challenges facing defined benefit schemes at this time to make appropriate allowances for them in the new AFS."

"The Pensions Regulator's AFS provides welcome news about the resilience of pension schemes in the face of the crisis, and fresh flexibility for schemes preparing and finalising valuations."

PLSA head of DB, LGPS and standards, Joe Dabrowski

On the decision to appoint Nicolai Tangen as NBIM CEO

ØYSTEIN OLSEN
Norges Bank governor
"The Executive Board believes that Nicolai Tangen is the right choice... Norges Bank's Executive Board believes that Nicolai Tangen will continue to develop both the organisation and management of the Government Pension Fund Global in line with the fund's purpose."

On Shell's commitment to achieve net zero admissions following engagement with Climate Action 100+

"As investors we need to be ambitious in our expectations of how the companies in which we invest can address the shift to a low carbon future and today's announcement demonstrates that collaborative engagement can encourage corporate action on this crucial issue."

USS Investment Management chief executive, Simon Pilcher