European Pensions

Quarter four 2020

Covid-19 pandemic:

Impact on pensions

How has the pandemic impacted pensions so far, and what does the future look like?

Risk-sharing pensions:

Tontines

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Irish Pensions **AWARDS** 2020

19 NOVEMBER 2020

Online

SHORTLIST ANNOUNCED

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Evolution in pensions

According to scientists, the human race is evolving at a faster pace than it has done at any point in the past 250 years.

The latest research found that more babies are being born without wisdom teeth and have an extra artery in their arm. They also have shorter faces, smaller jaws and extra bones in their legs and feet. This ‘rapid’ evolution, as it is termed, is all part of how populations adapt to their environment.

Of course, it’s not just species that evolve; we’re also witnessing change in the pensions industry.

“WE ARE IN THE MIDDLE OF A CRISIS BUT EVOLUTION IS HAPPENING IN THE PENSIONS INDUSTRY”

What stands out for me in this issue is how much development there is ongoing within the sector. We are in the middle of a crisis but evolution is happening in the pensions industry.

The Netherlands, for example, is throwing its pension system on its head in the hope of making it more sustainable. We look at whether uprooting savers and retirees from a DB-style pension system to a DC-like collective scheme, [*page 34*] is the evolution the system needs.

Such evolution, however, isn’t always needed, or indeed welcome. Estonia will make its second pillar system voluntary from January next year, but in an industry column [*page 41*] Estonian Insurance Association CEO, Mart Jesse, says this change will have a detrimental effect on the country’s pension system.

More generally, we examine [*page 42*] how Covid-19 will impact pensions in the long term within Europe, from investment to savers’ contributions and environmental, social and governance issues.

With the news that the European Insurance and Occupational Pensions Authority (EIOPA) has submitted draft Pan-European Personal Pension Product (PEPP) regulations to the European Commission, an old retirement product – tontines – popular with 20th century crime novelists, could be about to make a comeback.

European Pensions looks at whether tontines [*page 50*], a type of pooled-asset fund much like collective defined contribution schemes, have a place in a modern European pensions system. Its fans are convinced that these risk-sharing products are the future of pensions.

Our industry is notorious for being slow to adapt but could it be that ‘rapid’ evolution has finally reached the pensions industry?

Natalie Tuck, Editor

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

Publisher Member

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EIOPA submits PEPP delivery and design regulations to EC

REGS DETAIL THE FRAMEWORK FOR PEPP'S DESIGN AND DELIVERY

Written by: Natalie Tuck and Jack Gray

The European Insurance and Occupational Pensions Authority (EIOPA) has submitted a set of draft regulations to the European Commission (EC) to implement the framework for the design and delivery of the Pan-European Personal Pension Product (PEPP).

The regulatory provisions include quality criteria for PEPP to be used by providers, with the aim of ensuring that European consumers will be offered high-quality, safe, transparent and simple PEPPs.

EIOPA said that the regulations will leave "sufficient room" for innovation and competition.

Its draft regulations also include criteria for "sound and robust" investment strategies and risk mitigation techniques with the aim of delivering better long-term returns to savers and managing investment risks to match consumers' risk appetites.

EIOPA has developed two compulsory consumer information documents, the PEPP Key Information Document (KID) and PEPP Benefit Statement.

These documents will provide savers with relevant information to help with decision-making before entering a binding contract and monitoring the savings' performance.

They also look to provide a holistic approach for the analysis of the PEPP's risk-reward profiles, with the PEPP KID including a 'summary risk indicator' that aims to identify the riskiness of various investment options and comparative information to understand the relevant risk of future benefits.

Additionally, projections of future retirement income will be included to help consumers decide whether the product meets their retirement objectives.

EIOPA added that online distribution will be key, and it will be "crucial" that consumers can easily access, understand, and use the information presented in a digital format.

Using digital means will also help the process to be more cost-efficient, EIOPA said.

To try and ensure the PEPP is cost-effective, the annual cost of the Basic PEPP will be limited to 1 per cent of the PEPP saver's accumulated capital at the end of each year.

The Basic PEPP, which is the default investment option, has been regulated to offer a relatively high level of capital protection, according to EIOPA.

It can be further extended to a capital guarantee, the cost of which is excluded from the cost cap but must be disclosed.

EIOPA noted that the success of the PEPP will depend on supervision and cooperation between national authorities and member states, and it believes that regular supervisory reporting and intervention powers will be necessary to ensure efficient and effective monitoring of the PEPP market.

"With the delivery of EIOPA's proposed implementing measures specifying the PEPP regulation, EIOPA has fulfilled its objective to design the PEPP as a simple, safe and reliable retirement savings option for European citizens and to provide a powerful tool to close the pension savings gap," commented EIOPA chairman, Gabriel Bernardino.

"PEPP is a unique opportunity to offer consumers the participation in sustainable investments and the European Capital Markets Union, whilst ensuring good pension outcomes and protection against downside market risk."

Previously, PensionsEurope had raised some concerns over the proposed reporting requirements for the PEPP.

In a response to a consultation by EIOPA, the association said that whilst it understands the need for such stringent reporting requirements, they “always imply costs for pension providers”.

In particular, it highlighted that the reporting obligations and templates under consultation seem in line with the current reporting obligations of some potentially-eligible PEPP providers in certain member states, and much less with others.

“In our opinion, the PEPP reporting requirements should be as close as possible to current supervisory reporting used for national personal pension products and occupational pension schemes, to avoid useless additional workload and related costs for savers. In this perspective, the supervisory reporting should be sufficiently broad and granular to cover those data that must already be reported at the national level for personal pension products,” it stated.

"PEPP is a unique opportunity to offer consumers the participation in sustainable investments and the European Capital Market Union"

PensionsEurope did not believe that the consultation paper has sufficiently analysed and detailed the impacts that the new reporting standards would have on the different eligible PEPP-providers.

“The PEPP regulation requires that the reporting requirements reflect the nature, scale and complexity of the business of the PEPP provider concerned, and in particular the risks inherent in that business. This implies that EIOPA’s analysis should consider the differences between providers, investigating the current highly divergent national approaches to product supervision, and providing more details on the (different) administrative efforts and costs needed to comply with these standards.”

In addition, PensionsEurope highlighted that the reporting of national personal pension products is not subject to harmonised EU rules, so the efforts needed to adapt national reporting standards to these rules will be considerably different from one country to the other.

Meanwhile, EIOPA stressed that the Covid-19 pandemic has “taken its toll” on the financial situation of the European occupational pensions sector.

Publishing its July 2020 *Financial Stability Report* of the (re)insurance and occupational pensions sectors in the European Economic Area, EIOPA said that Institutions for Occupational Retirement Provision (IORPs) may be subject to funding and liquidity concerns due to suspended or lowered contributions from sponsors and members.

In addition, sponsoring undertakings in heavily affected sectors by the Covid-19 pandemic are expected to be in significant financial distress, putting members of such pension funds at risk of unemployment in the near future. Sponsors' financial difficulties in maintaining contributions or, in the worst case, sponsors' insolvencies, may test national pension protection schemes.

News in brief

■ The number of **Finnish** earnings-related pension insurance policies transferred between companies declined by 15 per cent to 3,500 in Q2 2020, according to the Finnish Pension Alliance (Tela). This is a drop from the 4,800 transfers reported in Q1, while transfers under the Employees Pensions Act (TyEL) dropped by 32 per cent to 1,323 and transfers under the Self-Employed Persons’ Pensions Act (YEL) fell by 21 per cent to 2,209.

■ A reform of the **Swiss** second pillar pension system is “urgently required” according to Swisscanto. It found that although the country’s pensions are “securely positioned”, the system faces “major structural challenges”. It said schemes had responded to demographic change and low interest and conversion rates. However, active members and the newly retired have had to accept declining benefit levels for more than 10 years.

■ **Irish**-headquartered TontineTrust has announced a partnership with Dutch pensions consultancy firm, Westerbrink, in a move it hopes will bring it closer to launching a PEPP. The company said the “long-term strategic cooperation” highlights its ambition of offering a tontine product as a PEPP to consumers in EU member states within two years.

■ **Finnish** mutual pension insurance company, Elo, has revealed it has submitted a recovery plan that has been approved by the Finnish Financial Supervisory Authority (FIN-FSA) after its solvency ratio fell below the limit. Publishing its half year results, Elo revealed it made a loss of -4.1 per cent in the six months to the end of June.

European countries top global retirement index for third year

ICELAND'S AND SWITZERLAND'S PENSION SYSTEMS TOP THIS YEAR'S NATIXIS RETIREMENT INDEX

Written by: Natalie Tuck and Jack Gray

Three European countries, Iceland, Switzerland and Norway, have come out top on a global retirement index (GRI) for the third consecutive year.

Natixis Investment Managers' GRI saw Iceland and Switzerland top the chart with a score of 82 per cent each, followed by Norway with a score of 80 per cent. In addition, Ireland has increased its overall score this year to 79 per cent, compared to 77 per cent in 2019, moving up one spot to fourth place, followed by the Netherlands in fifth place, moving up five places.

However, other European countries did not perform so well in this year's GRI. Sweden fell from sixth place in 2019 to 14th this year, due to poorer performances in the material wellbeing and finances in retirement sub-indices.

The UK saw a decline in its ranking for the third successive year, falling one place to 17th, mainly due to declines in the material wellbeing and finances in retirement sub-indices, where the UK ranked 19th and 29th respectively.

The GRI, which is developed by Natixis Investment Managers and CoreData Research, examines the factors that drive retirement security globally, providing a comparison tool for best practice in retirement policy. The GRI scores are split into health, finances in retirement, quality of life and material wellbeing sub-indices to create an overall score for each of the 44 countries included in the index.

Commenting, Natixis Investment Managers CEO, Jean Raby, said: "Balancing the needs of current and future retirees with other public policy demands has long been one of the most intractable issues for nations around the world, and the global pandemic and its economic fallout have only compounded the challenge.

"Individuals, employers, institutions, policymakers and asset managers all have an important role to play in addressing these issues, and we believe the 2020 GRI can help advance the dialogue by providing a clear and consistent picture of where each economy stands on a range of key indicators."

Meanwhile, in Mercer's *Global Pension Index*, the Netherlands retained its first place ranking with an overall score of 82.6. Denmark was ranked second with a score of 81.4, while Finland came fifth with a score of 72.9.

European pension systems fared reasonably well on the whole, with five participants in the top 10. Italy scored lowest of the European nations assessed (29th), with an overall score of 51.9 and the lowest score of any nation in the index for sustainability (18.8). Austria narrowly beat Italy to 28th place with an overall score of 52.1.

Other European nations on the list included Sweden and Norway (joint sixth), Germany (11th), Switzerland (12th), Ireland (14th) the UK (15th) and Belgium (16th).

In the index, Mercer acknowledged the impact that Covid-19 has had on pension systems, highlighting that the average sustainability score fell by 1.2 in 2020 due to the negative economic growth experienced in most economies.

It noted that the pandemic's impact on future pension provision will be negative due to reduced contributions, lower investment returns and higher government debt.

"Inevitably, this will impact future pensions, meaning some people will have to work longer while others will have to settle for a lower standard of living in retirement," commented Mercer senior partner, Dr David Knox.

Ireland to transpose IORP II Directive before the end of 2020 – Pensions Regulator

THE REGULATOR STATED SIGNIFICANT CHANGE IS COMING TO IRISH PENSIONS AND THE AUTHORITY IS IN ADVANCED PREPARATIONS

Written by: Natalie Tuck

Ireland is expected to transpose the long overdue IORP II Directive by the end of 2020, its Pensions Regulator, Brendan Kennedy, has stated.

Publishing a statement alongside The Pensions Authority's annual report and accounts, Kennedy said the transposition will lead to the "most significant changes in at least a generation".

"Transposition of IORP II into Irish pensions law is a very complex task and has taken longer than anyone expected. As a result, we have not been able to communicate the details of the forthcoming changes as soon as we would have wished. However, there can be no doubt that significant change is coming to Irish pensions, and the nature and direction of that change is clear. The authority is well advanced in preparing for these changes," he said.

Acknowledging that there are well-run pension schemes in Ireland, which will have little difficulty adapting to the new regulations, he warned that there are many schemes that are not run to the standard that members expect.

"It should not be a matter of luck for a member how well run their scheme is. Furthermore, given the significant value of pensions savings that can be built up by retirement age, there is no justification for the standard of care for pensions savings being any less than it would be for any other type of savings," he said.

Under the new regulations, trustees will be obliged to demonstrate their focus on members' interests. This means that they must satisfy themselves and the authority that they have the expertise, commitment, professional support and structured approach needed to fulfil their responsibilities to their members.

"Perhaps more importantly, they must demonstrate that they are actively managing their scheme and anticipating issues that might affect their members. Any trustees whose sole or primary focus is on compliance will not be doing enough," the regulator said.

The new regime will also specify the obligations of trustees. Although in the best schemes, these obligations are already being met, for many schemes this is not so and much change will be needed, the regulator said. However, the authority believes that all scheme members are entitled to the same level of protection, whether in large or small schemes. Kennedy believes that larger schemes are in a better place to provide protection to members than smaller schemes.

He also warned that IORP II will present a significant challenge for many defined benefit schemes. As well as the additional governance obligations that will apply to all schemes, defined benefit trustees will be obliged to prepare and examine a much wider range of financial and actuarial data, and to demonstrate that they understand and are managing their scheme so that members have a reasonable chance of receiving the benefits set out in the scheme rules.

In other news, the authority has reiterated to trustees of defined benefit pension schemes its expectations surrounding investment strategies for schemes with a funding proposal for a term longer than three years.

It has warned that if a scheme updates its investment strategy during the funding term, which it believes is inappropriate, then it has the right to rescind the extended funding period term, which would result in early termination of the funding proposal. The reminder is part of the authority's move to a risk-based and forward-looking approach to supervision.

Dutch pension reforms given green light by unions

PENSION SCHEMES WILL HAVE TO TRANSFER TO THE NEW SYSTEM BY 2026, WITH A POSSIBLE TRANSITIONAL PERIOD FROM 2022

Written by: Natalie Tuck

Plans to reform the Dutch pension system have been approved by the Dutch Federation of Trade Unions (FNV).

The reforms will see all defined benefit-style pension schemes become defined contribution-based collective schemes. Pension funds will have to transfer to the new system no later than 1 January 2026.

The government believes employees and retirees will get a "greater insight" into their accumulated pension capital under the new system, and a "realistic expectation" of their benefits.

Pension entitlements in the current system will be transferred over to the new system, and the need for funding ratios will be abandoned and reliance on interest rates will diminish. However, it said the new system would see collective investment retained.

Commenting on the agreement, Minister of Social Affairs and Employment, Wouter Koolmees, said: "I am proud of the agreements that are now in place and very grateful for the hard work that all parties involved have done. The new system is more personal, more transparent and offers an indexation perspective."

He said the new system "distributes the burdens and benefits in a realistic and fair way", whilst using "the power of the collective". Koolmees also believes that the new system is more in line with current society and the modern labour market.

However, AXA Investment Managers head of quant lab, Laurent Clavel, warned that the new system transfers the risk of the system to the individual.

In addition to occupational pensions, agreements have also been made on the rate at which the state pension age will rise. In 2020 and 2021, the state pension age will remain at 66 years and four months. After this, the state pension age will increase by three months per year, to 67 years in 2024.

From 2025, the state pension age will not rise by one year per year lived longer, but eight months. The state pension age therefore remains linked to life expectancy, but more in balance, the government said.

Koolmees has confirmed that he is looking into a 'transition period' to protect pensions until the new pension contract comes into effect in 2026.

In a letter to the House of Representatives, Koolmees explained that the details of the transition period will be "established at a later date for the years 2022 to 2026". Pensions schemes have protection in place until the end of 2021, following the introduction of a temporary minimum funding requirement introduced last year of 90 per cent, down from 104.3 per cent.

Commenting on the minister's plans, the Dutch Pension Federation said the transition scheme "offers funds more time to restore their financial position". Referencing the letter, the federation said the minister sees the need for a different financial assessment framework for the period of transition to the new pension system (2022-2026).

The minister included goals and principles for this transitional financial supervisory framework (transition-ftk) in the letter. For example, he aims to "offer perspective on the new system during the transition, encourage the transition to the new system and bring about a gradual recovery to a healthy financial position".

Danish commission urged to address flexible retirement needs

FORMER FORSIKRING & PENSION CEO, PER BREMER RASMUSSEN, CALLED FOR THE NEW PENSION COMMISSION TO BE ALLOWED TO EXPLORE INCREASED FLEXIBLE RETIREMENT OPTIONS

Written by: Jack Gray

The Ministry of Employment in Denmark should look to ensure that its new retirement-focused commission addresses the need for a more flexible retirement, said then-Forsikring & Pension CEO, Per Bremer Rasmussen.

The Danish government is preparing for what the commission, which is a spin-off of the Senior Pension Agreement from 2019, will look at.

Rasmussen noted that although the Danish system is "world-class", there were "several elements" that the industry wants to examine.

He urged the government to allow the commission to look at the possibilities of increasing flexible retirement options both before and after the state pension age, as many would prefer a smoother transition.

"The Minister of Employment has just announced that he will do away with the either-or principle in the withdrawal decision, among other things, by creating simpler rules," said Rasmussen.

"He will also work to break down the barriers that prevent the pension flexibility that many want."

Danish pensions are a "very complex area", according to Rasmussen, and he encouraged the new commission to make proposals to simplify the public pension system and the rules applicable to private pensions.

Danish pension savings recover well following Covid-19 crisis

ALTHOUGH MOST DANES' SAVINGS HAVE SEEN POSITIVE RETURNS FOR 2020 SO FAR, FORSIKRING & PENSION WARNED THAT UNCERTAINTY STILL REMAINS

Written by: Natalie Tuck

Danish pension savings have recovered well since the peak of the Covid-19 crisis in markets in March, according to Forsikring & Pension.

Since the turmoil in the markets, the status at the end of August for most Danes' savings was a small positive return for 2020 so far. However, based on the Council for Return Expectations' latest forecast assumptions, Forsikring & Pension has warned that uncertainty still remains, and this should be communicated to pension savers.

New Forsikring & Pension CEO, Kent Damsgaard, said: "2020 with the coronavirus crisis has shown that pension savers can occasionally encounter some big bumps in the road. But it should be remembered that retirement savings are long-term savings and there is time to recover what is lost."

In Denmark, pension companies provide savers with pension forecasts at least once a year. "It is important to tell customers about the uncertainty. Therefore, all pension companies must tell customers not only what they will get in retirement if the investments go as expected, but also if things are going better or worse than expected," Damsgaard added.

The pension forecasts are calculated on the back of the return expectations set by the Council for Return Expectations.

NBIM revises Nicolai Tangen's terms following conflict of interest concerns

THE FIRM REVISED THE CEO'S CONTRACT TO MINIMISE THESE CONCERNS

Written by: Natalie Tuck

Norges Bank Investment Management (NBIM) and Norges Bank's Executive Board have revised the terms of new CEO Nicolai Tangen's employment contract in a bid to minimise conflict of interest concerns.

It comes after the board had to defend its choice of CEO again, following further criticism during a parliamentary hearing in the summer. The concerns surround Tangen's connection to AKO Capital.

During the hearing, Norges Bank Supervisory Board chair, Julie Brodtkorb, said that there had been "a breach of guidelines, regulations and laws" in Tangen's appointment.

The revised conditions mean that Tangen will divest himself of his holding in AKO Capital LLP. He will transfer his holding and dividend rights to the charitable entity AKO Foundation. As a result, he will no longer have any ownership interest in AKO Capital LLP, which will apply in perpetuity.

In addition, Tangen has further stated that he will change the way his personal fund investments are managed, so that all assets are held as bank deposits. Tangen himself said that these actions "remove any doubt" about which hat he is now wearing. "I want to be CEO of the oil fund, and have only one objective: Creating wealth for future generations," he added.

Commenting, Norges Bank Executive Board chair, Øystein Olsen, said: "We are of the opinion that the agreement, which the Executive Board has now endorsed, addresses the concerns raised by the Storting's Standing Committee on Finance and Economic Affairs on the contract of employment with the new CEO of NBIM."

"The Executive Board has been of the opinion that the contractual framework surrounding Tangen's employment contract was sufficient in preventing potential conflicts of interest, but we have noted, of course, that the Storting takes a different view. Their concerns are something the Executive Board, in dialogue with Nicolai Tangen, has now addressed," Olsen added.

"I understand that the Supervisory Board, as the supervisory body, wants to remove risk"

The Norweigan Ministry of Finance was not initially informed that Tangen would continue to own AKO Capital while leading NBIM, and NBIM did not put his name on the applicants' list until just a few days before his appointment was announced.

Olsen admitted that the firm waited "too long" to put Tangen on the public applicant list but defended Tangen's appointment.

"In Nicolai Tangen's case, the Supervisory Board has been clear that the risk of conflicts of interest must be eliminated," said Olsen. "I understand that the Supervisory Board, as the supervisory body, wants to remove risk.

"At the same time, I would like to emphasise that any responsible board for a company must make discretionary trade-offs between different types of risk and consideration for the company's purpose."

Tangen, who has now taken up the role, revealed that the fund made a return of 4.3 per cent in the third quarter of 2020. "The financial markets were still influenced by uncertainty related to the coronavirus," he said. However, the US technology sector boosted equity returns.

MSZP calls for Hungarian pension reforms

THE HUNGARIAN SOCIALIST PARTY CALLED FOR IMMEDIATE CHANGES TO SUPPORT RETIREES, HIGHLIGHTING A PENSIONS PARLIAMENT REFERENDUM THAT WOULD ALLOW QUARTERLY REVIEW ADJUSTMENTS

Written by: Sophie Smith

The Hungarian Socialist Party, MSZP, has called on the government to raise pensions in line with broader shifts in inflation, arguing that the current increases in consumer prices are hitting pensioners worst.

The party has called for a return to Swiss indexation, which would have seen a 6.8 per cent increase at the beginning of the year.

It also called on the government to increase any pension below 100,000 Hungarian Forints (€275), as well as giving all pensioners a one-off pension supplement in light of the ongoing pandemic.

Although the government raised pensions by 2.8 per cent at the beginning of the year, MSZP parliament member and chairman of the parliament's Welfare Committee, Lajos Korózs, argued that the current 3.8 per cent inflation meant that pensioners were in effect lending to the government.

Korózs highlighted recent figures from the Central Statistical Office (CSO), which revealed that consumer prices were on average 3.8 per cent higher in July, while food prices had grown by 7.8 per cent.

He also noted that the CSO uses a separate measurement for retirees, excluding aspects that are irrelevant to the elderly, emphasising that pensioners are even worse off under these indicators.

According to Hungarian law, however, the pension supplement inclusive of the 2.8 per cent increase can only take place in November.

Romanian govt's 14% pension hike will have 0.3ppt impact on deficit - ING

THE GOVERNMENT ANNOUNCED THE INCREASE IN ITS DRAFT BUDGET

Written by: Natalie Tuck

The announcement by the Romanian government to increase pension payments by 14 per cent will have a 0.3 percentage point (ppt) impact on the country's budget deficit, according to ING.

The government announced the increase and published its draft budget on 14 August, in which it was revealed pensions would rise by 14 per cent, instead of the previously drafted 40 per cent, by the Social Democrats last year, which is now in opposition.

Publishing an update on Romania on ING's website, Romania economist, Valentin Tataru, and emerging market sovereign debt strategist, Trieu Pham, said the 14 per cent hike was slightly above their predicted 10 per cent.

"The adopted 14 per cent pension hike came slightly above our expectations for a 10 per cent increase, but admittedly it doesn't change the budgetary picture that much. It will have an impact of around 0.3 ppt in this year's budget deficit and around 1.2ppt in 2021," they wrote.

Romania's budget deficit forecast for this year is currently at 8.6 per cent. However, given the slightly higher-than-expected pensions increase, and a 20 per cent child allowance increase, as well as ING's expectations for the economy to recover at a somewhat slower speed in the second half of the year, it sees the 8.6 per cent deficit target as still reachable, but only under the optimistic scenario.

News in brief

■ **Abu Dhabi Pension Fund** (ADPF) and state holding company ADQ will invest USD 2.1bn in Abu Dhabi National Oil Co (ADNOC) gas pipeline assets, ADNOC has revealed. Under the terms of the agreement, ADNOC will divest 20 per cent in ADNOC Gas Pipelines HoldCo LLC, a wholly owned ADNOC entity that holds 100 per cent of ADNOC's interest in ADNOC Gas Pipeline Assets LLC (ADNOC Gas Pipelines), to ADPF and ADQ. ADNOC Gas Pipelines is a subsidiary of ADNOC.

■ The market value of the funded public service pension fund in **Zimbabwe**, which was established in 2018, has reached USD 1.4bn after starting with only USD 70m, according to *The Herald*. The cumulative pension contributions during the period January 2019 to June 2020 amounted to USD 759.5m, according to the government. Finance and Economic Development Minister, Mthuli Ncube, said the pension fund was mooted as part of efforts by the government to promote savings mobilisation, a critical element for driving domestic investment.

■ **Canada's** Ontario Teachers' Pension Plan Board's net assets totalled CAD 204.7bn, as of 30 June, its half-year results have revealed. The total fund net loss for the first half of 2020 was 0.4 per cent, decreasing from CAD 207.4bn at the end of December 2019. The fund's CEO and president, Jo Taylor, said they expected the pandemic to have "lasting repercussions" and the scheme wanted to remain "vigilant and agile" until the full impact can be established. "Our diversified and high-quality portfolio has so far been quite resilient," he stated.

Oz superannuation fund reforms announced

THE SHAKE UP TO THE SUPERANNUATION SYSTEM IN AUSTRALIA WAS ANNOUNCED IN THE GOVERNMENT'S 2020 FEDERAL BUDGET

Written by: Jack Gray

The Australian government has announced changes to the superannuation system in an attempt to improve retirement outcomes for members.

Australian superannuation pension funds will be required to meet an annual performance test and notify members if they are underperforming from July 2021. The establishment of an online comparison tool for fees and returns was also announced, alongside the introduction of a 'pot follows member' approach, where superannuation accounts will follow the member when they start a new job, rather than new super accounts being automatically created when they change jobs.

The Association of Superannuation Funds of Australia (ASFA) said the measures represented a significant change to the architecture of Australia's superannuation system.

"We don't suffer from a shortage of good funds and we need to ensure that these measures don't reduce competitive intensity or damage the nation building role of superannuation," said ASFA CEO, Dr Martin Fahy.

"In the absence of the release of the *Retirement Income Review* and the lack of specificity in the Budget papers, it is unclear how the changes will work in practice or what the implications will be for competition, efficiency and incumbents in the sector."

South Korea' s National Pension Service partners with Dutch fund

THE FUNDS WILL FOCUS ON INFRASTRUCTURE AND REAL ESTATE

Written by: Natalie Tuck

The National Pension Service of South Korea (NPS) has joined forces with Dutch asset manager, APG, to explore global investment opportunities.

APG is the asset manager for Dutch fund ABP, the pension fund for government and education employees. NPS is South Korea's public pension fund, with approximately 22 million members contributing.

The collaboration of the two pension funds will see them work together on investments in large international projects in the field of infrastructure and commercial real estate.

The South Korean pension fund is no stranger to APG. This year they worked together on two large investments. In April, they acquired a stake in the leading toll road operator, Brisa, and recently invested in Scape Australia, a market leader in student accommodation in Australia.

As part of the new partnership, knowledge exchange will be an important goal of the collaboration. APG board member, Ronald Wuijster, said: "Both APG and NPS have an excellent track record when it comes to investing in real assets. We can learn a lot from each other. In the coming period, we will be making use of each other's expertise."

Diary dates 2020/21

The latest events occurring across the European pensions market

IRISH PENSION AWARDS 2020
19 November 2020
Online
Now in their 9th successful year, the Irish Pensions Awards seek to give well-deserved recognition to those pension funds, pension providers, advisers and pension professionals who strive to maintain the highest standards of excellence and professionalism in everything they do, despite the challenging economic and political landscape they find themselves operating in. In line with government guidelines, this year's awards will be presented virtually online via a special broadcast.
europeanpensions.net/ep/events

EUROPEAN PENSIONS AWARDS 2020
10 December 2020
Online
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. In line with the current government guidelines, this year's awards will be presented virtually online through a special broadcast.
europeanpensions.net/ep/events

PENSIONS AGE AWARDS 2021
29 April 2021
London Marriott Hotel, Grosvenor Square
The Pensions Age Awards aim to reward both the pension schemes and the pension providers across the UK that have proved themselves worthy of recognition in these increasingly challenging economic times. They are free to enter and are open to any UK pension scheme or provider that serves pension schemes in the UK. This year's awards include two new categories: the award for the Pensions Marketing Campaign of the Year and the Thought-leadership Award.
pensionsage.com/awards/

Not to miss...

EUROPEAN PENSIONS NORDIC CLIMATE CHANGE SEMINAR
18 November 2020
Online
europeanpensions.net/climate-change-seminar

ALFI LONDON CONFERENCE 2020
23 November 2020
Online
events.alfi.lu/london-conference-2020/

IAPF GOVERNANCE WEEK 2020
23-26 November 2020
Online
iapf.ie/events

PENSIONS AGE NORTHERN CONFERENCE
1 December 2020
Online
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

IRENE HOLMSLYKKE

PFA Asset Management has announced the appointment of Irene Holmslykke as CEO. She stepped into the role following the retirement of Christian Lindstrøm Lage who, by mutual agreement, stepped down from the role after 12 years with PFA. Holmslykke joined PFA Asset Management in January 2019, having previously held a number of positions in the investment industry, including roles at Danske Bank and Danske Markets for over 10 years.

OLAF JOHN

Mercer Germany has strengthened its investment solutions division with the appointment of Olaf John as commercial leader. He will report to the European commercial leader of investment solutions, Michael Lernihan, and will also become a member of the German Mercer Wealth Leadership Team under the responsibility of Martin Haep, head of the wealth business unit at Mercer Germany.

CAMILLA LARSSON

Sweden's KPA Pension has appointed Camilla Larsson as CEO. She joins the firm from AMF where she has worked in various roles since 2004, most recently as unit manager for customer and business. Johan Sjöström has also been appointed acting CEO, and will also remain CEO of KPA Livförsäkring AB, until Larsson takes up her position as CEO, which will be no later than 2021.

KARSTEN KALLEVIG

Norges Bank Investment Management (NBIM) has appointed Karsten Kallevig as a special adviser to the CEO Nicolai Tangen, with a focus on real asset matters. Kallevig has built the real estate organisation and portfolio during the past decade, both as chief investment officer real estate in Norges Bank Investment Management (NBIM) and as CEO of Norges Bank Real Estate Management (NBREM), transitioning NBREM back into NBIM last year.

ROINE VESTMAN

The Swedish government has appointed Stockholm University associate professor, Roine Vestman, as a member of the board of the Seventh AP Fund (AP7). His appointment is effective from 10 September 2020 until AP7's income statement and balance sheet for 2020 is adopted. Vestman has a PhD degree in Economics from New York University. He teaches investments, asset pricing and macroeconomics.

Appointments

MICHAEL D'ARCY

The Irish Association of Investment Managers (IAIM) has appointed former Minister of State with Responsibility for Financial Services, Michael D'Arcy as its new CEO. D'Arcy, who served as an MP for Fine Gael until 2020 before losing his seat in the election, quit his role within the Seanad to take up the position of CEO. He will work closely with IAIM chairman, John Corrigan, on the development of the IAIM.

NIKHIL RATHI

The UK's Financial Conduct Authority (FCA) has appointed Nikhil Rathi as its new permanent chief executive, replacing the regulator's interim boss, Christopher Woolard. Prior to this, Rathi was the chief executive of London Stock Exchange (LSE) and has previously served as HM Treasury financial services group director. In this role, he led the Treasury's work on the UK's EU and international financial services interests.

YVONNE VAN ROOY

The Federation of Dutch Pension Funds has announced the appointment of Yvonne Van Rooy as chair of the Monitoring Committee for the Code of Pension Funds. She is a former politician, and has extensive experience with pension funds. She succeeds Margot Scheltema, who will step down from the role on 1 January 2021 after six years in the role.

IAN BROWN

LGPS Central Limited has hired Ian Brown as head of private markets, putting him in place to lead both the company's private equity and infrastructure and property teams. Brown has spent more than three decades working in the finance industry, having previously served as head of the leveraged finance execution team at UBS and held various roles in investment and commercial banking.

GERBEN PASMAN

Aon Netherlands has named Gerben Pasman as chief financial officer (CFO). He has been with Aon since 2011, having initially joined as a member of the Financial Planning & Analysis (FP&A team), before becoming responsible for the Financial Control department as country controller. Most recently, he held the role of FP&A director. He succeeds Rogier Sparreboom, who was appointed CFO Europe, Middle East and Africa (EMEA) of Aon earlier this year.

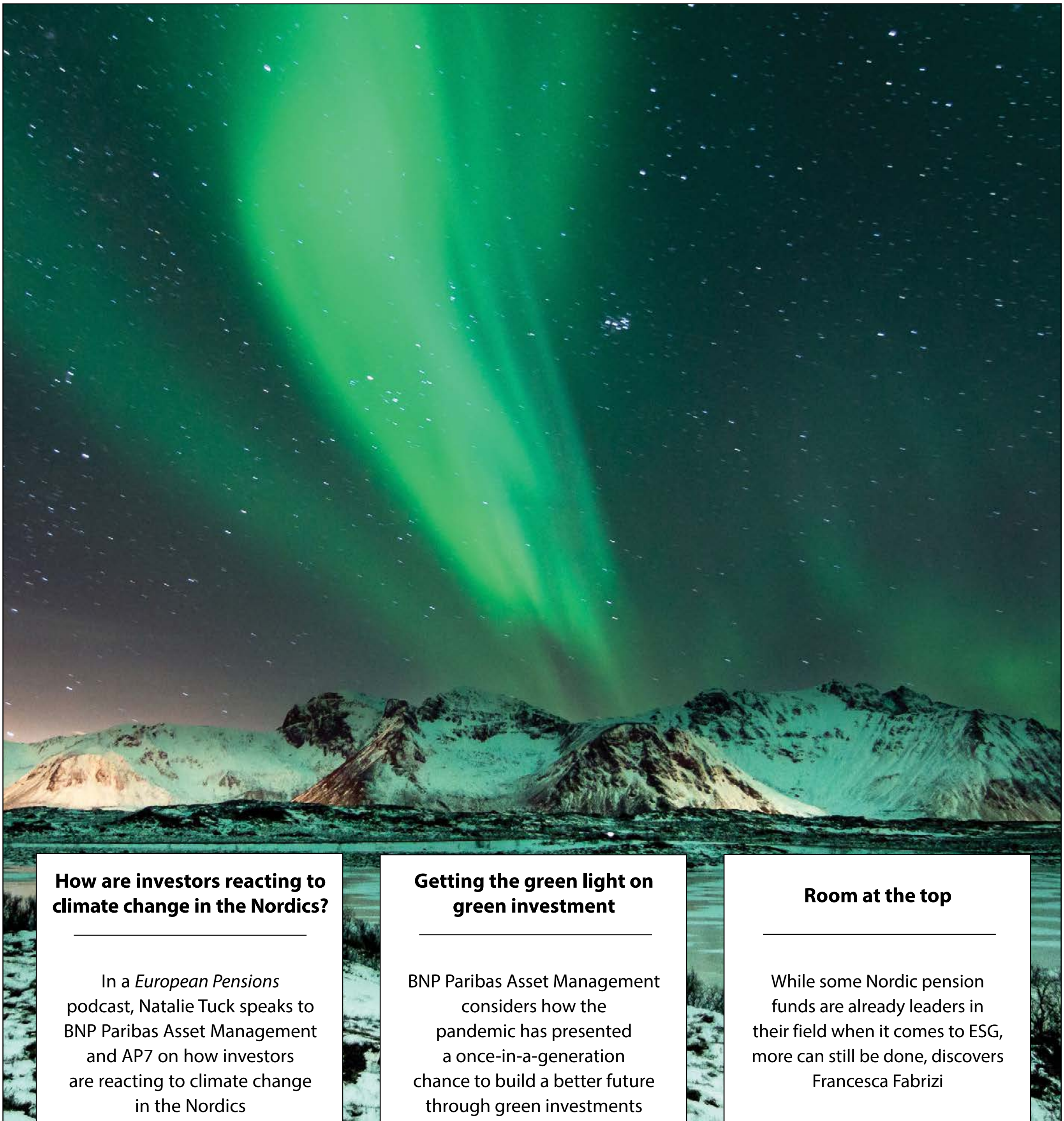
REBEKAH BENNETT

SEI Institutional Group has announced the appointment of Rebekah Bennett as consultant relations director in Europe. Bennett will be responsible for the management and development of existing and new relationships with fiduciary management and DC plan consultants. She joins the team from BlackRock, where she has spent the past decade in consultant relations.

Nordic climate change investment focus:

A LEADING LIGHT

In association with: BNP PARIBAS ASSET MANAGEMENT



PODCAST

How are investors reacting to climate change in the Nordics?

With land stretching up into the Arctic Circle, Nordic countries are already experiencing the worrying impacts of climate change in their own territories. What role can the investment community play in helping to combat the inevitable crushing humanitarian and economic consequences of climate change?

In this podcast, BNP Paribas Asset Management's Chief Sustainability Strategist, Mark Lewis**, and AP7's Head of ESG and Communications,** Johan Florén**, discuss with** *European Pensions'* **Editor,** Natalie Tuck**, how investors are reacting to climate change in the Nordics**

Johan, could you start by telling us how important climate change is to AP7 and the work the scheme has been doing to tackle climate change?

JF: We take a universal owner perspective on sustainability and in practise this means two things; one is a norms-based strategy that we apply to our whole portfolio, which covers the environment, human rights and labour rights etc. The other aspect is thematic work, where we prioritise the most important systemic challenges and look in depth at developing new methods and knowledge and engaging with specific companies.

At the top of our list of priorities is climate change. As an example, one thing that we have focused on for several years now is corporate climate lobbying, which is a global barrier for the Paris Agreement to materialise. This is something we have done with BNP Paribas Asset Management (BNPP AM) and the Church of England.

Mark, from the perspective of an asset manager, what do you think are the biggest challenges facing the industry and what action has BNPP AM taken to address these challenges?

ML: The challenges facing the investment industry are no different from those facing society and the world. The asset management industry ultimately is operating within the investible universe provided by economic, social and global conditions.

I think it is fair to say that we are living through an era of multiple crises. We clearly have a climate change crisis, the manifestation of that has been with us almost on a weekly basis throughout this year. We've seen wildfires, floods, hurricanes and this is increasingly impacting different parts of the world.

There is also an ecological crisis around the question of biodiversity and the loss of biodiversity. There is an economic crisis brought on by a public health crisis, in the form of the pandemic, and there is increasing concern, quite understandably, about gender and race inequalities.

We are living through an era of multiple crises and the asset management industry has to make responsible choices in the face of that. At BNPP AM, we put sustainability at the heart of our investment philosophy. We think that is the way a responsible asset manager should respond but it also makes economic, financial and business sense. It is no longer possible to ignore the impact of these crises on the financial performance of the companies and the asset classes.

Sustainability and responsible investing is an integral part within BNPP AM's portfolio construction; our asset managers are required to take a full account of environmental, social and governance (ESG) issues when building their portfolios. This is because their portfolios are being measured on financial performance and ESG performance. We think this will generate better long-term performance for our clients.

Johan, as a universal owner the bulk of your investments are in index strategies but you have also made dedicated 'green' investments both in the private and public markets. Can you explain what role these investments play as part of your overall investment portfolio and in your work against climate change?

JF: If you look at it conceptually, we blacklist the worst companies at one end of our portfolio and then at the other end we make thematic investments in companies that solve climate-related problems. These green investments are of course on the solutions side; we have problems globally and the companies here are part of the solution going forward. If you look at it financially, the green strategies are within a diversification part of our asset allocation, so it's a building block together with other things we do.

You also recently increased your allocation to BNP Paribas Asset Management partner Impax's green impact mandate, is this part of AP7's climate change strategy?

JF: Yes it is, and the mandate we have with Impax is an example of these solutions investments. In our view, companies create sustainability value for society and we want to help finance this. It also gives us a chance to develop methodologies and metrics to evaluate the impact of the investments together with one of the most advanced asset managers in this area. We have two separate goals; one of course is for financial returns and the other is to measure this value, as we want to see where we are making an impact.

As a large pension scheme and asset manager you not only manage clients´ money, but you can also have a wider influence on the asset management industry, clients and the wider society. What specifically do AP7 and BNP Paribas Asset Management do to exert that influence?

ML: On issues we are concerned by we look to engage, both in terms of our bilateral engagements with companies we invest in and with companies that we're not currently invested in that we perhaps would if there weren't certain barriers. We have also instituted several policies that signal our concern and commitment in areas of importance. On climate change, for example, we have introduced a very strict coal exclusion policy, which affects our ability to invest in coal mining companies and power generation companies that are particularly reliant on coal.

There is also the element of working with other like-minded asset managers and owner institutions to deliver broader change. As Johan mentioned earlier, we have worked very fruitfully with AP7 and other asset managers and owners. One example is our work within investor network initiatives, such as the Climate Action 100+ initiative. As part of this we are taking the lead on engaging with seven of the world's largest emitting companies to put pressure on them to align their business models with the Paris Agreement.

JF: From our perspective, we have stated that the final goal for our work is to create a real world impact, so we want to have an effect on and make a difference on the real economy. To do this as a pension scheme, one key success factor is collaboration. We are trying to make our companies develop and change their behaviour towards a more sustainable direction.

To be able to succeed in this, I would say that collaboration is the number one factor; nobody is strong on their own but together we are quite a force. We actively look for like-minded peers with similar philosophies. Then we work with them to agree on good principles that we think are healthy. As part of our active ownership, we then encourage companies to change.

Mark, as a final point, looking more broadly at Nordic investors, what trends, in general, do you see with those investors in terms of climate change?

ML: The thing that has always impressed me about the Nordic region is that it has always been one step ahead of the rest of the world on climate change. I think its governments and society, more generally, really understood the seriousness of this issue much earlier than other regions in the world. Even within Europe, the Nordic region stands out as a beacon of action and commitment on this topic.

For example, electric vehicles are a very hot topic as people see electrification as a very essential way of decarbonising transport. However, on my last trip to Scandinavia I had a lot of questions on the end of the battery life cycle, the pollution impact of batteries, whether they can be recycled and issues relating to child labour with regard to the cobalt mining. This is what I have found, that in the Nordics they have always been leading this debate on climate change, setting clear targets and leading shareholder initiatives on many topics. ■

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INVESTMENT

Getting the green light on green investment

The lessons the world is learning from the Covid-19 pandemic are as multi-faceted as they are wide-ranging. We have learned that new ways of working are possible and that our habits are surprisingly easily changed. We have also learned that from great challenge often comes great opportunity, which should stand us in good stead for the future

WRITTEN BY
BNP PARIBAS ASSET MANAGEMENT CO-HEAD OF ENVIRONMENTAL STRATEGIES GROUP, EDWARD LEES

While the world has been distracted by the current pandemic, even greater threats have continued to build. Global warming, climate change and other environmental issues remain ruthlessly pressing. The global population is still on course to reach nine billion by 2035, increasing demand for energy, food and water by 35-50%. Without immediate intervention, our current practices to meet these needs involve huge and irreversible environmental impact.

Unlike the coronavirus, these issues are not localised, nor can they be solved by short-term, isolated measures. Instead, they require coordinated, focused efforts or risk failing at the first attempt. The good news is that the reaction to the pandemic – or rather to its catastrophic economic impact – has seen governments and a range of other stakeholders keen to take a fresh approach to rebuilding.

Support for a green rebuild

We can see a consensus emerging for the money earmarked to address the economic fallout to align with and even support measures to tackle climate change, along with other challenges such as pollution, water shortages, flooding and electrification. Encouragingly, the support for this approach to ‘build back better’ can be seen around the world. Although not yet universal, there is already considerable backing – and this is the largest and most important investment theme I have come across in my career.

US presidential candidate, Joe Biden, has embraced the ‘Green New Deal’ and, if successful in taking over the White House, is looking to turn the world’s largest economy into a global clean energy superpower. Already, the Democrats’ long-term stimulus plan includes replacing more than 200,000 polluting and unreliable US Postal Service trucks with electric vehicles. Similarly, the European Commission has put forward a detailed roadmap aiming for net zero greenhouse gas emissions by 2050 – just one of the aims within the trading bloc’s overall plan. Elsewhere, Indian Prime Minister, Narendra Modi, unveiled a substantial Green Plan in July, with China pledging in September to be entirely carbon neutral by 2060.

So far, governments and other interested parties have offered high subsidies and low interest rates to companies developing new, future-focused strategies. But, as we enter the economic post-Covid recovery, it is the creation and capturing of opportunities that is going to be the catalyst for this green rebuild to really take off.

Designing a financial, fiscal and monetary system with environmental issues at its heart will not come cheaply -- but nor will it be a zero-sum game. Showing how we can turn climate and environmental challenges into investment opportunities is the carrot needed to drive more capital to fund the huge change we need. Long-term plans need long-term solutions funded by long-term capital, but it will only come if there is a demonstrable benefit to this reallocation.

Broaden your horizons

We need this broad governmental

support to become a green light for investors to begin to explore the huge range of opportunities on offer. From energy, materials, agriculture and industrials, there are companies providing solutions to decarbonise and futureproof these sectors of all shapes and sizes. The investment universe ranges from solar and wind energy to batteries, electrification, green buildings, biofuels, and pollution control and testing. There are also noteworthy opportunities in cleaner shipping and ocean freight.

These forward-looking investment ideas are fundamentally tied to a clear growth opportunity, which will increase and solidify in line with the escalating global policy response. For example, the EU has set hydrogen – a source of clean energy – as a key instrument for its 2050 Green Deal objectives. This signals that there is likely to be a huge jump in the investments in renewable hydrogen – estimates put the cumulative figure in Europe to reach between €180-470 billion by 2050[1]. The turnover in the hydrogen economy is also predicted to jump from the current €2bn to €140 billion by 2030[2].

The global offshore wind market is also set to expand significantly in short order. The International Energy Agency is forecasting 13% growth per year and a 15-fold increase in capacity by 2040. This is expected to become a $1 trillion industry over the next two decades[3].

This is just the tip of the renewable energy iceberg. Distribution of this power is as important as its creation and requires similar, if not greater, levels of innovation and capital. Existing grid networks need updating, with storage another key piece of the puzzle that requires immediate and rapid attention. All these new technologies align with one theme: creating a world that not only prevents further deterioration of the planet but helps create resilience to deal with what is yet to come.

Sustainability and sustainable returns

For investors, this should chime with the responsibility of not just targeting sustainability for its own sake, but also expecting sustainable returns. We can and should not just commit blindly to ideas that promise a greener future – rigorous investment processes are now more important than ever.

Importantly, we have witnessed an encouraging mindset shift over the last decade. After years of research, there is now substantial evidence showing that companies with strong environmental scores outperform those that are less committed over time. This research also confirms that companies acknowledging and working to resolve environmental challenges will outperform those that do not. We can already see stranded assets and outdated technologies causing significant issues for companies in all sectors.

Companies that appreciate how embracing the future can add value are already pulling ahead in investment portfolio performance, while also reducing overall risk. Their performance is also more stable than their peers, as they suffer less in downturns and are less susceptible to swings in market trends. Of course, it is possible to short the companies that may be set to lose out in the long term – we are, after all, investors seeking returns.

Future first

At BNP Paribas Asset Management, we are already exploring the investment opportunities arising from this once-in-a-generation chance to shape a better future – all while targeting attractive returns and managing myriad risks. While all our strategies integrate environmental, social and governance considerations, we offer thematic and impact funds that cover a wide range of future-focused ideas. We are pleased to see investors aligning with our view that opportunities lie ahead, with new assets flowing into sustainability themed investments, even amid the coronavirus outbreak.

Covid-19 has shown us that we cannot control the future, but that we need to prepare to face it. As investors, we have the opportunity to help the world be as well-positioned as possible – and ensure our portfolios are prepared, too. ■

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[1] Source: https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_1257
[2] Source: https://www.pv-magazine.com/2020/06/19/leaked-eu-hydrogen-strategy-eyes-e140-billion-turnover-by-2030/
[3] Source: https://www.iea.org/reports/offshore-wind-outlook-2019

INVESTMENT

Room at the top

While some Nordic pension funds are already leaders in their field when it comes to ESG investing, more can still be done, discovers Francesca Fabrizi

WRITTEN BY FRANCESCA FABRIZI

Nordic pension funds are undeniably some of the most sophisticated in Europe and, most significantly, recognise the significance of environmental, social and governance (ESG) issues much earlier than their European counterparts.

While in some countries, pension fund investors are only now recognising that ESG considerations are not just about doing something positive for future generations, but about mitigating real risks to pension fund assets, in the Nordic space this has been at the core of some pension funds' thinking for many years – in particular, in relation to the potential impact of climate change on their portfolios.

BNP Paribas Asset Management co-head of environmental strategies group, Ulrik Fugmann, comments: "The Scandinavian investor base is very much at the forefront of the integration and thoughtfulness of ESG. Whilst a lot of climate-related investments have been in the infrastructure space, there is a broader awareness of opportunities in the public markets through environmentally themed portfolios."

One only needs to look at the news headlines daily to see evidence of such commitment. In recent weeks alone, several Nordic names were confirmed to be among an international group of 30 institutional investors delivering on a commitment to transition their investment portfolios to net-zero greenhouse gas (GHG) emissions by 2050; while a number of Nordic pension asset owners were included in the Principles for Responsible Investment (PRI) leaders' group for 2020, which showcases signatories that demonstrate a 'breadth of responsible investment excellence'.

"Nordic pension funds are clearly at the forefront in the field of sustainable finance," agrees PensionsEurope secretary general, Matti Leppälä, "and have taken ambitious decisions to support the pathway towards a carbon neutral economy. All over Europe, the interest among pension funds in generating a positive, measurable social and environmental impact, alongside a financial return has been steadily growing over the past few years. The Nordic pensions market reflects this reality, as pension funds have continued increasing their investments in green and social bonds, dedicating a greater share of their portfolio to impact investing," he says.

On a country level, examples are plentiful. The Swedish Pensions Agency recently announced it had invested SEK 1 billion in the government's new green bond, which launched on 1 September. Sweden's AP1 also announced the adoption of a new fossil-free approach to emerging market equity and global high-yield exposures.

Meanwhile, in Denmark, the pensions industry has, in collaboration with government, announced plans to invest more than €46 billion in green transition towards 2030, to include investments in energy infrastructure and other green activities such as green stocks, green bonds and investments in energy efficient construction. Leppälä comments: "The Nordic pension industry has often played pioneering role in the adoption of new green initiatives. For example, PFA and Danica Pension have recently launched their respective green pensions, for which the underlying investments have clear sustainability objectives and will contribute to the green transition."

Danish labour-market pension fund Sampension has also reached a milestone of DKK 1 billion invested within green bonds.

ESG responsibilities have also been one of the key focus points within the Icelandic pension market in recent years, EFIA and LSBI pension fund managing director, Snaedis Ogn Flosadottir, confirms. "Every pension fund in Iceland has put forward a responsible investment policy, which defines the board's objectives, focus points, methods and metrics. Keep in mind that every pension fund is different so the implementation of the policy, follow-up and decision-making does not have be analogous. But I believe they are, as a whole, keeping pace with their responsibilities and impressive work has been done in recent years."

In recent weeks, Icelandic pension funds have also, alongside Prime Minister Katrín Jakobsdóttir and the wider Icelandic financial market, signed a Declaration of Intent to use funds to maintain sustainable development both on a national and international scale.

Finland boasts a number of

trailblazing pension funds in the areas of ESG; while Ilmarinen, the biggest of Finland's pension insurance companies, has defined a stricter target and will make the firm's €48 billion of investments carbon-neutral by the end of 2035.

In Norway, the sovereign wealth fund maintains a negative exclusion list that Norwegian pension funds generally adhere to, which sets a solid foundation; and the funds employ a simple "follow-the-leader approach", explains Mercer Norway's investment consultant, Maria Haugtomt, which ensures that all trustees are familiar with the importance of incorporating ESG on some level. "We're therefore ahead in terms of coverage, which provides a base for developing and broadening the pension funds' efforts," she explains.

Of course, ESG strategies vary across the countries, as Leppälä explains: "The Finns have been using a more best-in-class approach and less exclusions than many other Nordics; while Swedish pension insurers have sustainable investments at the heart of their actions", but on the whole, the dedication to ESG across the Nordic space is undeniable.

Room for more

But while the positive examples of ESG integration across the Nordic space may be plentiful and numerous ambitious targets are being set daily, the topic of sustainability is wide-reaching and complex and, in particular, a lot of work still needs to be done by investors in articulating what the objective and use case is for E, S and G. "In other words", says Fugmann, "is it being used as a tool for screening in – and out – companies or portfolios, or is ESG being used as a tool for managing non-financial risk in portfolio allocation?" ESG and sustainability themed investing are not the same thing, he argues: "One is a tool for assessing non-financial risk in portfolios and/or companies and the other a thematic approach to invest in companies driving sustainable solutions through their products, processes or services."

Haugtomt agrees with this sentiment. While some Norwegian pension funds have a sophisticated approach to ESG, the pension fund population can do more, she argues. "The negative exclusion practice has remained unchanged over the years, while a great deal has happened in the market," she argues. For example, knowledge and science regarding climate change and its impact on capital markets has evolved; data availability and quality has improved considerably; and the breadth of products available to climate cautious investors has widened. "It's time to look beyond exclusion and into practicing a proactive, transformational approach to ESG," she adds.

According to Haugtomt, this view is also being reflected in the opinion of Norwegian pension funds. "Understanding the effect of climate change in the portfolio as well as the portfolio's effect on climate change is certainly on many pension funds' agendas. The exclusion-focused market we are seeing today won't prevail much longer."

The pandemic

But before asking pension funds to devote more time and energy to ESG, one needs to consider the topic in the context of recent market events. One could argue that the pandemic of 2020 may have justifiably pushed ESG down Nordic pension funds' agendas. Haugtomt argues otherwise: "While the pandemic hasn't pushed a specific agenda, it has highlighted the importance of 'the unknowns' or systemic risks that affect the portfolio but that fall outside the traditional view of pension fund risks. It is probably more straightforward to envision now how a risk such as climate change can impact markets, which means it's a good time to start discussing it with trustees," she stresses.

Fugmann agrees that the pandemic has not and should not push issues such as climate change out of the spotlight: "I think market participants see the pandemic as a transitory, exogenous shock to the economy that we will eventually come past – maybe even stronger than before through business models adapting quickly. However, climate change is only becoming a bigger problem the longer we kick the can down the road and so is the commercial opportunity in addressing it. What this year showed us was empirical evidence from numerous studies that investing in companies with strong environmental credentials tend to outperform those with poorer ones," he says.

So, while the argument may be there for doing more, the question for Nordic pension funds is: where do they start? "In my opinion, it is about starting to form a set of principles for what the objective is for ESG integration as well as climate change," says Fugmann. "Once you know what you want to achieve – which is often not as easy as it sounds and can lead to conflicting outcomes – then you are halfway to a successful implementation."

Finally, he adds, common sense perspective always should prevail, whilst keeping your objective in mind; and embracing the fact that ESG is not a black and white exercise. "Nuances and potential compromises may be needed in achieving your ultimate objective," he concludes. ■

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INTERVIEW

Back in the hot seat

Eight months into his role as CEO of the State Pension Fund of Finland (VER), Timo Löyttyniemi **talks to** Francesca Fabrizi **about his position at one of the most challenging times in pensions history**

WRITTEN BY FRANCESCA FABRIZI

In March 2020, when the whole world appeared to be falling apart, Timo Löyttyniemi took his seat as chief executive officer (CEO) of The State Pension Fund of Finland – Valtion Eläkerahasto (VER). For most incoming CEOs, this would have seemed like an impossible task, at the worst possible time, but for Löyttyniemi, he was just coming home.

Löyttyniemi boasts a long history with VER, the Finnish government buffer fund, which today manages €20 billion of pension assets, having held the role of CEO for 12 years from 2003. In 2015, he was given a five-year leave of absence to take up the prominent post of vice-chair of the European Union's Single Resolution Board in Brussels, who were looking for someone with his level of professional knowledge and experience. He is now content to be back at VER in the role of CEO.

Löyttyniemi explains: "My experience in Brussels was extremely interesting and quite unique – I was involved in starting up an organisation, helping to recruit 400 people and raising over €30 billion for the Single Resolution Fund; but I was eager to come back once I knew the five-year term was coming to an end. I felt truly motivated to come back to VER in particular because I knew the processes well at the organisation and I knew most of the people."

Within days of being in the new role, however, it was clear to Löyttyniemi that the coming months weren't likely to go as planned: "For two weeks I was in the office, together with my co-workers, carrying out normal practice, but by that time the markets were already in turmoil. Then on 16 March, we decided to move to remote working following government advice and, since then, we have been mainly working from home. Of course, we expected to be back to some kind of hybrid model after the summer break, but that didn't materialise and now that we are clearly seeing a second wave of Covid-19 in Europe, we have to stay in remote mode."

The downsides of remote working for the organisation, however, have been minimal, argues Löyttyniemi, and in fact the situation has helped staff to focus on what really matters at this challenging time. "Remote working is less sociable, of course, and there is possibly less innovation in certain areas, but it is also easier to say no to many items that aren't entirely necessary and that keeps us focussed on what really matters to us."

In terms of the fund's investment approach to date, despite the unprecedented times, VER has fared well. "Luckily we sold some equities before the crisis and therefore we were mentally ready to buy some equities during the crisis too – but while we did some of that buying, it wasn't quite in the same magnitude as we did during the financial crisis of 2008. This time my feeling was that there was a little bit more of the unknown in terms of what was lying ahead, so we didn't buy as aggressively as we did in 2008."

Alongside this, continues Löyttyniemi, VER has not made any significant changes to its strategy, which has worked to the fund's benefit: "As the crisis developed, there were counteractions by central

"ONE IS ALWAYS TEMPTED TO MAKE LARGE MOVES IN CRISIS MOMENTS, BUT BY NOT DOING SO AND STICKING TO OUR STRATEGY, WE AVOIDED ANY BIG MISTAKES"

banks and governments that supported the equity markets very strongly. We kept to our strategy and asset allocation, of course underweighting and overweighting depending on what was happening, but we were largely exposed to equity markets and therefore we got the full benefit of the upside during any upswing.

"One is always tempted to make large moves in crisis moments, but by not doing so and sticking to our strategy, we avoided any big mistakes."

With the first eight months as CEO behind him, Löyttyniemi is now looking ahead to what the future might hold for the fund.

"At this time of year, we are in the midst of our investment planning work, looking towards 2021. The turmoil in the market has, of course, left its footprint in everything that lies ahead; and on a large scale, in terms of equity risk, credit risk, government bond risk, the developments that were ongoing have been intensified because of the crisis – government yields were already low, but now they are even lower; risky assets, which were high in price are now even higher in comparison to earnings than they were before. So, the crisis has intensified the trends that were already prevailing, so we will plan accordingly."

In terms of next steps, he continues, one thing VER will be doing is continuing to put more emphasis on non-liquid investments including infrastructure, private credit, and private equity.

"These investments are, however, quite labour intensive and they require a lot of due diligence. Therefore, there are limits as to how much one can do per year but, still, we are expanding and taking the next steps in that direction."

Another area where VER is further developing its approach is in relation to environmental, social and governance (ESG) investing. Löyttyniemi explains: "We started a number of years back with negative screening and that has since evolved. We are also signatories of the UN Principles for Responsible Investment (PRI) and we have developed that into ESG integration in general. Going forward, we are further updating our ESG and sustainability approach and one of the concrete ingredients in that new approach will be in relation to carbon matters in general and how we are integrating carbon footprint into our investment strategy.

"One of the metrics we are using is carbon intensity as a measure – public equities are fairly transparent on these matters as are, increasingly, fixed income securities and credit instruments – the metrics are developing as we speak."

On the ESG front, Löyttyniemi is keen to set reasonable expectations and avoid doing anything to simply follow a trend. "Typically, Finnish people are quite practical, so if there are buzzwords or something that is gaining popularity, we will look at doing it without making a fuss about it.

"But lately I can see that some pension investors in the Nordics have been trying to take quite ambitious steps when it comes to ESG. Of course, we are following what the market and other participants are doing, however we want to implement what is implementable so I wouldn't declare a vision that is too aggressive in this arena.

"For example, when it comes to the topic of carbon footprint, pension investors should take into account what politicians are doing; so if politicians are making actions in the carbon footprint arena, towards carbon neutral societies, then pension funds should be following suit. But at the same time, if politicians are delaying actions, then pension funds in my view should also be adjusting." ■

Global small caps focus:
A WORLD OF OPPORTUNITIES

As recovery strengthens, look for opportunities in global small caps

American Century Investments discusses the opportunities the pandemic, and ensuing recession, has created for global small-cap investors

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Bouncing back stronger

As the world's financial markets look to recover from the coronavirus pandemic, Jack Gray explores the possibilities that global small-cap investments present for pension schemes

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INVESTMENT

As Recovery Strengthens, Look for Opportunities in Global Small Caps

American Century Investments Senior Portfolio Manager, Trevor Gurwich, discusses the opportunities the pandemic, and ensuing recession, has created for global small-cap investors

It has been said that the one constant is change. Change may be inevitable, but I don't think anyone anticipated the speed or severity of change global markets have experienced so far this year. While the coronavirus pandemic and resulting recession have pressured economies and investment markets alike, they have also created opportunities for global small-cap investors who can adapt quickly to shifting conditions.

As we continue to navigate the uncertainty around the current health crisis, we believe our bottom-up investment approach helps us identify opportunities in companies whose earnings are inflecting positively despite current volatility.

While we note that small-cap stocks have historically underperformed large caps during risk-off periods like we saw at the peak of the pandemic, they have also led during recoveries, as seen during the past two recessionary environments. Because it's difficult to time such moves, we believe it's important to maintain a long-term allocation to global small caps. While the length and scope of this crisis remains uncertain, we think small caps may now be able to lead markets higher following their underperformance in this downturn.

The Importance of Staying Nimble

We believe our investment process helps keep us nimble, allowing us to capitalize on persistent inefficiencies and recent market dislocations in the global small-cap universe. Our process seeks to identify early fundamental inflection points that lead to sustainable acceleration in earnings growth. Small caps tend to experience higher frequency of inflection points and greater share price volatility than their large-cap peers. For example, when a large global company like Nestlé launches a new product or expands into a new geography, it is less likely to translate into a positive fundamental inflection point than for a comparable small-cap company.

Global small-cap markets also tend to be slow to recognize inflection points in growth trends. We focus on exploiting such inefficiencies by identifying companies in the early stages of a growth cycle. Capturing an inflection point and reacting quickly in an effort to take advantage of potential earnings acceleration are key to our process and particularly important in global small-cap investing.

Recent stock market volatility, changes in consumer patterns and higher earnings variability have translated to a broad array of compelling investment opportunities, including companies that are inflecting positively and with shares we believe are mispriced. We believe the key to success in such an environment is the ability to quickly source and research new ideas, capitalize on market dislocations, and objectively incorporate both upside and downside risks. An additional key benefit to this approach is a broad opportunity set. We seek sustainable improvement and don't limit ourselves to companies delivering above an absolute level of growth. We are finding such earnings improvement in a wide range of companies, including those benefiting from secular growth trends, cyclical recovery and evolving consumer behavior trends.

Advantages of a Global Approach

In our view, investing globally delivers more compelling risk-adjusted returns compared to a regional small-cap approach. We believe our global approach can offer diversification and performance potential through exposure to a greater opportunity set, while helping to offset any home country bias. We believe active managers can avail of the best opportunities and highest conviction ideas regardless of region, sector, industry or domicile. A universe of more than 6,000 names provides access to 'best-of-breed' companies on a global basis and, importantly, to those companies that represent good process fits.

We view environmental, social and governance (ESG) factors as an important input into our fundamental research, which could potentially help decrease downside risk or increase exposure to upside potential. Our integrated ESG approach focuses on issues that may materially impact a company's business fundamentals, notably a company's earnings visibility and growth trajectory.

Selectivity Is Key as the Outlook for Earnings Remains Unclear

The impact of COVID-19 on earnings has been large and notable. Visibility for future earnings remains murky, with many companies withdrawing or declining to give guidance. The range of potential earnings scenarios underscores the importance of selectivity. We seek to differentiate between businesses facing cancellations and longer-term demand hits versus those that may only experience delays in revenues. For example, travel-related companies such as airlines, hotels and cruise lines have taken dramatic hits to revenue, as business and recreational travel has all but ceased during the pandemic. However, companies exposed to outdoor recreational activities, such as boating and recreational vehicle makers, saw sharp drop-offs in revenue as the pandemic worsened, but rebounded strongly as consumers turned to outdoor recreation and vacation activities closer to home.

Pivoting to Take Advantage of Opportunities as Economic Recovery Evolves

Early in the COVID-19 crisis, our bottom-up focus on companies with accelerating and sustainable earnings growth helped us identify companies that were beneficiaries of shelter-in-place measures. Examples included online education, video gaming, and data center companies. We are now keenly observing the recovery in global markets. Signs of improvement or stabilization in multiple countries are further supported by substantial fiscal stimulus measures. As a result, our process is now finding companies that may have suffered during the crisis but are likely beneficiaries as economies begin to reopen.

An example has been a low-cost gym operator in Benelux, France and Spain, whose share price declined by nearly 70% earlier in the year. Its revenues were severely impacted in the short-term due to lockdowns and stay-at-home measures, but we believe the company will benefit as economies continue to reopen. Revenues could decline by 15% in 2020, but we forecast accelerating revenue and earnings growth in the latter half of 2020 and into 2021. Additionally, the company recently raised extra funding that we believe will support future revenue growth and market share gains versus its weaker competitors, many of which lack scale and are struggling. ■

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Historically, small cap stocks have been more volatile than the stock of larger, more-established companies. Smaller companies may have limited resources, product lines and markets, and their securities may trade less frequently and in more limited volumes than the securities of larger companies.
Diversification does not assure a profit, nor does it protect against loss of principal. Past performance is no guarantee of future results.
A strategy or emphasis on environmental, social and governance factors (ESG) may limit the investment opportunities available to a portfolio. Therefore, the portfolio may underperform or perform differently than other portfolios that do not have an ESG investment focus. A portfolio's ESG investment focus may also result in the portfolio investing in securities or industry sectors that perform differently or maintain a different risk profile than the market generally or compared to underlying holdings that are not screened for ESG standards.
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INVESTMENT

Bouncing back stronger

As the world's financial markets look to recover from the coronavirus pandemic, Jack Gray **explores the possibilities that global small-cap investments present for pension schemes**

WRITTEN BY JACK GRAY

Immediately following the outbreak of the coronavirus pandemic, many European pension schemes saw their investment returns plummet as the world's economy reeled from the shock. As time has passed, markets have shown tentative signs of recovery. Although much uncertainty remains, investors have seen opportunities arise to help schemes bounce back stronger. However, it is not just following times of financial hardship that global small caps present an attractive investment opportunity, with evidence showing their long-term risk-adjusted returns outperforming many other asset classes.

Risk and reward

"When you take a look at small caps, you see that small caps deliver superior risk-adjusted returns over time," begins American Century Investments vice president and senior portfolio manager, Trevor Gurwich.

"You have a higher annualised return, you have a slightly higher standard deviation, but ultimately the value proposition and Sharpe ratios confirm superior risk-adjusted returns. Looking back over 20 years (1 January 2001 to 30 September 2020), small caps have delivered a far more compelling Sharpe ratio of 0.37 versus large caps, whose Sharpe ratio was 0.24."

Gurwich notes that although the standard deviation of small caps is slightly higher than large caps, 17-18 per cent compared to 15-16 per cent, annualised returns for small caps average 8 per cent, compared to 5 per cent on large caps.

"I would say it is much higher return versus slightly higher risk," he says. "That is what gives you the superior risk-adjusted returns over long time periods.

"To mitigate the risk, I think what you do is portion the size of the allocated amount of small cap exposure you want in your portfolio. If you are a more aggressive type of pension fund, you take a larger slice.

"Global small-cap exposure is something you must have in this world where rates are low and you are seeking growth opportunities. Also, if one wants to get exposure to 90 per cent of the world's initial public offerings (IPOs) and 90 per cent of the world's mergers and acquisitions (M&As), small caps are your ultimate destination."

Legal & General Investment Management fund manager, Andrzej Pioch, adds that small-cap exposures can provide an additional return driver (size premium) from a factor investing approach due to the theoretical reasons of reward for additional risk, and familiarity and availability bias.

Furthermore, there appears to be a global small-cap premium going forward, according to AP1 head of equities and strategy, Mats Larsson. He continues: "The market for small caps also offers a better potential for positive alpha, which might be more important than ever as the expected return for equity beta is relatively low over the next decade."

Russell Investments head of multi-asset EMEA, Alain Zeitouni, echoes this positivity. He notes that, in annual rolling 10-year returns, smaller companies have always outperformed large caps, and investing in them provides a good opportunity for growth for pension schemes with long investment horizons.

"The second benefit of investing in smaller companies is the breadth of the market," he explains. "The MSCI ACWI Small Cap Index has almost 6,000 constituents, while the MSCI ACWI (large caps only) has fewer than 3,000 stocks. Investors have almost twice as many stocks to choose from when seeking out the best risk-adjusted returns.

"Thirdly, smaller companies are less followed by the analyst community, offering better opportunities for active stock-pickers."

Active managers

When looking to incorporate small caps into a pension scheme investment portfolio, Gurwich recommends hiring an active small-cap manager rather than going passive, as there is a lot of room to exploit the inefficiencies in the small-cap world and deliver additional excess returns.

"People sometimes look at the annualised return and the standard deviation and they think it is risky," he adds, "but ultimately your risk-adjusted returns are highly compelling, especially when you take an active manager."

Zeitouni notes that, when looking at managers' performance dispersion, the impact of picking the right manager is even higher for small caps than in the large-cap space, which he attributes to heterogeneous performance. However, he states this can be overcome by using a multi-manager approach to mitigate idiosyncratic risk and therefore build a strong portfolio of proven experts in the asset class with a solid investment process and robust risk management expertise.

Bouncing back

Small caps have historically performed well following an economic shock, with Bloomberg data showing that after both the dot-com crash and the 2008 financial crisis, global small caps bounced back stronger than large caps.

Gurwich explains that global small caps have this ability as they are nimbler at cutting costs and re-positioning their business. Additionally, rates appear to be low and are expected to continue to be low for a long time, which allows firms to refinance, replenish cash reserves and engage in more M&A.

"We are expecting, after negative 10 per cent growth in 2020, almost 32 per cent earnings growth in 2021, so a dramatic acceleration in earnings growth in a small cap is higher than what is going to happen in the large cap universe," says Gurwich. "I think that you are poised, if you believe we are in an economic rebound phase, to get a strong recovery in small caps."

Larsson agrees that the current economic situation presents opportunities for global small-cap investments "in relative terms", while LGIM global equity strategist, Lars Kreckel, notes that small caps are part of the equity universe that is more sensitive to the economic cycle and benefits the most from early recovery dynamics.

"In the early parts of the year, as the pandemic spread, small caps were among the stocks suffering the largest drawdowns," he adds. "But they have also bounced back more sharply than large caps in most regions as economies began to recover and risk appetite returned. Looking ahead, we continue to like the prospects of some recovery trades."

As the current economic environment is characterised by lower yields for longer periods of time, Zeitouni says, borrowing costs will remain low, which is supportive for smaller companies given their need to grow and invest into future growth.

"Having lower yields should help them expand at a cheap price," he explains. "Moreover, in a low-growth environment, as we stand, and with companies still holding significant buffer of cash on their balance sheets, smaller companies are potential targets for M&A activities (given the cheaper funding costs) which should benefit the asset class."

Gurwich concludes: "A global small-cap allocation is something that should be in everybody's portfolio, ultimately it is delivering almost private equity-like returns with daily liquidity and at a fraction of the fee. Our 20-year track record in our non-US small cap product has compounded at above 13 per cent per year on average vs the index at 8 per cent." ■

COUNTRY SPOTLIGHT NETHERLANDS

Blades of change

Newly-agreed changes to the Dutch pension system represent a great leap for one of the planet's forerunners. Duncan Ferris **examines how the reforms might affect savers on the street, pension professionals and investment tactics**

WRITTEN BY DUNCAN FERRIS

When Michael Jordan said: "I believe greatness is an evolutionary process that changes and evolves era to era," it's unlikely that he was speaking about the Dutch pension system. It is a quote that seems oddly pertinent when examining the upcoming changes to how the nation's workers will be saving for and enjoying their retirement though.

In 2019, the Dutch pension system was crowned as the world's finest by the *Melbourne Mercer Global Pension Index*, narrowly beating out Denmark to hold the top spot for the second year in a row. If you like, the Dutch seem like the Michael Jordan to Denmark's Magic Johnson. But just as Jordan spoke of the need to keep things moving, the seemingly exemplary Dutch pension system is set for a shakeup.

In essence, the transformation will see it move from a defined benefit (DB) style structure to defined contribution (DC). The government, employers and trade unions reached an agreement in July for the new measures to gradually come into force by 2026/27.

A fair deal?

With such sweeping reforms being introduced, it makes sense to first examine whether they are fair to the people to whom they will matter the most – retirement savers.

APG managing director for strategic portfolio advice, Onno Steenbeek, is positive about the effect that the changes will have for savers, arguing that the new system "better reflects the risks in the system and it will enhance the personalisation of pensions".

He adds: "Tailoring pensions to individual preferences will improve by, for example, the provision of a partial lump sum, more detailed tailoring to risk appetite and retirement date flexibility (in case of physically demanding jobs).

"Choice architecture will develop to enable participants to shape their pension to their personal needs. The new pension contract also unlocks value in existing pension savings by introducing annuities that move along with investment returns."

Aon senior ALM consultant, Corine Reedijk, examines how the removal of so-called buffers from the system will affect savings, noting that this means that "all available means can be given to the participants", which will increase pension incomes but create a "bigger risk of reductions" because of fewer safety nets.

Reedijk adds that investment returns can be attributed differently to different age groups, sharing the example that "young people can invest 100 per cent" in equities, which she states "will lead to welfare gains for the total population, according to the calculations of the Dutch Central Planning Bureau (CPB)".

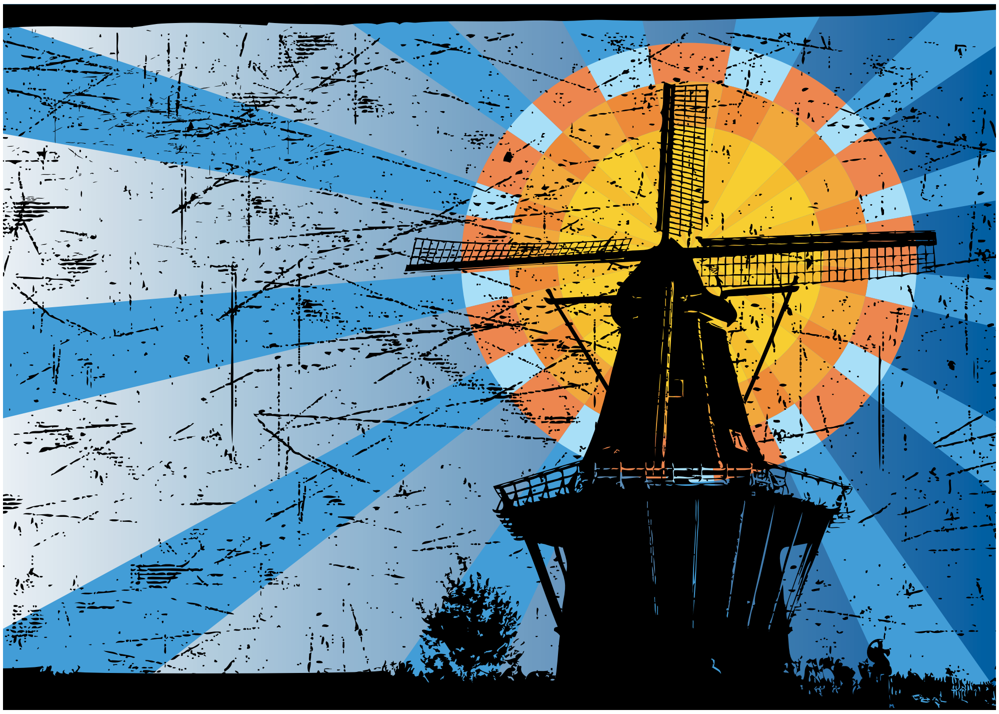
Reedijk concludes on the matter: "From calculations of the CPB, it shows that all participants benefit from moving to the new system. The participants receiving their pension benefit from the fact that in the new system no buffers are built up and investment windfalls are directly translated in indexation. The drawback is that in the case of setbacks, benefits are reduced. Participants will receive a more volatile pension."

Speaking in June, AXA Investment Managers head of quant lab, Laurent Clavel, raised a similar issue as he made one major downside of the new system clear. He commented: "You have to be mindful that the risk is not gone. You have transferred the risk from the state, eventually, and the regulation, to the people, to the pensioners, because you are no longer guaranteeing anything."

This makes it seem like something of a slam dunk for savers, but once we arrive at the issue of how the changes will affect those already receiving their pension, we begin to learn about the challenges that administrators could face.

Admin challenges

For those already receiving benefits, Reedijk points out "if participants already receive a pension from an insurer" it is not



"BY DEFAULT, THE ACCRUED RIGHTS ARE MOVED TO THE NEW SYSTEM"

expected that their benefits will be affected by the changes.

She further explains: "By default the accrued rights are moved to the new system. However, it is possible to leave them behind if the calculations show that leaving them behind benefits the participants. In that case, two different pension contracts have to be administered; one for the old accrued rights and one for the new rights."

While this is fairer for individuals already receiving a pension, this of course represents a difficulty for administrators and pension fund boards, who will either be responsible for the fair transition to the new contract or be left spinning two plates at once.

But it is not the sole challenge that pension professionals will be confronted by during the transition to the new system.

Reedijk outlines several further key challenges for administrators, beginning with the fact that, under the new contract, investment returns are attributed differently to different age groups. Administrators will also be expected to organise hedge returns and a solidarity reserve, which Reedijk explains is meant to be "fed with excess returns and premiums and is used in times of bad investment returns".

Steenbeek concurs that administrators face "substantial adjustment" due to the reforms but points out a different concern for administrators, stating that "the most important challenge concerns the communication to participants and pensioners".

He comments: "For them it is important to understand the value of their pension and pension savings and the choices they have to tailor it to their personal needs. Also, the administrative systems will be further enhanced in order to communicate via personal pensions accounts, possibly incorporating other sources of pension income such as first pillar benefits."

Despite the difficulties caused by this process, Steenbeek remains confident that, following the adjustments required to adapt, the administration systems "should be simpler than they are today".

Investment

Research from the European Commission published in April 2019 found that bonds were the most common investment, with debt and fixed-income securities accounting for 48 per cent of total investment. Meanwhile, equities and other variable-yield securities made up 37 per cent, real estate was 9 per cent of the total, and other investments made up 5 per cent.

However, this makeup could change with the leap to a new system, as institutional investors look to achieve new targets for their funds in a DC environment, meaning that administrators will not be the only pension professionals with a tricky task on their hands.

Reedijk first notes that, although it will be standard practice for the assets to be transferred to the new system, they can be left behind in the old one "based on substantiated arguments and calculations".

Then, on the topic of how investment practices might change under the new system, she notes that the first step for funds is "the determination of the risk attitude of the population".

Reedijk comments: "It could be that the risk appetite is somewhat more offensive as the new system has more volatile pension payments. Then the total asset portfolio can be invested somewhat riskier. Furthermore, the hedging of the interest rate risk will be set up differently.

"Currently, the liabilities are determined based on the risk-free interest rate term structure and this is the basis for hedging collectively. In the new system the hedging return is based on (probably) individual cashflows."

Speaking in June, AXA Investment Managers country manager in the Netherlands, Hanneke Veringa, stated that asset allocations were expected to change "massively" over the period of transition to the new system, predicting that the changes would lead to €500 billion-worth of assets being transferred from liability driven investments to cashflow driven investments.

She added: "That will imply that pension funds are expected to move out of govies, potentially out of long-dated swaps with a maturity of over 10 years and increase their allocations to credits in particular, and potentially also index linked bonds."

Steenbeek agrees, stating that the move will mean that the focus of investment policy will likely shift "from benefits and coverage ratios towards capital accumulation and return".

He continues: "Depending on the details of the contract (either the more individual or the collective variant), asset management and the corresponding risk management may be affected. In case of the collective variant, the strength of long-term responsible investing in broadly diversified portfolios will be strengthened.

"Corresponding risk management may be affected by changing attitudes towards interest rate hedging and resulting liquidity requirements. In case of the individual variant, diversification may be limited to mostly liquid asset classes."

"WE THINK COMMUNICATION IS KEY IN BOTH THE TRANSFER TO AND IMPLEMENTATION OF THE NEW SYSTEM"

Steenbeek adds that none of this is certain as "many important details of the new pension contract are still not decided upon", explaining that the mixture of assets invested in "may become more or less risky" depending on the final deal.

Risks

As well as some challenges for pension professionals, there are of course always some risks associated with any sweeping systematic changes. While this piece has already covered the issue of the element of risk being passed on to individual savers, what wider issues are there?

Reedijk explains: "Currently, most pension funds in the Netherlands are not in good shape and have reserve deficits. For this year the minister changed the rules for benefit cuts. Normally, a pension fund would have to cut benefits if the funding ration is below 104.3 per cent five years in a row. Now this has been changed to 90 per cent.

"It is still unclear what the rules will be in the period till 2026. The risk of significant benefit cuts in the transition period is one of the big risks at this moment. That risk affects the support for the new system and more specifically the time needed to move to the new system. Pension funds would rather move quicker."

Reedijk adds that another risk of the reforms is the member communication associated with it, noting that the introduction of more transparency and solidarity mechanisms such as different investment returns for different age groups "will require good communication".

She adds: "The move from the old to the new system and how current entitlements are transferred to individual savings requires good communication as well. We think communication is key in both the transfer to and the actual implementation of the new system."

"Furthermore, starting points for the transition from the old to the new system are cost neutrality on one hand, and compensation of participants who have a deterioration of pension outcome on the other hand. These starting points will be difficult to combine."

Steenbeek is more positive, commenting: "The transition to a new pension contract mitigates risks by personalising pensions to fit ever-changing labour markets and offer income security to pensioners as well. In this transition, pension funds and their pension delivery organisations are challenged to use their ability to be in control to manage change." ■

Royal Dutch Actuarial Association

Slowing longevity and its impact on pensions

THE ROYAL DUTCH ACTUARIAL ASSOCIATION EXPLAINS THE RESULTS OF ITS LATEST MORTALITY TABLE AND THE IMPACT THIS HAS ON DUTCH PENSION SCHEMES

Every two years, the Royal Dutch Actuarial Association publishes a model that estimates life expectancies for men and women in the Netherlands. This model also provides the mortality table that is used for Dutch pension calculations and a method to generate scenarios for future survival probabilities. In the most recent estimates, the increase in life expectancy has been adjusted downwards to an average of 89 years for men and 92 years for women. Future improvements in survival rates have been taken into account in the calculations.

Slower rise in retirement age and lower technical provisions are expected

The Dutch pension system consists of three pillars. The first pillar is the state pension, and the age at which those payments start depends on life expectancy. It is currently 67 years and it is now expected to rise to 67 years and three months around 2030.

In the second pillar, which consists of occupational pension schemes, the update has led to a decrease in pension technical provisions of approximately 2.5 per cent for average interest rate levels at the end of 2019. For the individual pensions that are found in the third pillar, increased benefits at the start of the retirement period are expected.

Inclusion of European data leads to stable trends

The model uses Dutch data and data from European countries with a comparable level of prosperity, such as the United Kingdom, France and Germany. As a result, the prognosis is based on a dataset that contains about two million deaths per year, which enhances the stability of the estimates over time. In our model, Dutch life expectancies are expected to converge to long-term European trends eventually. Any European country with comparable prosperity can use our approach, when its data is added to the common European dataset. In Belgium, a very similar method has already been implemented.

The effect of Covid-19 has not been included yet, but preliminary sensitivity analysis indicates a possible further decline.

"THE EFFECT OF COVID-19 HAS NOT BEEN INCLUDED YET, BUT PRELIMINARY SENSITIVITY ANALYSIS INDICATES A POSSIBLE FURTHER DECLINE"

It is not yet possible to fully include the impact of Covid-19 in our forecasts. There are still too few datapoints available for 2020 and the impact in different European countries varies considerably. As a first indication of the possible impact, a sensitivity analysis has been performed, based on data from the Netherlands, Belgium, the United Kingdom, France and Germany.

We looked at two possibilities. In the first analysis, only the effects of the coronavirus wave in the spring is taken into account. The second study estimates the impact of a possible doubling of that effect due to developments in the rest of 2020. In the first case we find a reduction in remaining life expectancies of 0.44 years for men at age 65 and 0.19 years for women of that age. In the second case the impacts grow to 0.87 years and 0.33 years respectively. When more data becomes available, it will be possible to provide better estimates for such effects. ■

Written by Royal Dutch Actuarial Association, Mortality Research Committee (CSO) members, Marco van der Winden and Michel Vellekoop

The full mortality table can be found at ag-ai.nl/ tuarieelGenootschap/ Publicaties.

COUNTRY SPOTLIGHT UK

Stepping up to the plate

As sustainable and responsible investing enters the spotlight, the UK is trying to harness the power of pensions to bring about positive change. Jack Gray **assesses the regulatory changes designed to achieve a greener pensions system and their impact on trustees**

WRITTEN BY JACK GRAY

"Net zero is a long-term challenge facing our country. By unleashing the productive power of our pensions and engaging with savers, we can get there," UK Pensions Minister, Guy Opperman, stated in a recent essay series. His call for pension schemes to unleash their power is an example of the changing attitudes in the UK to utilise pensions to help fight climate change.

Several consultations and policy initiatives have been published and enacted in the past few months to help nudge trustees and providers to consider more environmentally-friendly investments and actions. In August, the Department for Work and Pensions launched a consultation proposing requirements for larger occupational pension schemes and authorised master trusts to publish climate risk disclosures and have effective climate-related governance, strategy, and risk management in place from October 2021.

It also proposes that large schemes report on climate risks in line with the Task Force on Climate-Related Disclosures' (TCFD) recommendations by the end of 2022. These requirements would apply to schemes with more than £5 billion in assets and authorised master trusts, before extending to include schemes with £1 billion or more in assets from 2023 and consulting on extending them to all occupational schemes in 2024.

Additionally, from October 2020, trustees will need to publish an implementation statement alongside their scheme annual reports and accounts, describing whether certain climate-related policies in their statement of investment principles (SIP) have been followed and disclose the trustees' voting behaviour. However, this will not apply to most trustees until their next SIP on 1 October 2021.

"These changes were designed to ensure that trustees identify all investment risks, they take action to mitigate them and they disclose their actions on a publicly-available website," explains Aviva policy manager for workplace savings and retirement, Dale Critchley. "The intention is to evidence trustee oversight to members, but also to enable easier enforcement activity by The Pensions Regulator (TPR). The challenge for many trustees has been in synthesising the necessary voting and engagement data from numerous fund managers."

The Financial Conduct Authority

(FCA) has also recently confirmed plans to require asset managers and FCA-regulated pension schemes to report on the climate risks of their assets in accordance with recommendations from the TCFD, while measures on climate reporting have been included in the Pension Schemes Bill currently making its way through parliament.

Taking the initiative

The increased focus on greener pensions has been partially member-driven. Now Pensions director of policy, Adrian Boulding, explains: "Increasing numbers of members want to know that their pension is invested in areas where the money will do good things as well as earn a good return.

"Initiatives like Richard Curtis' Make My Money Matter have made the issue more respectable and mainstream than the efforts of radicals like Extinction Rebellion. This is fine if a pension scheme offers a choice of funds, such as an ESG-tilted version of the standard stock market index, but it presents a communication challenge to schemes that run a single default fund."

Herbert Smith Freehills pension practice counsel, Michael Aherne, adds that public criticism over inadequate disclosures or a failure to properly consider ESG factors could force trustees to reconsider their investment strategy.

"ESG-related challenges against pension schemes in the UK have already been seen, so there is also a risk for the scheme's sponsor of indirect reputational damage (particularly if the approach of the trustees is not in line with corporate values)," he continues. "Put together, this means careful consideration should be given to the form of disclosures to ensure they are meaningful, substantive and engaging."

Adapting trustees

With so much change in attitudes and regulation, pension scheme trustees are having to adapt to the evolving environment. Critchley says the biggest challenge facing trustees is in measuring the progress within their investment strategy towards their goal, as there is a dependency on the availability and robustness of data, an area which is evolving.

"A further challenge for trustees will be monitoring the solutions they adopt within their investment strategy, along with their investment adviser, to ensure it's consistent with their ESG beliefs," Critchley explains. "It may be that trustees will need to alter their course as the market and the new economy develops, but that doesn't mean they should delay setting off in the right direction.

"None of the proposals require trustees to follow a particular investment strategy, but in asking trustees to address more searching questions, the expectation is that the answers will become increasingly obvious. Changes will need to be made to focus on those investments with the brightest future in a world aligned to fulfilling the goals of the Paris Agreement."

Aherne notes that, although trustees and schemes will face challenges, there are a range of possible mitigations. "To begin with is the basic issue of non-compliance with the new and upcoming requirements, particularly in respect of timing and form of disclosure," he states. "Failure to comply can lead to fines from TPR, so trustees should make sure to obtain legal advice."

Aherne adds that trustees will be expected to genuinely consider how their scheme is potentially vulnerable to and affected by climate change as part of their disclosure process, rather than taking a 'box-ticking' approach.

Looking to the future

Despite the challenges, Dalriada Trustees head of technical, research and policy, John Wilson, says that most trustees do not need reminding of their changing duties as the amount of material published and months of explanations by the investment, legal, trustee and consultancy sectors mean that trustees are aware of their evolving roles.

"Trustees are aware of the changes and have responded; some by bringing forward the date of signing of their accounts to reduce the impact for this year; and many by taking a practical approach to reporting, bearing in mind that the investment reports in this year's annual accounts will be based on a statement of investment principles in force during the last scheme year," he explains.

"There are more requirements still to come in 2021 and we expect that, like chairs' statements, implementation statements will evolve as 'best practice' is defined."

However, Wilson ponders whether the increased information made available to members will be read and if there will be changes in the behaviour of asset owners.

"At very least, the implementation statement, like the chair's statement, will focus the minds of trustees," he summarises.

Looking forward, reporting obligations are only going to increase and become more burdensome for UK trustees, according to Aherne.

"The form of the reporting is still to be decided but whatever shape regulations take, affected trustees will need to reconsider their governance and decision making processes generally to accommodate the new disclosures requirement given that TCFD is not just a reporting obligation but a fully integrated approach to climate change risk management," he concludes. ■

INTERVIEW

Navigating the changing tides

Merchant Navy Officers Pension Fund (MNOPF) chair of trustees, Rory Murphy, **chats to,** Sophie Smith**, about how the scheme has helped its members throughout the coronavirus pandemic and going forward**

WRITTEN BY SOPHIE SMITH

With Covid-19 bringing both financial volatility and social lockdowns, how has the MNOPF been able to support members, both in terms of their retirement savings, and in terms of their broader wellbeing?

The MNOPF has delivered increased security for members' pensions savings through its ongoing programme of risk-reduction exercises and investment management, which has resulted in an increase infunding level (on a technical provisions basis) to 100 per cent over the year to 31 March 2020, despite the global investment market turmoil as a result of coronavirus.

A collaboration between the MNOPF, our executive services provider Rock Pensions, and Wellbeing People delivered a series of 13 free wellbeing webinars to the MNOPF's 23,000 members and their friends and families, weekly, throughout May, June and July. With around half of members in the vulnerable over 70s group, the webinar series was designed to support members to achieve optimal wellbeing not only through this testing period but also to deliver lasting long-term benefits.

Why did you feel it was important to support members in their broader wellbeing, such as mental health, and what impact has this had on scheme members?

A key fiduciary duty for trustees isto act in the best interests of members and their beneficiaries and this has often focused solely on their financial interests. However, there's more to wellbeing than just a comfortable retirement income. The coronavirus pandemic, and the various social restrictions associated with it, have led to growing levels of anxiety, loneliness and depression. The webinar programme gave members help in dealing with self-isolation, nutrition, and mental health and created a 'community spirit'.

What role do you think the broader pensions industry should have during the current pandemic, especially in terms of communicating with members?

The pensions industry has recognised the importance of communicating with members during the pandemic. The Pensions Regulator in the UK released guidance for trustees on doing just that. This guidance, however, focuses on the financial impact of the pandemic on members' benefits.

In these exceptional times, trustees are in a unique position, through their contact with their scheme member communities, to consider members' interests holistically and provide support in areas other than just financial. As a pension fund, the MNOPF believes that it has a responsibility not only to ensure that the fund's long-term goals are met and pensions are paid, but also to reach out and provide support to members so that they can maintain good physical and mental health.

As the pandemic continues to rattle on around the world, how will the MNOPF continue to support members amid the current circumstances?

The wellbeing webinars have provided a virtual way for hundreds of MNOPF members to meet up with other members, share experience, and improve their wellbeing. To build on the momentum created bythe webinars, the MNOPF is continuing its collaboration with Wellbeing People to host two further wellbeing events, at a free or subsidised cost; a Virtual Optimal Wellbeing Retreat – a one-day workshop for members and their families, and a 12-week Recalibrate Wellbeing Programme.

The success of the MNOPF wellbeing initiative has shown that,done properly, the pensions industry can, and should, do more than just provide a retirement income.

We can enhance members' positivity about the scheme, build better communications with our members and, above all, make a real contribution to their wider wellbeing, beyond the purely financial. ■

Estonian Pension System

A time of uncertainty

ESTONIAN INSURANCE ASSOCIATION CEO, MART JESSE, DISCUSSES THE IMPACT THE GOVERNMENT'S PLANS TO MAKE THE SECOND PILLAR VOLUNTARY, AND GIVE EVERYONE THE RIGHT TO ACCESS THEIR FUNDS EARLY, WILL HAVE ON THE LONG-TERM SUSTAINABILITY OF THE COUNTRY'S PENSION SYSTEM

For the last two decades, the Estonian pension system has been stable, having been built on a three-pillar model. As usual, the first is the state pay-as-you-go pension, the second is a mandatory funded pension and the third is a voluntary funded pension. Minor fixes have been introduced over the years, but the general principles have remained unchanged.

In recent years, general dissatisfaction regarding the performance of the second pillar has increased due to low investment returns in comparison with the performance of peers in other OECD countries. The conservative regulation of pension products in Estonia should have been reviewed years ago but discussions regarding a major revamp started too late.

The Estonian experience should be used as an example for all countries to monitor the performance of their pension systems and to use all opportunities to improve it.

After the March 2019 General Election, a populist coalition came to power, agreeing to reform the second pillar and convert it into a voluntary system. This included giving the right to everyone, regardless of age, to withdraw funds. This right to withdraw funds was not limited to the contributions invested by the member but also contributions made by the government.

The funding of the second pillar includes a 2 per cent payment from the employee based on their gross salary, and a further 4 per cent is supplemented by the state budget. Thus, the reform means two-thirds of funds invested by the government originally intended to secure the sustainability of the pension system could be used for consumption and purposes other than providing a pension.

The rhetoric behind the change was to give freedom and flexibility to people. At the same time, projections even by the government itself showed a decline of the future pension replacement rate. However, politically, the change was extremely popular, the draft law was quickly prepared and rushed through parliament without major discussions and amendments.

The changes of the regulation were not promulgated by the President of Estonia and were submitted for assessment to the Supreme Court, referring to violations of the constitution, including inappropriate use of tax revenues, disrespect for rights of future generations and illicit termination of valid annuities.

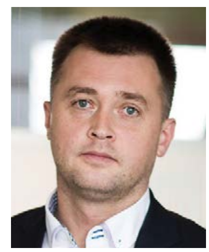
The judgment was released on 20 October 2020. While the court noted several infringements of rights and risks deriving from the law, they were not considered as major violations of the constitutional rights. Thus, the changes to the law were considered lawful and the reform was given the green light.

There are about €5 billion in mandatory pension funds. It is predicted that about 50 per cent of customers will withdraw their investments from pension funds. According to surveys, the people most likely to withdraw the funds are people with less savings and lower level of education. The number of annuities to be terminated remains unclear, but as the regulation gives the insurer the right to transfer their annuities portfolio to the government with the surrender value, it is expected that most insurers will use this right.

Although the right to withdraw the funds will be granted, the system of funded pensions will remain in place. Individuals entering the labour force will be included automatically, however they will be granted the right to opt out.

It is very unlikely that the mandatory funded pension for all labour market participants will be restored in the near future.

The confusion around the second pillar has damaged the image of the funded pension and it will take years of joint effort by the financial sector and the government to restore it. Whether it is doable, or even worth trying, remains unclear. ■



"IT IS PREDICTED THAT ABOUT 50 PER CENT OF CUSTOMERS WILL WITHDRAW THEIR INVESTMENTS FROM PENSION FUNDS"

Written by Estonian Insurance Association CEO, Mart Jesse

COVID-19

Awash with change

As the second wave of Covid-19 sweeps across Europe, Laura Blows considers the effects of the pandemic on the pensions industry so far, how the sector has responded, and the future challenges to come

WRITTEN BY LAURA BLOWS

A second wave of the Covid-19 pandemic is amongst us. Across Europe cases are once again on the increase, with knock-on consequences for all aspects of work and life. The pensions industry is not impervious to the flood of change; it is still 'drying out' from the first wave as this second swell continues to rise.

Investment

Arguably first to be swept away within the European pension funds sector were much of its investment returns.

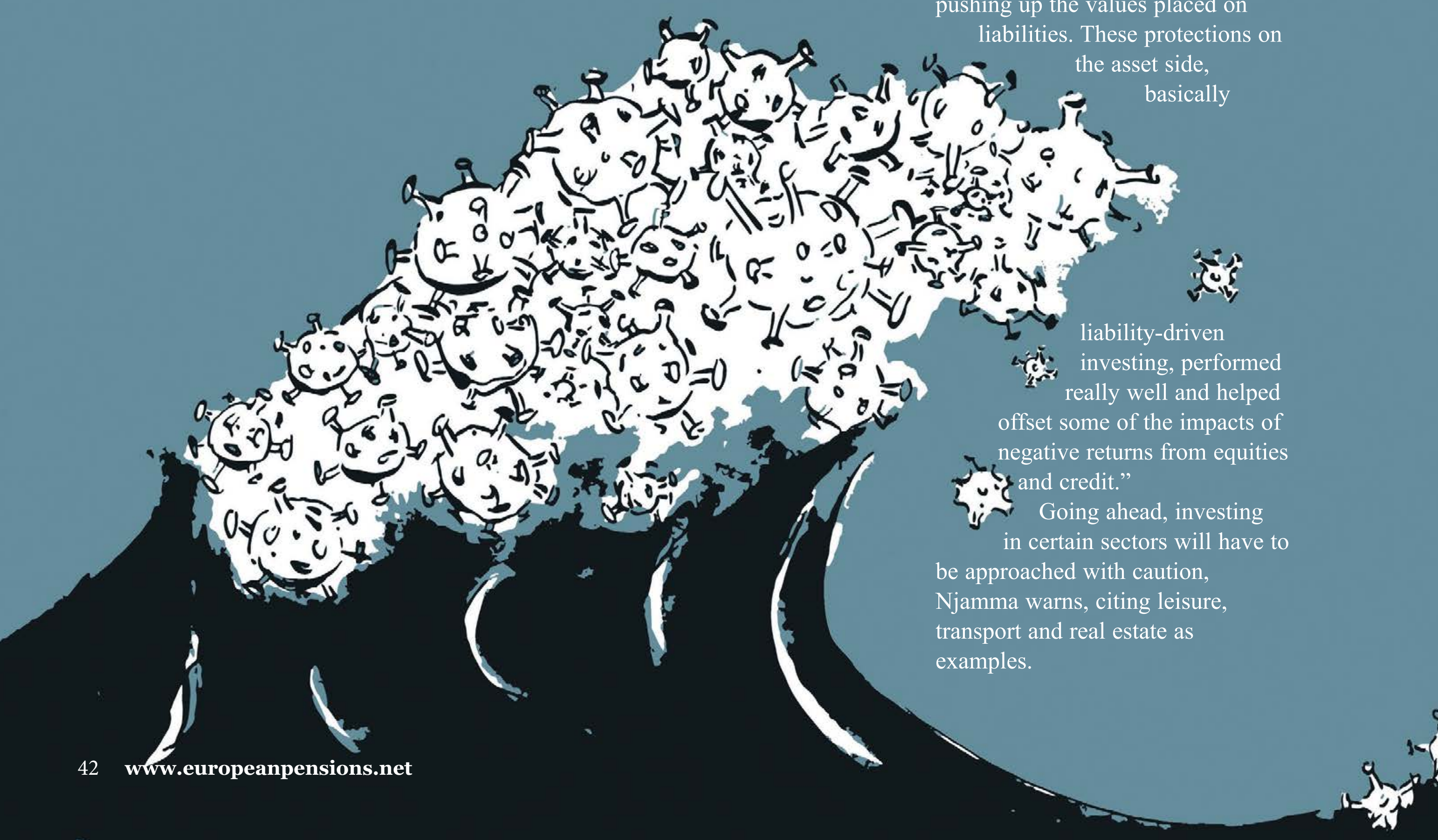
"Particularly at the beginning of the Covid-19 pandemic, the IORP sector has been heavily affected by the market turmoil, which swept away substantial value gains of 2019 from IORPs' investments," a European Insurance and Occupational Pensions Authority (EIOPA) spokesperson says.

Sweden's AP2 buffer fund certainly saw evidence of this, reporting in September that it had returned -5.1 per cent in the first half of 2020, equivalent to SEK -19.3 billion, which it attributed to Covid-19's impact.

"We saw heightened volatility in financial markets with equity exposures experiencing significant drawdown and credit spreads widening (consequently their prices falling)," SEI director for the institutional advisory team, Cyprian Njamma, says.

"Schemes with significant protection against interest rate and inflation risk (ie, highly hedged) fared quite well over the period as long-term interest rates tumbled, pushing up the values placed on liabilities. These protections on the asset side, basically liability-driven investing, performed really well and helped offset some of the impacts of negative returns from equities and credit."

Going ahead, investing in certain sectors will have to be approached with caution, Njamma warns, citing leisure, transport and real estate as examples.



In contrast, areas that provide opportunities and also allow pension schemes to take advantage of their liquidity profile are private assets and infrastructure, Njamma notes.

While many investments indubitably took a hit in Q1, by the second quarter they were already recovering quite well, PensionsEurope CEO, Matti Leppälä, states.

"Funds were able to keep their positions and rebalance after the market started to recover. There were already net increases in equity and bond investments in Q2 in comparison with Q1 and most likely that has continued in Q3," he explains.

Indeed, by the end of August, for most Danes' savings there was a small positive return for 2020 so far, Insurance and Pension Denmark reported in October.

However, according to Leppälä, while the financial markets "seem to be doing much better", the "real economy is in trouble".

EIOPA also notes that while equity markets in Europe have recovered to a significant extent in recent months, concerns on corporate bond downgrades and defaults are still looming.

"Both defined benefit (DB) and defined contribution (DC) IORPs were heavily affected by the market turmoil, which significantly affected the financial situation of DB IORPs and led to significant losses of the investments allocated to members of DC IORPs," it says.

"Investment allocations and strategies of IORPs in Europe are quite diverse, yet generally IORPs are – due to their long-term obligations – capable of investing for the long term and usually have some flexibility in the time horizon for re-balancing to their strategic investment allocation after a plunge that we observed in the first and second quarters of 2020."

> **"ONE ASPECT THAT SHOULD NOT BE SHORT TERM IN NATURE IS CHANGES TO INVESTMENT STRATEGY"**

Indeed, Njamma argues against pension funds reacting too quickly.

"One aspect that should not be short term in nature is changes to investment strategy," Njamma says.

"There is always the temptation to try to time the market (which, by the way, you have to get absolutely spot on twice, in exiting and re-entry)."

It is therefore reassuring to hear BlackRock head of UK institutional defined contribution, Alex Cave, say that the vast majority of its clients have taken very much a long-term view on their investments, believing that in time markets will recover and that members by and large have enough time in order to see the benefit.

"In short, we haven't seen a significant amount of investment activity directly as a result of Covid-19, as decision makers have trusted their long-term asset allocations."

Industry concerns

This keeping calm in a crisis will need to continue as IORPs may not only face further market volatility in the upcoming months, and impairment of market values in a persistent low interest rate environment, but may also be subject to funding and liquidity concerns due to suspended or lowered contributions from sponsors and members, EIOPA warns.

As over 80 per cent of pension schemes in Europe are still DB, Covid-19's hit on employers may well result in problems with funding levels and solvency in DB plans and/or lowering their capability and ability to pay contributions, Leppälä agrees.

In a worst-case scenario, sponsors' insolvency may test national pension protection schemes, EIOPA warns. "The set-up, structures and design of such pension protection schemes are heterogeneous amongst member states and the potential need to use such pension protection schemes may require supervisory attention," it states.

However, Leppälä is pleased with how regulators have responded to the crisis so far.

"It was good that countries provided more flexibility on the recovery plans of DB schemes. It was also good that the supervisors in many cases extended reporting requirements and other supervisory measures and thus strengthened the operational capabilities of pension funds."

In April, PensionsEurope gave some examples of this in a statement. It highlighted how the Dutch National Bank indicated that it will temporarily relax the supervisory burden on pension funds and provide an additional three months for reporting of all annual statements will be provided to IORPs, while Germany offered flexibility for some reporting requirements.

In contrast, the OECD warned in July that several OECD countries have implemented measures, with the goal of providing short-term relief, which could have a "large negative impact on the long-term retirement saving arrangement".

This includes deferring pension contributions, reducing contribution rates, suspending contribution payments, allowing easier access to retirement savings and facilitating loans to employers and employees from pension plans, it stated.

Those many pension schemes themselves have implemented a number of short-term changes, Njamma notes, such as frequency of reporting, meetings and member communications.

Communicating with members has certainly grown in importance during the pandemic, particularly to those saving in a DC scheme.

"In DC schemes people bear the investment risk and when the markets dropped it is easy to understand that many wanted to sell their riskier investments. In order to protect the long-term interests of members and to limit the materialisation of investment losses, many pension funds warned their members about the impact of the crisis on their pension savings and about the consequences of hasty investment decision or requesting early withdrawals," Leppälä says.

He highlights how early withdrawals are a right in Italy and therefore Italian pension funds actively advised their members against getting out of their investment positions.

"Some other countries, like Spain and Portugal, opened possibilities for people to take money out of their pension savings in order to cover the losses in wages. This is understandable as people may not have other ways to manage their daily subsistence, but of course detrimental for saving for a pension that is a long-term endeavour."

Those who are tempted or need to access their savings early (for example, in their 50s) due to unemployment, need help from the pensions industry for them to understand the consequences of this decision for their income in later life, State Street Global Advisors (SSGA) EMEA head of pensions and retirement strategy, Alistair Byrne, says.

"FOR DB SCHEMES THE CHALLENGE IN THE WAKE OF THE (ONGOING) CRISIS WILL BE FUNDING"

"Challenges around guidance and education – the process of demystifying pensions – have been longstanding ones for the sector and Covid-19 has thrown the importance of this work into even sharper relief," he adds.

SSGA's survey of UK, Irish and Dutch DC savers in March found very few people had reduced contributions, "which is probably a reflection of the inertia we generally find in pensions", Byrne says. Instead, it found a proportion of people checking their balance more often – 10-20 per cent of people.

"The key consideration is, what message do savers get when they do so – should managers provide some reassurance, or just show them their pot is down 20 per cent for example? Pension savers are generally cautious, but we didn't find any evidence of people wanting to sell out at the bottom," he adds.

BlackRock's data found that Covid-19 has had a "significant, but hopefully short term, impact on members' confidence," Cave says, with just over half concerned that they will be unable to enjoy the retirement they want, compared to 33 per cent in 2017.

Yet Covid-19 has focused attention, Cave adds, as "86 per cent of the members we've spoken to recognise that they need to make more effort to understand their pension".

"On a more positive note many recognise this as a shorter-term challenge, with a greater number expecting to prioritise pension savings in five years' time than are able to currently."

Looking ahead

Savers may be looking to prioritise retirement saving more in the future if they can, but they are less optimistic about what may happen to their pensions as a result of Covid-19.

For instance, a survey in July by DNB of Dutch households found two-thirds expect their pension benefits to be reduced because of the coronavirus crisis.

Meanwhile, in September, a report by Skandia found that the coronavirus pandemic could reduce the future pensions of Swedes by thousands of kronor each month, due to its impact on investments and wage growth. To compensate for this, Skandia recommended that people should save an extra SEK 500 to SEK 3,000 a month, depending on an individual's circumstances. Alternatively, people may need to work longer before retiring, it said.

Even worse may be a rise in the number of people being worse off at retirement due to fraudulent means.

"During the Covid-19 crisis we have observed a growing number of scams, frauds and cyber-attacks," Leppälä says.

"Against this background, we have noted a number of initiatives taken

Joining the fight for the vaccine

INSTEAD OF JUST reacting to the challenges encountered by Covid-19, some pension schemes are more actively trying to tackle the disease.

For instance, in August, Finnish pension provider, Varma, joined an appeal from international investors and pharmaceutical companies to develop a Covid-19 vaccine that will be distributed fairly.

It said the joint petition had been signed by 65 investors, such as insurers, asset managers, banks and pension companies, with a total investment asset of €5,000 billion.

Varma stated that the signees had invested their assets in several different pharmaceutical companies and opened discussions about the potential pricing, availability and cooperation of some of the more than 200 candidate vaccines and drugs being tested around the world during the spring.

Commenting at the time, Varma director for responsible investment, Hanna Kaskela, said: "Varma wants to be at the forefront alongside major investors in engaging with pharmaceutical companies, as the pharma industry is in a position to resolve fundamental global problems.

"When a viable coronavirus vaccine is developed, it is essential that it is also made available to lower-income, developing countries. This requires ensuring fair allocation and reasonable pricing."

by member states or pension providers to warn and protect their members, beneficiaries, and consumers. There are big differences between countries, and it's been said that the biggest risk for pension fund members in the UK is the risk of being defrauded out of their retirement provision."

On the DB side, the impacts of the Covid-19 crisis may well lead to benefit cuts for members and/or require sponsoring undertakings to finance funding gaps, potentially creating additional pressure on the real economy and on financial institutions sponsoring an IORP, EIOPA warns.

The emergency measures brought in by governments and central banks to tackle the virus will have lasting financial strain on pension schemes and sponsors alike, Njamma adds, giving the example of the significant fall in longer-term interest rates adding billions to deficits.

"For DB schemes the challenge in the wake of the (ongoing) crisis will be funding," Byrne says. "Low funding for longer interest rates will inflate liabilities at the same time as challenging economic conditions weaken many sponsors' willingness and ability to fund their schemes."

However, those managing pension schemes have not just stayed afloat amongst these challenges, many have also changed their operations.

"The industry has been very resilient to quite a lot of the lockdown measures from an operational standpoint," Njamma says. "A lot of service providers, advisers and even trustees have adapted to the virtual world in which we operate. Perhaps this may lead to the industry embracing further technological changes that will be beneficial for the way we work and invest."

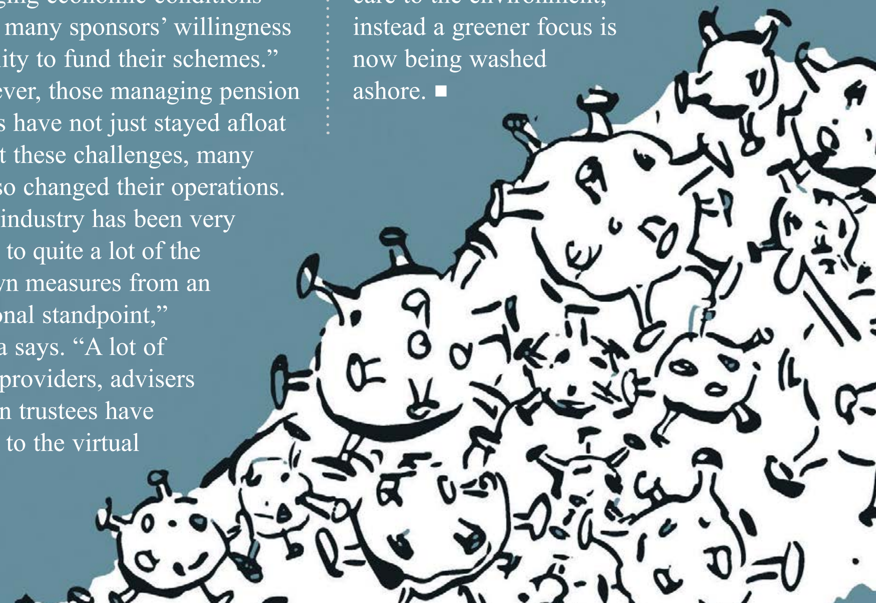
A positive change that has risen to the surface during the pandemic is the increased focus on climate change investing.

"Climate-related issues have moved up the agenda as emissions dropped significantly during the lockdown," Njamma says. "In addition, there are certain climate-related scenarios that could play out that would have a similar or more dire effect on financial markets."

This was evidenced in June, when several European pension funds signed a letter calling on European leaders to ensure the economic response to the Covid-19 pandemic delivers a sustainable recovery.

The letter stressed the need to ensure "an accelerated transition to a net-zero emissions economy in line with the Green Deal and the Paris Agreement", as well as stating that "recovery plans that overly exacerbate climate change would expose investors...to escalating financial, health and social risks".

If one positive can come out of this crisis, it may be that once the pandemic subsides we find this was the high-tide mark of pensions schemes investing without much care to the environment; instead a greener focus is now being washed ashore. ■



INTERVIEW

A seat at the ethical table

John Howchin, secretary-general of the Council on Ethics of the Swedish National Pension Funds, tells Francesca Fabrizi about the essential work the council is doing to influence sustainable change

WRITTEN BY FRANCESCA FABRIZI

What does your role as secretary-general of the Council on Ethics Swedish National Pension Funds entail?

The AP funds are invested in approximately 3,500 companies worldwide. Together with our service providers, we collect facts and engage with the companies on human rights, environmental and corruption issues, covering about 400 different cases every year. I oversee the process whereby we monitor incidents or issues that have happened within any of these holdings. Learning from these processes, we work proactively with sectors to help companies avoid making the same mistakes and to become more responsible/sustainable.

What are the main aims and objectives of the council?

The aim is, through dialogue and engagement, to influence companies around the world to address critical ethical, environmental, and human rights issues within their operations. The council will recommend the AP funds to exclude a company if it is deemed not to be doing so and in breach of a convention that Sweden has ratified, but we prefer engaging with companies to resolve the issues where possible.

How does it and has it achieved these aims over the years?

The council has been operational with this concept for nearly 15 years. The main success from our work is that we have established the idea of engagement in preference to exclusion and that companies worldwide accept and understand this model as to how institutional owners engage with them on these issues.

What have been some of the council's biggest successes?

I would say showcasing what engagement is, in a transparent manner. I would not use the word success since 270 people tragically lost their lives as a result of the tailings dam disasters in Brumadinho, but I think the work we have done with the Church of England pension board and a fantastic group of investors to address this issue in the long term (tailings dams security) is a template for institutional owners on how to engage going forward – a global standard and a global database driving transparency and best practice. We will see more of this going forward.

Has the recent pandemic changed the council's approach in any way?

I was planning to visit Brazil and follow-up on the tailings disasters in Brumadinho and Mariana as well as visit the Amazon to see cattle farmers and soybean production. That is an important trip that is unfortunately not doable right now, but maybe next year.

What would you say are the main challenges facing the council going forward?

These are challenging times. The world is in a tricky situation with climate change unfolding, biodiversity loss, human rights issues and of course Covid-19 pushing away the old ways in relation to work and consumption patterns. Transitioning the global economic system to a low carbon economy but also a resilient and sustainable one, needs engagement of unforeseen scale from not only the financial markets but every stakeholder. So, yes there are challenging times ahead, but the AP funds and the council intend to be at the table. ■

The Council on Ethics Swedish National Pension Funds

In 2007, Sweden's four AP funds launched the Council on Ethics – an ownership collaboration focused on pursuing positive sustainability change through dialogue and engagement with listed, non-Swedish companies.

Since its formation, the council has conducted dialogue with several thousands of listed non-Swedish companies. Many of these dialogues have been constructive and have led to tangible improvements. In some cases, the council recommended the AP Funds to exclude the companies in question as the objectives of the dialogue had not been achieved. A number of these companies became investible once again after having adopted measures in line with the council's demands.

INTERVIEW

A new cross-border occupational pensions vehicle on the horizon

Francesca Fabrizi **speaks to secretary general of CBBA-Europe,** Francesco Briganti, **about the development of a Pan-European Occupational Pension (PEOP)**

WRITTEN BY FRANCESCA FABRIZI

At last year's European Pensions Conference, secretary general of the Cross-Border Benefits Alliance-Europe (CBBA-Europe), Francesco Briganti, stood up to tell delegates about an idea the alliance had to boost cross-border pension provision in the European occupational space.

One year on, and the realisation of a project of a European Union (EU) vehicle known as the Pan-European Occupational Pension (PEOP) is a few steps closer to reality.

At what stage are you with your proposals?

We are working on a detailed reflection paper that outlines a new legal framework for a pan-European/cross-border occupational pension, which we believe is needed in the European pensions occupational space.

We are proposing to the European institutions the creation of a PEOP, which would be the corresponding occupational vehicle to the existing Pan-European Personal Pension (PEPP), the recent product created by the EU. The paper will be sent to the EU and published on the CBBA website in the following weeks.

Why is this vehicle necessary?

We think this vehicle would overcome many of the obstacles deriving from the IORP Directive. For several reasons, cross-border activities under the IORP Directive are quite complicated because of the authorisations needed, because of the compliance with social labour law – there are numerous reasons; and many operators, even employers, are reluctant to create cross-border activities using the IORP Directive.

We believe we can develop something that is similar to the PEPP, but for the occupational space. Like the PEPP, the PEOP would be a second EU legal regime, a voluntary regime, so not mandatory. Local pensions would not have to comply with new regulation, so it would cohabit with existing national occupational/workplace pensions.

What are the other key features?

Like the PEPP, the PEOP would work on a defined contribution (DC) basis, be fully portable across EU member states, so workers moving from one country to another would have the right to take and transfer their money to a new country of destination, which is not the case with the IORP Directive.

Also, even if it will be a DC vehicle, it will have the possibility of offering guaranteed investment options, again like the PEPP, and also the option to cover biometric needs.

As for the investment, governance and information requirements, here we think that many rules would be the same as already prescribed by the IORP II Directive and the PEPP regulation.

Could any aspects be regulated by the national jurisdictions?

Yes, there will be some areas where member states can have a say – where this would not undermine the smooth functioning of the PEOP vehicle throughout Europe. For example, in relation to the level of pension contributions; the pay-out options and the retirement age.

What are the advantages of this new proposal?

First of all, large employers/multi-national companies would finally make significant savings in managing their workplace pensions across Europe, because they could operate with new economies of scale, they would have the centralisation of governance, common administration and investment policies and so on.

Furthermore, the development of the PEOP could encourage further occupational pensions coverage in Europe, especially in the countries where IORPs almost do not even exist. SMEs could also join the pan-European vehicles. Finally, members themselves would have the big advantage of being mobile without any problem around the portability of their pensions.

Also, we can assume that, if everyone is benefiting from greater economies of scale, this will mean lower costs all round which should mean larger pension pots in the long run for the members themselves. ■

FLEXIBLE RETIREMENT

Finding flexibility in retirement

Flexible retirement trends have been growing in recent years throughout Europe, but what impact has the pandemic had, and is increased flexibility the right answer for savers?

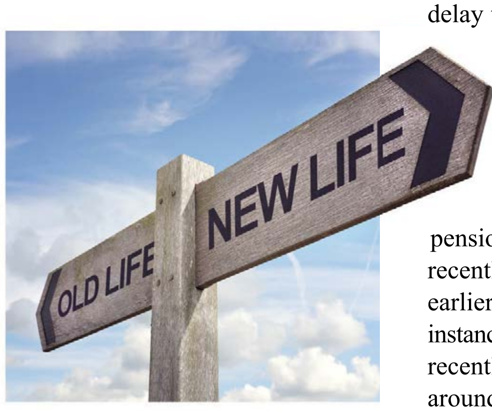
WRITTEN BY SOPHIE SMITH

Ask a group of people what their dream retirement would look like, and you're likely to get very different responses. Whilst some would love to simply relax, others might be itching to spend more time baking, gardening or golfing. But not everyone is so keen to step back, and an increasing number of people are looking to continue working well past retirement age.

A recent report from Aegon found that in the UK, retirement is far more likely to be viewed as a transition, rather than a fixed date, with 58 per cent of workers seeing an alternative route to stopping work immediately. However, this may not be a universal truth, comparing to just 35 per cent in France, and 49 per cent across broader Europe. Furthermore, whilst just 30 per cent of UK workers want to immediately stop working at retirement age, this increases to 57 per cent of workers in Spain, 49 per cent in France and 40 per cent in Germany.

A transition not a switch

"Retirement has long been characterised as a three-pillar model with government benefits, employer pensions and personal savings all supporting individuals when they stop working and no longer have earnings from employment," explains Aegon pensions director, Steven Cameron. He emphasises however, that there are significant differences across Europe in the extent to which people expect their retirement income to come from each of these pillars, depending on the retirement system in the country where they live.



Indeed, Aegon's recent research highlights that whilst workplace savings are very important in countries such as Netherlands and UK, in Spain, just 11 per cent of retirement income is expected to come from employee savings plans, whilst 65 per cent of overall income is expected from government benefits.

However, retirement patterns and ages are shifting as European governments attempt to ensure sustainability of their state pension systems. Mercer Spain wealth leader, Miguel Ángel Menéndez, explains for instance, that whilst it is possible to retire from age 61 in Spain, the latest changes in pension legislation have seen the "real retirement age" increase from 63 to closer to 65.

He continues: "The government expects a tightening of the requirements of early retirement in order to more closely align the real retirement age to the legal retirement age (67). This means that there will still be flexibility to retire but with incentives the state will attempt to delay the access to closer to 65-67 years due to the increase in life expectancy."

A shift in age

Whilst some countries are looking to reduce state pension age however, others have recently made strides to allow for earlier retirement. In Denmark for instance, political parties have recently come to an agreement around the parameters for early-retirement, or ret til tidlig pension.

The agreed upon proposals, Mercer Marsh Benefits Denmark head of technical department, Heine Olsen, explains, would grant early retirement rights from one to three years before mandatory retirement age, to 'worn down' individuals.

Approximately 41,000 individuals are expected to qualify to take advantage of the proposal in 2022, according to Olsen, with a further 24,000 individuals expected to take advantage of the offer in 2022.

Insurance & Pension Denmark deputy director, Karina Ransby, however, does not expect pension saving patterns to change radically due to the new early retirement option, predicting that around 60 per cent will choose the new retirement option, based on the experience from "efterløn".

"Almost every blue-collar worker

is covered by a collective agreement and hence a pension saving via their employer," she explains, noting that those who choose the new early retirement option will end up with a relatively smaller pension when retiring earlier, although the new retirement options are for workers with a "very long career".

Indeed, Ransby states that a shift in the timeline of a life expectancy indexation is something that a new pension commission will have to look into as more and more parties in the parliament are beginning to think that an official pension age of 72 by 2050 is presenting a "downside" for some workers in particular.

"The indexation has proven very successful and has had a massive impact on the actual retirement age and thereby the long-term public economy," she states, clarifying that whilst individuals have a financial incentive to postpone their retirement, more flexibility in retirement is demanded, as retirement shifts from an either or decision to a more gradual transition.

Cameron adds that recent increases to the UK state pension age were also aimed at making the state pension more affordable as people live longer.

Flexibility amid crisis

Long-term strategy and policy around pension systems and retirement flexibilities have likely been thrown into flux amid the Covid-19 pandemic however, with regulatory and legislative pensions work around the world delayed or shifted. Mercer partner and director of consulting, Brian Henderson, states that there is also some evidence of members behaviour adjusting in light of the pandemic, with some savers accessing their pots flexibly in light of Covid-19 related financial difficulties.

OECD principal economist and head of private pensions unit, deputy head insurance, pensions and financial markets division, Pablo Antolin, however, warns that whilst many countries have allowed access to assets, this is something the OECD would warn against.

Short term pain for long term gain?

"What we at the OECD recommend is access to retirement saving should be a measure of last resort," he explains, "and it should never be based on 'across-the-board' access, but rather, should be based on exceptional hardship in individual circumstances."

Antolin states that early access to pension pots could have further implications for the scheme and its members, as the funds will be invested in long-term strategies, with specific levels of liquidity. He explains that this, in turn, means that when savers access savings early, they run the risk of materialising losses. Furthermore, he notes that as these investment strategies are based on a long-term average return, by readjusting this investment, average future returns will likely be lower.

However, it is not only schemes that could have concerns, as Henderson stresses that reducing contributions or accessing pension assets early will have a detrimental impact on future pay out.

"Many savers have put their plans on hold during the crisis," states Henderson, explaining that whilst much of the early market loss has actually been recouped over the period, uncertainty persists, with many savers facing the difficult decision of when they can afford to retire.

Despite this, Antolin emphasises that most people in public systems have continued to accumulate pension rights thanks to government support schemes, and as such, might not need to postpone retirement.

An ageing population

Cameron argues that as a society, we need to maximise the number of people in the workforce to ensure we can adequately provide for those in retirement.

"As we on average live longer, we must prioritise encouraging more people at or near retirement to stay in the workforce," he states, highlighting that a key aspect of this will lie in employers creating the right working conditions.

However, Aegon research has found that just 31 per cent of UK workers state that they have the option to move from full time to part time work to help them phase into retirement, falling further to just 22 per cent in France and Spain, 28 per cent in Germany and 29 per cent in the Netherlands.

Indeed, Antolin agrees that more flexible retirement options are a good idea broadly, and have long been a recommendation of the OECD. And it seems that governments are beginning to step up, as Ransby highlights that the Danish parliament has already increased the economic incentives to postpone or work part time after the official retirement age. Although perhaps more encouraging is the shift in consumer attitude.

"When asked, senior employees over 65 years old mostly keep working because they like it and because they still have good health," Ransby notes, underscoring the need for the Danish pension system to shift in order to meet the future demand around flexibility.

It seems likely then, as longevity shifts continue to emerge and the long-term impact of the pandemic come to fruition, that greater flexibility will be needed from governments and savers alike. Although where each country's policy will guide them, remains to be seen. ■

TONTINES

Back to the future

Tontines were wildly popular in the 18th and 19th centuries but their status suffered at the hands of fraudulent life insurers. Natalie Tuck **explores whether tontines have a place within a modern European pensions system**

WRITTEN BY NATALIE TUCK

As a retirement product, tontines are a rare sight in the 21st century but references to their existence remain in many a mid-20th century murder novel.

The likes of Agatha Christie, P.G Wodehouse, Robert Louis Stevenson and even *The Simpsons* have all made use of the tontine in the name of entertainment. Such references are caricature-like, based on a bygone era, but the age-old product is about to make a comeback.

The concept of a retirement tontine is simple; a group of people pool their assets together and receive a sum of money paid to them for the rest of their lives. Whenever someone in that group dies, the remaining members benefit from a share of the deceased member's assets.

"Tontines had their heyday in the late 19th century and gradually became mired in scandal and corruption," Irwin Mitchell pensions partner, Penny Cogher, notes. "There is a Russian roulette aspect to the pure tontine concept – that the final survivor of the tontine is the winner who collects all," which explains their popularity with crime novelists.

A report by CFA Institute Research Foundation's Richard Fullmer, published in 2019, *Tontines: A Practitioner's Guide to Mortality-Pooled Investments*, notes that their previous success did not last long because, "the products fell victim to misappropriation and fraud on the part of tontine issuers".

After this their popularity faded, but they never completely disappeared. As the report states, tontines still exist in France as a niche product, and Fullmer highlights the Swedish pension system as being "explicitly tontine-like".

"Moreover, a slow trend toward acceptance of such longevity pooling arrangements has arisen over the past few decades. European Union member states now allow tontine offerings under the Second European Life Insurance Directive of 1990," the report notes.

A role to play

Set against a diminishing number of defined benefit (DB) schemes in Europe, tontines are being "seriously re-examined to see if they could have a role to play as a new retirement product", Cogher says.

Expanding on this, Heriot-Watt University associate professor and director of the Risk Insight Lab, Catherine Donnelly, highlights the main choices facing UK savers in defined contribution (DC) schemes currently – income drawdown or a life annuity.

"I definitely think people should be buying life annuities, but they're not buying them for various reasons. With income drawdown, you are taking a huge risk as you could run out of money very easily. If you invest in a tontine or a pooled annuity fund, then you are pooling mortality risk, which is the same principle underpinning a life annuity. This allows you to significantly reduce your risk of running out of money in retirement compared to income drawdown," she states.

University of Leeds professor, Iain Clacher, says that a tontine-type structure is something that "could be part of the mix" of products alongside existing retirement solutions, but he does not believe that it's going to be the only product that emerges.

"A tontine may well be suitable for a portion of the population, but other products will be more suitable for others. It's about trying to have that mix in the marketplace so there's a greater diversity of products and so people are given more choice, and hopefully this leads to people getting the right product they need for their retirement," he says.

In terms of other products, tontines are very similar to collective defined contribution (CDC) schemes – some would even argue they are two of the same kind. These schemes are currently seen in the Netherlands, and the UK is in the process of legislating for CDC.

Compared with the current 'income for life' options in the market, research puts CDC on top. Cogher references a report published by Willis Towers Watson in October for the UK, which found that with a typical CDC, the pension provided would be 70 per cent higher than an individual DC insured annuity and 40 per cent higher than the average pension from a DB scheme.

One of the backers of risk-sharing products is TontineTrust CEO, Dean McClelland, who believes these products, such as CDC schemes and tontines, will "take over the whole industry" because the current DC option is "just a savings account".

"It's not a pension, it's not deserving of the name. Our traditional understanding of what a pension is, is that it pays you an income for life in retirement, and that's what people want," he adds.

"OUR TRADITIONAL UNDERSTANDING OF WHAT A PENSION IS, IS THAT IT PAYS YOU AN INCOME FOR LIFE IN RETIREMENT, AND THAT'S WHAT PEOPLE WANT"

The concept

In regards to the way a tontine works, Donnelly says, it should look very much like a life annuity, in that it is providing people with a stable income, but you are pooling mortality risk rather than having it transferred to an insurer. She says it is cheaper than buying a life annuity because it does not provide any guarantees, such as investment and longevity risk, which is why a premium is paid for an annuity.

"A pure pooled annuity fund doesn't guarantee you those things so it's less expensive but it should still give you the main benefit of a life annuity, which is this pooling of mortality risk, and you can add guarantees to it if you like," Donnelly notes.

"There are many ways of constructing these tontines but the method of withdrawing income from a tontine looks like income drawdown. However, you would adjust what you're paying people in line with experienced mortality in the tontine pool, as well as with investment returns." She adds that because of the pooled aspect of the investment, the tontine should be able to have a very low risk investment strategy and still have a very good chance of paying a stable, lifelong income.

A gap in the market

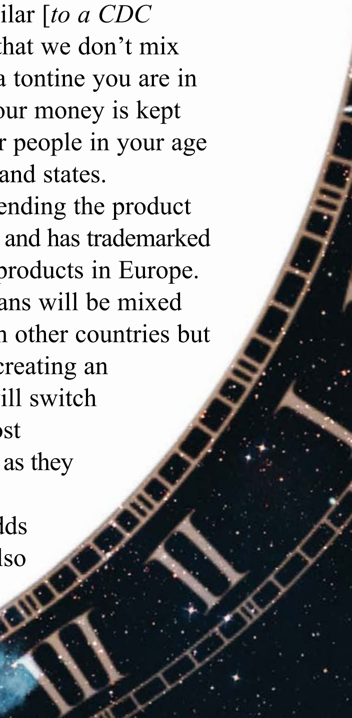
Tontines are offered as a niche product in France, but with the introduction of legislation for Pan-European Personal Pension Products (PEPPs) imminent, other players are using it as an opportunity to bring tontines back into the foreground.

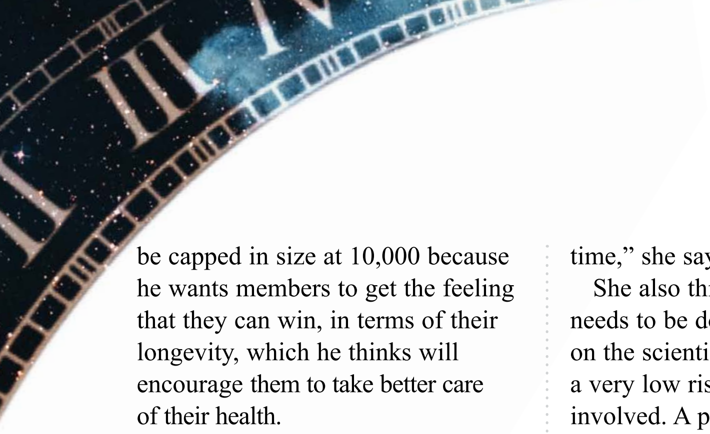
McClelland's TontineTrust is hoping to launch its product in the next few months, before applying for PEPP accreditation next year. His firm recently partnered with Dutch consultants Westerbrink to help fulfil that ambition. In contrast with traditional CDC schemes, which see all members of different ages and genders in one scheme, TontineTrust will segregate men and women into separate groups and will split people into similar age groups.

"It is very similar [*to a CDC scheme*] except that we don't mix age groups…in a tontine you are in separate pool, your money is kept with all the other people in your age group," McClelland states.

He is patent pending the product around the world and has trademarked tontine pension products in Europe. Initially, Europeans will be mixed with people from other countries but the company is creating an algorithm that will switch people to the most appropriate pool, as they grow in size.

McClelland adds that pools will also





be capped in size at 10,000 because he wants members to get the feeling that they can win, in terms of their longevity, which he thinks will encourage them to take better care of their health.

Another entrepreneur, Nobuntu CEO, Tyron Fouche, has launched a tontine in South Africa, which has recently been through a fintech regulatory sandbox to receive regulatory certainty. However, he has also formed a new venture called Nuova Longevita with a group of global tontine research experts, including Richard Fullmer and Pascal Winter, which is specifically targeting the European market.

"Our approach is business to business to consumer (B2B2C), so we will help existing asset managers and insurers launch tontine products to their customer base. These are clients who want to offer their customers higher yield through an alternative investment," he says.

Like McClelland, he sees the opportunity that tontines have in solving "many of the limitations of traditional life annuities". He also plans to structure the product within the PEPP and Solvency II legislation.

"Because as a team we have written papers on the topic of tontines and have successfully implemented them, we *[Nobuntu]* are optimistic that we have a good value proposition to asset managers and insurers in Europe."

Fine-tuning

Like most retirement products, there are pros and cons, and a tontine is not without its drawbacks.

Not least, Donnelly has reservations about the name tontine, and prefers pooled annuity fund, as she says people think that tontines are illegal and the last survivor gets everything. "Yes, there were tontines like that in the past but this is not what is being proposed at the current time," she says.

She also thinks that more research needs to be done within academia on the scientific basis of having a very low risk fund for the people involved. A paper Donnelly recently published with a co-author, Thomas Bernhardt, proved mathematically that when the pool is left with just a small number of participants, there is a lot of volatility in payments.

"This is because when someone dies in a tontine you share out the funds with everyone else, and you want to do this is an actuarially fair way. When people age, they are highly likely to die... This makes the income withdrawn from the tontine very volatile as the membership becomes very old."

"IN MY VIEW, THE TONTINE SHOULD BE PAYING AN INCOME IN RETIREMENT UNTIL YOU DIE"

On the flip side, Donnelly believes more work needs to be done on systematic longevity risk – the chance of people living longer than expected. There is academic research ongoing on these issues currently; Donnelly will start an Actuarial Research Centre project in January, funded by the Institute and Faculty of Actuaries, looking at systematic longevity risk and other risks, such as investment risks.

Communication will also be a challenge when it comes to launching a tontine, something the experts agree on. "As with all new pensions products, your challenge is going to be making sure people know what they're buying and making sure that products, all of them not just tontines, start to do something around providing people with adequate retirement incomes, which is clearly quite a challenge," Clacher says.

For McClelland, he says the biggest part will be explaining that payments can vary depending on investment performance, and that "tontines are for life, not just for Christmas", the idea that once you invest in a tontine, that's it. "Those are the main things that we have to get people to understand, if you're in, you're in it for life."

Room for guarantees?

One of the factors that makes tontines cheaper than a life annuity is the lack of guarantees. A tontine in its purest form cannot guarantee that income will always rise, or indeed stay stable. Neither do they pay out any bequests as a result of a member dying, or a spouse's pension.

McClelland does not see this an issue, as he believes the industry has this idea wrong: "I think they perceive that what everybody wants is for the parent to live frugally in retirement and pass away at 90 and pass on some money to their kids.

"With a tontine you can immediately go and purchase the lifetime income that you want now for a fraction of the cost than if you bought an annuity, which means you have cash leftover. You can give that cash to the kids now, which means they can go buy a house, start a business, they don't need to sit there waiting for you to kick the bucket [*to die*]."

And if people join a tontine and subsequently receive news of a terminal illness? "They are only going to put in the amount of money that they deem necessary to take care of them for the rest of their lives," he says, "if they join, and subsequently get bad news, then they don't need the money and they've already taken care of the kids. That's the quid pro quo, that's what keeps it fair."

A 21st century tontine, however, is in its infancy and Donnelly is

"A TONTINE MAY BE BETTER VALUE NOW, BUT NOBODY KNOWS WHAT WILL HAPPEN TO THE ECONOMY OVER THE NEXT 40-50 YEARS"

working on how tontines could have more choices built within them, such as spouse's pensions or bequests. She has already published a paper with her co-author, Thomas Bernhardt, on how to include a bequest in a tontine.

A member could have two accounts with one of them linked to the tontine and another in a separate account. Every time someone else dies in the fund, a fair share of the deceased's money is paid to each survivor's tontine account and nothing to the non-tontine accounts. However, these accounts are instantly re-balanced to some pre-determined proportion. When the member dies, the non-tontine account is paid to their estate and the tontine account goes back into the pool to be shared out by the remaining members. Of course, both of these options, the bequest and the spouse's pension, would result in a lower pension paid to the member, she notes.

Accumulation aspirations?

On the face of it, a tontine is purely a decumulation product, but McClelland has aspirations to use behavioural science to get young people saving into a tontine. Initially, he says, the TontineTrust will be about "solving decumulation" in order to get assets under management but in the long term he wants to get everybody saving.

"Everybody is trying to figure out how to get younger people saving, their problem is young people think they're invincible and they are not worried about retirement. If we give them a pension, which is essentially in a large financial game of *The Hunger Games,* that invincibility works in their favour," he says.

"You know if you put the money in and take good care of your health, you're going to collect all the money of the people who don't do as good a job as you of taking care of your health in retirement. You hold the winning lottery ticket, you are the winning lottery ticket. My belief is that we can move the needle in terms of getting younger people to start saving by turning the whole feeling of the pension upside down."

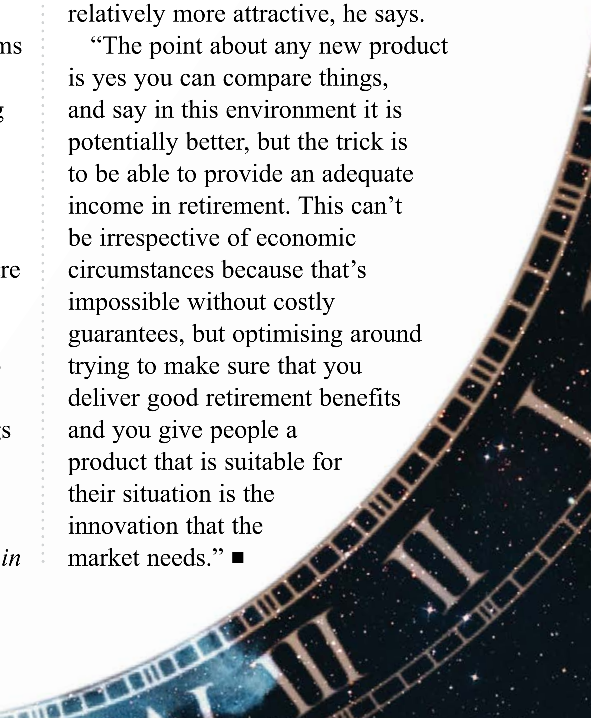
Others, however, are not so convinced that the tontine concept can work for the accumulation phase. "When you are young you are highly unlikely to die, so I don't think it's a very attractive proposition for somebody young to have a chance, however small, of losing all of their retirement savings to a tontine pool in exchange for what would be a minuscule stream of longevity credits *[money paid to the tontine survivors due to deaths in the tontine*] while they were alive," Donnelly says.

"The longevity credits are proportional to your chance of dying – the more unlikely you are to die, the smaller they will be," she adds.

"In my view, the tontine should be paying an income in retirement until you die, that's what it's for. You could have a situation where you have people saving for retirement in a DC plan and then you have a tontine or pooled annuity for their retirement, so you're not just being kicked out of the pension scheme upon retirement."

Clacher also raises the issue of the long-term nature of saving for retirement. A tontine may be better value now, but nobody knows what will happen to the economy over the next 40-50 years. A period with higher interest rates would push up the value of annuities making them relatively more attractive, he says.

"The point about any new product is yes you can compare things, and say in this environment it is potentially better, but the trick is to be able to provide an adequate income in retirement. This can't be irrespective of economic circumstances because that's impossible without costly guarantees, but optimising around trying to make sure that you deliver good retirement benefits and you give people a product that is suitable for their situation is the innovation that the market needs." ■



In their own words...

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

On pension schemes investing in renewable energy

"Collaboration is the best approach. The UK can and will lead the way both in terms of achieving net zero, but also in the provision of green tech and the financial know-how to get us there. Net zero is a long-term challenge facing our country. By unleashing the productive power of our pensions and engaging with savers, we can get there."

UK Pensions Minister, Guy Opperman

On promoting diversity and inclusion

"We believe that diversity is about empowering people regardless of their differences, whether it's their age, gender, ethnicity, religion, sexual orientation, education or nationality. Luxembourg is a multicultural country with a multitude of different nationalities, each one bringing a diverse set of perspectives, alongside work and life experiences. As an industry, we wish to help shift the asset management mindset towards becoming more diverse and inclusive."

Association of the Luxembourg Fund Industry (Alfi) chairperson, Corinne Lamesch

On the news that less than 20 per cent of Swedes discuss pensions in the job application process

ANNA ALLERSTRAND

PTK pension specialist

"There is too little talk about occupational pensions in job interviews. The occupational pension is the most important employment benefit and it can mean a lot for people's finances after working life. It's important for employees to find out how much employers pay in each month."

On evidence that ethical funds have shown resistance amid market volatility

RICHARD EAGLING

Moneyfacts head of pensions and investments

"The momentum behind responsible investing has been steadily building for some time, but there is a sense that a raft of new initiatives, changing regulation and some truly impressive sustainable fund performances could prove a catalyst for further growth. The argument that investing responsibly must mean a trade-off between value and values or profits and principles has been increasingly debunked in recent years and the latest results of our ethical fund performance survey provide further clear evidence to refute it."

On the Covid-19 crisis leading to new digital pension solutions

CARSTEN HOLDUM

PFA consumer economist

"Digital consulting will solve one of our customers' greatest needs, namely a quick clarification on whether to do something. Then you have the opportunity to do the easy things yourself and book a counselling session when it is more complicated. Overall, retirement is becoming much easier to deal with, and it is needed by many."

On ceasing investment in China

JENS MUNCH HOLST

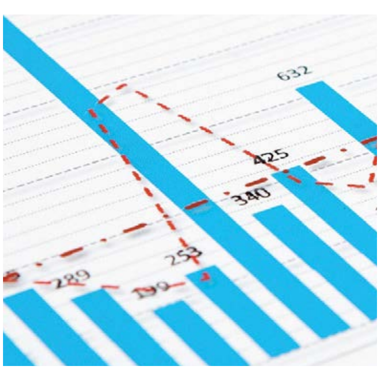
AkademikerPension director

"Our ambition in AkademikerPension is to sharpen the profile when it comes to responsibility. Our motto is that return and responsibility must go hand in hand, and when we talk about responsibility it is difficult to argue that we should keep China in our portfolio."

On the European Supervisory Authorities' proposals on ESG disclosures

PensionsEurope spokesperson

"The lack of flexibility of the new disclosure requirements raises concerns as a one-size-fits-all approach does not always reflect market realities and would not fit the information needs of pension funds' members and beneficiaries"



On the world's 300 largest pension funds growing their assets under management by 8 per cent in 2019

"Overall, the world's largest pension funds staged a strong rebound in growth in 2019, following a tough market environment the year before. However, this positive result does not detract from the multiple pressures currently facing pension funds, from concerns around solvency levels to rising expectations with regards to ESG considerations, particularly concerning climate and social issues."

Thinking Ahead Institute co-founder, Roger Urwin