European Pensions

February / March 2016

Industry:

Technology

Why pension fund managers are increasing their spending on new technologies

Interview:

Gabriel Bernardino

EIOPA chair Gabriel Bernardino reveals his plans for the next five years

Scheme management:

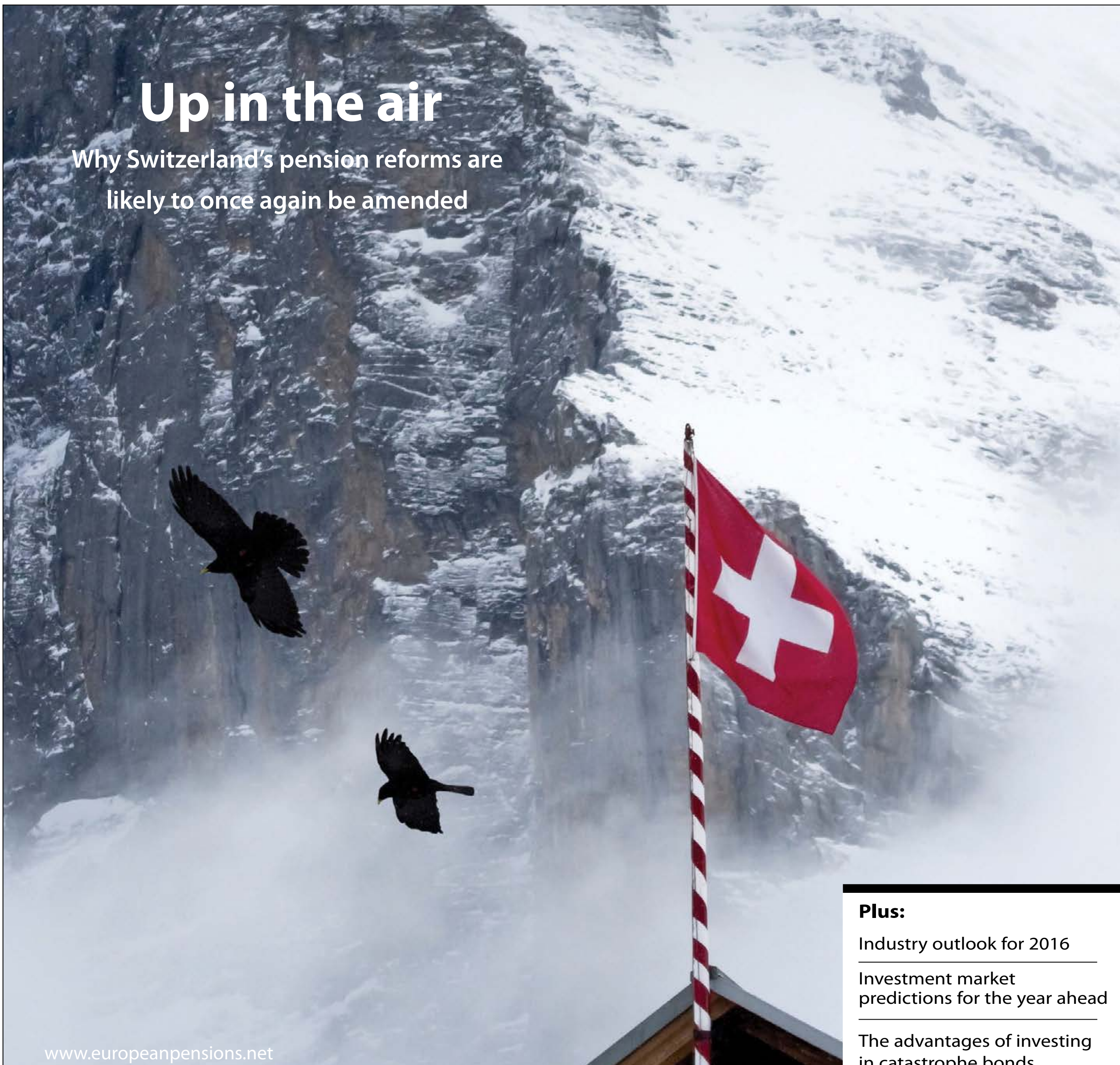
Longevity

How the UK is leading the way with creating solutions to tackle longevity risk

Investment:

ESG

The effects of the first EU directive mandating non-financial corporate disclosures



Up in the air

Why Switzerland's pension reforms are likely to once again be amended

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Investing
with style,
managed
with care.

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Subscription rates:
£198 or €299 per annum

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ISSN 1753-5859

Back and forth

At times it felt like the conversations around the upcoming IORP II Directive would never end; indeed the first discussions exploring the possibility of amending the 2003 IORP Directive took place half a decade ago, when the EC issued a call for advice on potential changes in 2011.

However, fast forward five years and it seems that the end is in sight. January this year saw the Economic and Monetary Affairs Committee vote in favour of the IORP II Directive proposals made by Irish MEP Brian Hayes. The next step should be negotiations with the European Council and predictions are for the revised directive to be implemented in the spring or summer.

A bone of contention for many had been the solvency stipulations the revised directive originally suggested for pensions, which could have greatly added to the costs of a running a pension scheme. Thankfully the approved proposals no longer contain this requirement.

However, the relief at the demise of EIOPA's much-contested Holistic Balance Sheet was short lived. Several industry voices have expressed disappointment with EIOPA, accusing the authority of pressing ahead with the Holistic Balance Sheet under the new name of Common Methodology for the purpose of its recent pensions stress test.

For any pensions industry participant, this back and forth with regards to reforms and regulations is nothing new. Various pensions debates have raged for many years at a European-wide level, but at the same time most European countries have also grappled with their own reforms, counter reforms and additonal changes to their individual pensions systems.

Our cover story looking at the Swiss pension system is a prime example of this. Its proposed AV2020 pensions reform legislation is looking fragile due to the country's recent elections giving the conservative Swiss People's Party the largest share of the vote and seats in the country's lower parliamentary house. The lower house is now more likely to overturn amendments to the pensions proposals introduced prior to the elections by the upper house.

These constant changes, pauses, and reversals can feel like 'two steps forward one step back'. But while European pension reform does seem to be moving slowly, I remain confident that we are at least moving in the right direction.

Laura Blows, 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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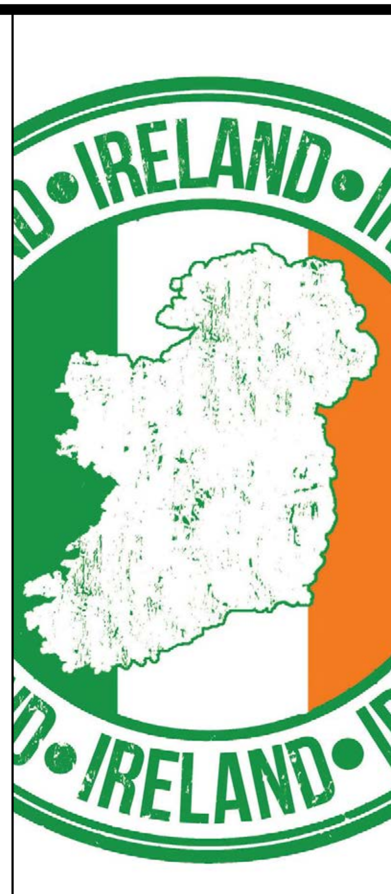

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MEPs vote in favour of revised IORP II proposals

THE DIRECTIVE, WHICH WILL INCREASE CROSS-BORDER PENSIONS ACTIVITY, WAS APPROVED WITH 47 TO THREE VOTES

Written by: Natalie Tuck

The Economic and Monetary Affairs Committee has voted in favour of the proposals made by Irish MEP Brian Hayes for the Institutions for Occupational Retirement Provision II Directive.

The IORP II Directive was approved by the council on 25 January, with 47 to three votes.

Speaking at the ECON committee, following the vote, Hayes called for the committee to open negotiations with the European Council on IORP II. Hayes said he believes the committee is in a "strong position" to enter into negotiations with the council.

"It seems logical with the very substantial majority that we go into that negotiation," he stated.

Following this, the committee then voted in favour of entering into negotiations with the European Council, which agreed its negotiating stance in December 2014.

The first IORP directive was introduced in 2003 and proposals for a second IORP directive began in 2014. One of the key goals of the new directive is to increase cross-border pensions activity.

If successful IORP II will see the removal of the current legislation that requires all cross-border schemes to be fully funded at all times. Instead, the introduction of the IORP directive would mean cross-border schemes would simply be subject to the same funding rules as single country schemes.

As lead negotiator Hayes submitted revised proposals for the new directive last summer. In his report Hayes made it clear that there should be "no one-size-fits-all approach".

Hayes also took out a lot of the proposals relating to solvency for pension schemes, which he said was crucial because pension schemes are not insurance products and adding more costs would not be beneficial.

"The IORP II is about better governance and disclosure, it is important to take into account different types of pension schemes"

"I've been clear to make sure that there would be no extra cost to pension schemes as a consequence of IORP II. I think that would be a disaster quite frankly. We're trying to get people to save and to make sure more people save within pension schemes and we encourage more occupational pension schemes. I think I've tried to reflect that principle in my thinking," Hayes told *European Pensions* in November last year.

Commenting on the vote, chair of PensionsEurope Janwillem Bouma said they are happy that the ECON committee has adopted a much more "practicable, proportionate and less prescriptive proposal, with more flexibility for the member states".

"Member states should be given the necessary scope to tailor requirements, taking into account the differences between different systems. The IORP II is about better governance and disclosure, it is important to take into account different types of pension schemes, as well as the role social partners have and the differences in social and labour law," he said.

In addition, PensionsEurope chief executive Matti Leppälä explained that one of the original goals of the Commission was to increase the number of cross-border pension schemes.

However, Leppälä said the Commission did not propose to modify rules requiring full funding at all times of cross-border schemes – a major barrier to the development of cross-border pension schemes.

Stress test reveals DB schemes sensitive to 'abrupt drop in interest rates'

RESULTS REVEAL DB SENSITIVITY AS INDUSTRY FIGURES RAISE CONCERNS OVER IMPLEMENTATION OF HOLISTIC BALANCE SHEET

Written by: Natalie Tuck

The results of the first pensions stress test have revealed defined benefit pension schemes are sensitive to an abrupt drop in interest rates and an increase in inflation rates, the European Insurance and Occupational Pensions Authority (EIOPA) has said.

The test, which was conducted last year, covered 17 European Economic Area countries with a material occupational pensions sector representing over €500m in assets. It was introduced to produce a comprehensive picture of the heterogeneous European occupational pensions' landscape.

It aimed to test the resilience of DB and hybrid pension schemes against adverse market scenarios and increased life expectancy. For DC schemes, it sought to identify potential vulnerabilities and to reveal areas that require further supervisory focus.

"The report reveals the damage that the [HBS] would do to pension provision by inflating deficits to far higher levels than under current methods of measurement"

In order to compare diversified stress test results, EIOPA developed a common methodology using market-consistent valuation for assets and liabilities. Simultaneously, EIOPA conducted an assessment based on the national balance sheets (NBS).

The results show that DB and hybrid schemes demonstrated relative resilience to a permanent decrease of 20 per cent in mortality rates. However, they also appeared to be more sensitive to an abrupt drop in interest rates and an increase in inflation rates (under the common methodology) and to a severe drop in assets prices (under NBS).

The satellite module for DC schemes showed the impact on the pension's level strongly depends on the time scheme members have before retirement. Eldest scheme members have the highest pension wealth and the least time to recover from price falls of assets. Youngest scheme members are most heavily impacted by long-term low returns on assets.

EIOPA chairman Gabriel Bernardino said the stress test has "deepened the supervisors' understanding of the impact that different future stress scenarios can have on the pension plans resilience".

"While pension plan liabilities have a very long-term nature, it is important that supervisory regimes are prepared to deal with these stresses in a transparent way, be it through appropriate recovery periods, the role of pension protection schemes, increased sponsor's contributions and/or benefit adjustment mechanisms," he said.

However, several industry voices have said they are "disappointed" with EIOPA for pressing ahead with the Holistic Balance Sheet under a new guise.

Pensions and Lifetime Savings Association chief executive Joanne Segars said it was "disappointing" that EIOPA are still pursuing its Holistic Balance Sheet concept under the new name 'Common Methodology' for the purpose of the stress test.

"The report reveals – once again – the damage that the Holistic Balance Sheet would do to pension provision by inflating deficits to far higher levels than under current methods of measurement. The result would surely be many more scheme closures," she said.

Irish Pensions Authority to reform schemes

THE IRISH PENSIONS AUTHORITY HAS PLEDGED A FIVE-YEAR PLAN TO ENSURE SCHEMES ARE BETTER SUPPORTING MEMBERS

Written by: Lauren Weymouth

The Pensions Authority in Ireland has pledged to make a number of reforms over the next five years to ensure schemes are 'properly run'.

Speaking at a Pensions Authority seminar recently, pensions regulator Brendan Kennedy said he intends to ensure the authority implements a number of different changes after concerns that some schemes haven't been supporting their members well enough.

Among these reforms is the implementation of a varied programme of proactive compliance activity, which would include on-site inspections of administrations, reviews of PRSA compliance and checking of employer pension access provision.

A particular focus would be on the timeliness and accuracy of annual scheme information data submissions, Kennedy said.

Other changes would include resolution of the small number of DB schemes whose funding position have not been resolved. This could include issuing orders for wind-up where appropriate.

Additionally, he said there would be a significant increase in its programme of engagement with trustees of DB schemes, which comprises detailed discussions of how they undertake the management of their scheme and their governance responsibilities.

Further guidance for all trustees would also be published, including the DC codes that the authority had just launched, further model documents, and guidance for DB trustees on actuarial advice.

"There are good schemes, whose members are supported to make the decisions they need to. But there are other schemes, and it is these schemes which are our concern"

The Irish pensions body would also update its website to improve navigation and make it more 'user-friendly' and develop pension reform proposals for submission to the Department of Social Protection.

“There are good pension schemes, whose members understand their pension situation and are supported to make the decisions they need to. But there are other schemes, and it is these schemes which are our concern,” Kennedy said.

“Members in less well-run schemes will be less comfortable, are less likely to save, less likely to make reasonable decisions and less likely to have as good an outcome.

“What we must have is a pension system where pension schemes are always well run. We need a pensions system that is much more capable of providing consistently good value. The pension system should help people understand their position and clearly explain and guide and support them though the decisions they are asked to make. We also need people to be happy that the pension system is well regulated.”

Kennedy stressed, however, that the Pensions Authority “does not and should not” run pension schemes, but it is within the authority's responsibilities to see that pension schemes are “properly run”.

“We – trustees, the pension industry and the Pensions Authority – must work so that everyone saving for their retirement is comfortable with their pension. They must be familiar with it, understand it and be supported properly in the decisions they have to make. It is your responsibility to make sure that their best interests are at the centre of all you do. It is our responsibility to oversee and support you. There is a great deal of work for all of us to do," he said.

IMF's Lagarde rejects 'draconian fiscal measures' for Greece

THE ORGANISATION'S MANAGING DIRECTOR SAYS GREECE MUST BE ABLE TO WALK ON TWO LEGS

Written by: Natalie Tuck

International Monetary Fund managing director Christine Lagarde has said she does not want to see "draconian fiscal measures" applied to Greece.

Speaking during an online press conference, Lagarde said the Greek programme must be able to walk on two legs, the first being the significant reforms and the other being the debt relief from the IMF and the Eurozone.

Her comments follow a day of strikes in Greece on 4 February, following the government's proposed pension reforms.

"If the pension reform cannot be as significantly, substantially, deeply reformed as is needed it will mean more debt relief on the other side. Now equally, no matter how big, the debt relief will actually make the pension system sustainable," she explained.

Lagarde stated the current pension system in Greece cannot be sustained because in order to finance it every year, around 10 per cent of Greece's GDP would have to be given to fund pensions. She said the average amount in Europe is about 2.5 per cent, significantly less.

"It all needs to add up but at the same time the Greek pension system needs to be sustainable in the medium and long-term and that requires taking short-term measures now that will last in order to make it sustainable," she continued.

However, responding to criticism, Lagarde said she does not like it when the IMF is portrayed as a "draconian, rigorous, terrible IMF" because it does not want "draconian fiscal measures to apply to Greece" as it has already made a lot of sacrifices.

"We've said all along that the fiscal consolidation should not be excessive so that the economy could continue to work and eventually expand, but it needs to add up. The pension system needs to be reformed and the tax collection system needs to be improved so that revenue comes in," she added.

Dutch ABP pension fund could be decentralised as part of alternative governance structure model

PROPOSALS TO SPLIT THE FUND INTO CLUSTERS HAVE BEEN PUT FORWARD TO IMPROVE GOVERNANCE

Written by: Natalie Tuck

The Dutch civil service pension fund ABP could be split into a number of different clusters to save on costs.

The proposal was made in a report for the government on the efficiency of pension funds on the public sector by the Home Affairs Ministry.

ABP is one of the biggest pension funds in the world with 2.8 million members, covering those in the public sector and education in the Netherlands. As many as one in six people in the Netherlands receives or will receive a pension from ABP.

The report found that employers experience a lack of control over the development of their pension and the cross-sector pension scheme leads to increasing dissatisfaction among government employers.

The report made several alternative governance models to improve the fund, which included dividing the fund into different clusters. The report said if pay and pensions were dealt with simultaneously it would be easier to negotiate with unions.

Therefore, the report proposed that each public sector group could be given their own pension fund or the option to leave the ABP. Another proposed option is to split the pension fund into national government, local government and education sectors.

Earlier this year, ABP said the likelihood that it will have to reduce pension payments in 2017 is growing.

ABP chairman Corien Wortmann-Kool announced the news alongside the release of the pension fund's Q4 quarterly report for 2015 showing a policy coverage ratio declining by 1 per cent from Q3 2015.

As the fund has not met the expectations set out by the Pensions Act, which is a policy coverage ratio of 126.5 per cent and minimum requirement of 104.2 per cent, ABP will be submitting another recovery plan before 1 April 2016.

News in brief

■ **Canada pension plan Ottawa** returned a net 4.5 per cent for the quarter ended 31 December. Plan assets totalled around $282.6bn as of the end of the month, up 3.6 per cent from the previous quarter.

■ **CBRE Global Investors** has acquired a prime retail portfolio comprising four high street assets on behalf of clients from Legal & General Property's life fund for £37.04m, reflecting a net initial yield of 3.9 per cent a year.

■ **Russian President Vladimir Putin** is considering the idea of Russia's non-state pension fund taking part in planned privatisation sell-offs, *Reuters* has reported.

■ Indian e-commerce company **Snapdeal.com** has bucked a slowdown in startup investments in India, securing $200m from the **Ontario Teachers' Pension Plan** and others. The investment takes the company's valuation to $6.5bn.

■ **The Austrian Finance Ministry** has opposed plans by Bank Austria to move around 3,300 employees into the state pension system as part of an overhaul of its retail operations in the country.

■ More than half of institutional investors still favour equities over other asset classes, a recent study has found. As many as 54 per cent of institutional investors that took part in **NN Investment Partners'** recent Risk Rotation Index stated that they favoured equities over other asset classes, 26 per cent strongly, while the next most favoured asset class was real estate (44 per cent).

Japan's GPIF denied stock freedom

JAPAN'S GOVT PENSION FUND BLOCKED FROM DIRECT STOCK INVESTMENTS

Written by: Lauren Weymouth

Japan's biggest pension fund has been blocked from direct stock investing after it pushed for permission to bypass asset managers.

According to *Bloomberg*, the proposal to allow the Government Pension Investment Fund to directly buy or sell stocks has been halted.

Japan's fund, which is also the world's largest pension fund, has been actively seeking permission to act directly rather than hiring asset managers in order to lower operating costs and increase the size of its investments.

Tokyo-based *Kyodo News* reported that while a panel picked by the government recommended a complete overhaul of how GPIF manages Japan's retirement money, the ability to directly manage stocks won't be among the changes.

The fund underwent a number of reforms in October, pruning back its bond allocation to make way for more equities and a foray into alternative investments.

Canada's largest pension funds to walk away from infrastructure

THE SHIFT COMES AMONG INTENSE COMPETITION FOR ASSETS

Written by: Lauren Weymouth

Canada's biggest pension funds have said they are walking away from an increasing amount of global infrastructure deals among concerns that high competition for assets has driven valuations too far.

Financial Post reported the move could help lower global prices for tunnels, airports, toll roads, energy networks and other infrastructure as Canadian pension plans are among the world's biggest and most active buyers.

Pension funds' investment in infrastructure has increased dramatically since the financial crisis as declining interest rates and bond yields drove pension fund investors to look for steady returns elsewhere.

Senior executives at the leading Canadian funds have defended the merits of past infrastructure deals, but have also said they are worried prices no longer reflect the illiquidity of the assets, which cannot be sold quickly like stocks or bonds, *Financial Post* said.

"The market is overheated. We have stepped out of the bidding for a lot of assets over the last two or three years," a spokesperson for Canada's biggest pension fund told *Reuters*.

Canadian funds still expect infrastructure to grow as a proportion of their overall investments as infrastructure is a good match for long-term liabilities.

Diary dates 2016

The latest events occurring across the European pensions space

PLSA INVESTMENT CONFERENCE
9-11 March 2016
EICC
Edinburgh, Scotland

Formerly the NAPF Investment Conference, this will explore the UK's relationship with Europe and other issues to bring some clarity as to how schemes can best manage their short-term pressures whilst also being responsible long-term investors delivering what their scheme members want and need. Over 900 pension professionals are set to attend.
www.plsa.co.uk

PENSIONI & WELFARE ITALIA CONFERENCE: LE NUOVE SFIDE
15 June 2016
Milan, Italy

The Pensioni & Welfare Italia Conference: Le nuove sfide offers pension funds, pension consultants, investment professionals, and all those working in the Italian pensions and investment space the opportunity to both learn and network alongside their peers at one of the most exciting yet challenging times in the history of Italian pensions. Registration is now open.
www.europeanpensions.net

EUROPEAN PENSIONS AWARDS 2016
26 June 2016
Grosvenor House Hotel
Park Lane, London, UK

The European Pensions Awards aim to recognise outstanding achievement in the varied fields of European pension provision during increasingly challenging times. The eight previous awards were hugely successful, each receiving hundreds of nominations from key providers across Europe. The 2016 European Pensions Awards are now open for entries. The awards are free to enter.
www.europeanpensions.net/awards

Not to miss...

PMI ADMINISTRATION SUMMIT
29 February 2016
America Square Conference Centre, London
www.pensions-pmi.org.uk

PENSIONS AGE HALF DAY SEMINAR
18 March 2016
Hilton London, Tower Bridge
www.pensionsage.com/events

PMI ANNUAL CONFERENCE
14 April 2016
Cavendish Conference Centre, London
www.pensions-pmi.org.uk

PENSIONS AGE SPRING CONFERENCE
28 April 2016
Hilton Tower Bridge, London
www.pensionsage.com/conference

If you have any European pensions events to promote, please contact lauren.weymouth@europeanpensions.net

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

PHILIPPE ROSET

State Street Global Advisors has appointed Philippe Roset as head of SPDR ETFs for the Netherlands. Roset will be responsible for business development and overseeing sales of SPDR ETFs in the Netherlands. Prior to joining SSGA, Roset spent three years as head of Benelux for ETF Securities; and was previously vice president for Benelux business development and capital markets team associate at iShares between 2008 and 2012.

FLORENT HERVÉ

BMO Real Estate Partners has appointed Florent Hervé as a European asset manager. His appointment follows Assia Amore, who joined BMO Real Estate Partners as European transaction manager in January 2016. Hervé will be responsible for asset and project management activities on both BMO Real Estate Partners' core and value-added business lines across Continental Europe.

CHRISTOPHE BRAUN

Capital Group has appointed Christophe Braun as an investment specialist. He joins Capital Group from CBP Quilvest S.A. in Luxembourg, where he was a portfolio manager and investment adviser responsible for the implementation of CBP's investment strategies and asset allocation. Prior to this, he was an investment representative at TD Direct Investing International.

DAVID ROWE

Neuberger Berman has appointed David Rowe as head of marketing – EMEA and he will be responsible for developing and implementing its marketing strategy. Rowe has over 17 years' experience in the asset management industry. He joins from PIMCO where he was head of MarComms EMEA since 2012 and additionally responsible for APAC since 2014. Previously, he held several senior marketing roles at Threadneedle.

MARK GENESTE

Kempen Capital Management has appointed Mark Geneste as an executive director for global institutional and marketing. He will focus on maintaining and expanding KCM's assets under management in the Dutch domestic market and abroad. Previously, Geneste was chief sales officer at Dun & Bradstreet and executive vice president - institutional sales at Instinet.

ERIK WESTERMARK

LGIM Infrastructure has appointed Erik Westermark as a senior investment associate. He will report to Silja Turville, head of LGIM Infrastructure and he brings the infrastructure team to six strong. He joins with considerable experience in the sector, having worked at Citi Global Markets and at Lloyds Bank, focusing on infrastructure, energy and aquisition finance.

ROB VENEBOER

Graydon has appointed Rob Veneboer as its chief operating officer, as well as a member of the board of directors. He was previously managing director - business information solutions for LexisNexis International. Furthermore, he has been active as a managing director for Sdu Publishers and De Persgroep in Amsterdam. He has substantial knowledge and international expertise on various business information platforms and systems.

STEFANIE MOLLIN-ELLIOT

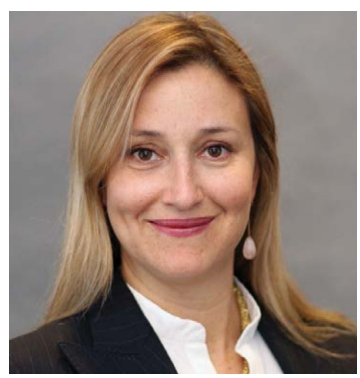
Unigestion has appointed Stefanie Mollin-Elliott as fundamental analyst (senior vice president) within its equities team, covering global small and mid-cap stocks. She is based in London and reports to Bruno Taillardat, executive director and investment director within the equities team. She joined Unigestion from Allianz Global Investors.

ALEXANDRE RAHMATOLLAHI

Palamon Capital Partners has appointed Alexandre Rahmatollahi to the partnership. He joined Palamon from Morgan Stanley, where he spent nearly eight years in its investment banking division, most recently as an executive director. Prior to that he was an engagement manager at McKinsey & Company in its general strategy consulting and private equity practices.

AXEL HÖRGER

Lombard International has appointed Axel Hörger as CEO Europe. He succeeds John Van Der Wielen, previously interim CEO, who will remain a non-executive director of the company. He joins Lombard International from his role as CEO at UBS Deutschland AG. Hörger will be responsible for continuing the progress of the transatlantic business model and will be based in Luxembourg, working closely alongside the executive chairman and the management team.



LUISA GRESELIN

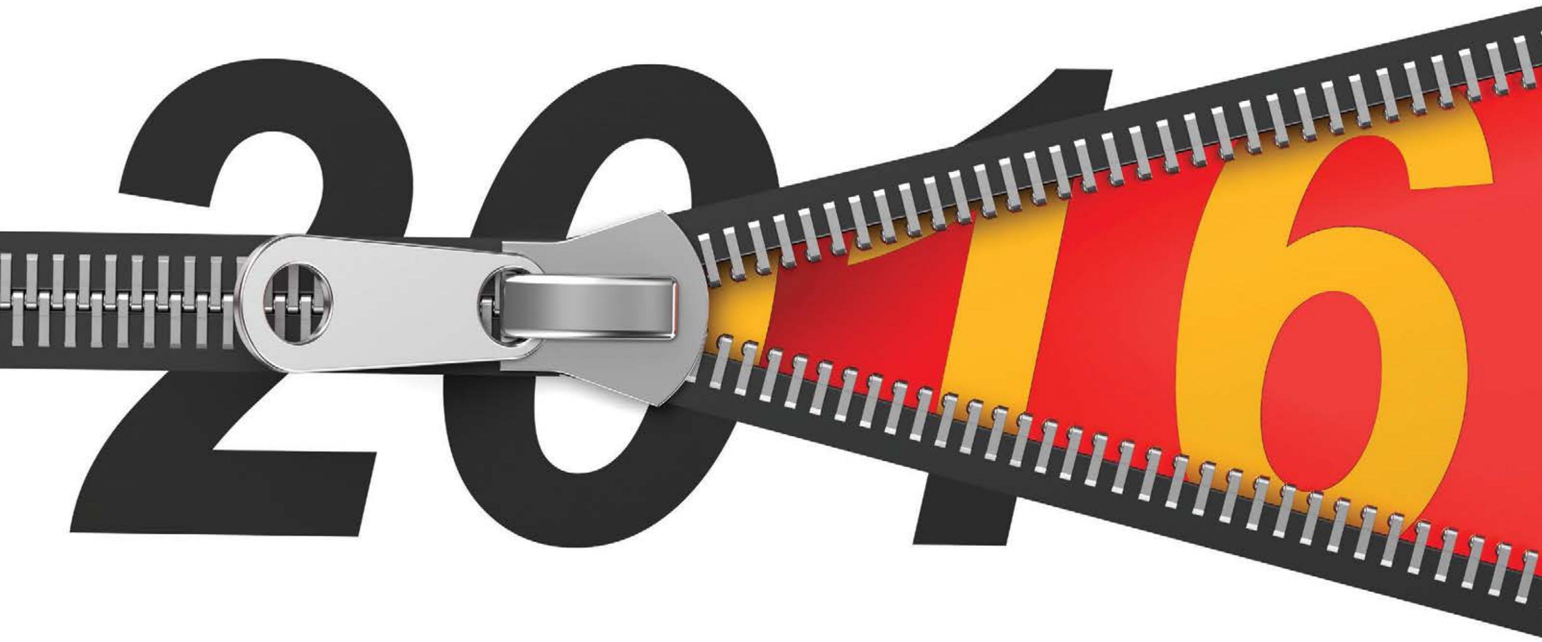
Macquarie Investment Management has appointed Luisa Greselin as head of Italian distribution. Greselin has over 20 years of asset management experience. Prior to joining Macquarie, she spent 17 years at MFS Investment Management in several distribution roles across the Americas and Europe. Her focus has been on the Italian market in the past 10 years.

OVERVIEW

2016 and all that

Edmund Tirbutt explores what this year could have in store for European pension funds and the impact of political risk

WRITTEN BY EDMUND TIRBUTT, A FREELANCE JOURNALIST



The fact that the likely introduction this year of the revision of the Institutions for Occupational Retirement Provision Directive (IORP II) is being heralded as a broadly positive development is surely proof enough of the sense of pessimism elsewhere within the European pensions community, particularly regarding the ominous outlook for investment markets.

Regulation and legislation

Having to implement the risk reporting and, to a lesser extent, benefit reporting requirements of the directive will involve significant expense at a time when pension schemes are working hard to reduce costs. Nevertheless, individual member states are likely to have two years to implement IORP II from the time it is published in the Official Journal of the European Union, and they will enjoy much more room for manoeuvre when doing so than was the case with the original proposals.

Further reasons to be cheerful are to be found in the fact that the Pillar I solvency proposals have been thrown out for the time being, meaning that the directive applies only to governance and communications, and in the news that the European Insurance and Occupational Pensions Authority's (EIOPA) unpopular holistic balance sheet is unlikely to be included.

THE EUROPEAN COMMISSION'S STAFF HAVE INDICATED TO US THAT THE HOLISTIC BALANCE SHEET DOESN'T FIT IN WITH ITS POLITICAL AGENDA, AND IT'S FAIRLY CLEAR THAT IT WON'T BE FEATURING

A STABILISING OF LIFE EXPECTANCY INCREASES COULD BODE WELL FOR THOSE MANAGING PENSION SCHEME LIABILITIES THIS YEAR

Pensions and Lifetime Savings Association policy lead EU and international James Walsh says: "The European Commission's staff have indicated to us that the holistic balance sheet doesn't fit in with its political agenda, and it's fairly clear that it won't be featuring. I am expecting IORP II to be implemented this spring or summer.

"The amendments being made to it in recent months by the European Parliament are roughly speaking broadly similar to those already made by the European Council. The overall gist is that they have been simplifying the original European Commission proposals and making them much more practical and workable."

PensionsEurope chief executive Matti Leppälä agrees the revisions by the Council and Parliament have been very positive but he is still concerned that the directive in its current form requires full funding at all times for cross-border schemes.

"We feel this hinders cross-border provision as there are very few cross-border schemes in Europe," he states. "We have pointed out that if you want more of them the cross-border funding requirement should be lifted but we are not optimistic about the outcome. Otherwise IORP II is good.

"We've all along recognised that good governance and good disclosure are very important, especially as the move from defined benefit to defined contribution schemes makes transparency more important, as members must have the risks disclosed to them adequately."

Investment and life expectancy

Reasons to be cheerful away from the legislative front include the news that an interest in riskier investment strategies is unlikely to get out of control as pension funds continue to grapple with the implications of a low interest rate and low growth environment.

The Organisation for Economic Co-operation and Development (OECD) principal administrator for private pensions Emmy Labovitch says: "Given that interest rates could stay low for a long time, over the past year we have been monitoring whether there could be an excessive search for yield."

However, he emphasised that "we haven't seen any general pattern yet in this respect".

Architas chief investment officer Caspar Rock feels that a stabilising of life expectancy increases could bode well for those managing pension scheme liabilities this year.

"Life expectancy in the early part of this decade consistently rose by approximately three months a year but for the last four years we have experienced a low or negative improvement. There is no guarantee, but people are observing that this could ease cost pressures," he comments.

LCP partner Alex Waite, on the other hand, feels a lot of pension schemes throughout Europe are "still deluding themselves we are all going to die at 85" and reports that many pension fund managers received "a nasty shock" in December 2015 when Switzerland issued its five year review of longevity. But he also emphasises that bulk annuities are likely to become better value as a result of the insurance market recovering from the impact of having to implement Solvency II, and points out that this has already been happening in the Netherlands.

"If you need to get rid of the longevity risk you need to get someone to take it off your hands, and insurers are always willing to take it if the pension fund is realistic about the liability. This year we will see an increase in liability transfers to insurers as more and more pension funds get realistic about longevity across Europe," he says.

De-risking, fiduciary management and upping contributions

Zurich Insurance global head of corporate life and pensions Hanno Mijer also singles out the de-risking of longevity exposure as being one of the main themes of 2016.

He states: "To date many of the de-risking solutions have focused on the larger funds with the capacity to engage the many specialists needed to plan and deliver complex bespoke solutions. This year will see this tool become more common amongst mid-sized and smaller pension funds as more off-the-shelf solutions are provided.

"These may be buyouts, buy-ins or swaps, but the common theme will be straightforward transactions to pass longevity risk to insurers or reinsurers who are better able to manage the exposure. We know the pension fund appetite to solve this longevity issue is high as we have seen unprecedented demand for solutions from the UK, Ireland and elsewhere."

Away from the investment climate, IORP II and de-risking, there is little overlap between commentators regarding what they consider to be the main issues for 2016.

Lincoln Pensions head Darren Redmayne expects fiduciary management work to be to the fore this year.

"I expect pension funds to award fiduciary mandates, especially in the case of defined benefit schemes where a fiduciary manager may be better placed to respond to volatility than trustees that meet quarterly, or possibly even monthly for larger schemes."

Punter Southall International head Julia Whittle feels the key theme for 2016 is the need for employers to realise the importance of contributing more to pensions.

THIS YEAR WILL SEE THIS TOOL BECOME MORE COMMON AMONGST MID-SIZED AND SMALLER PENSION FUNDS AS MORE OFF-THE-SHELF SOLUTIONS ARE PROVIDED

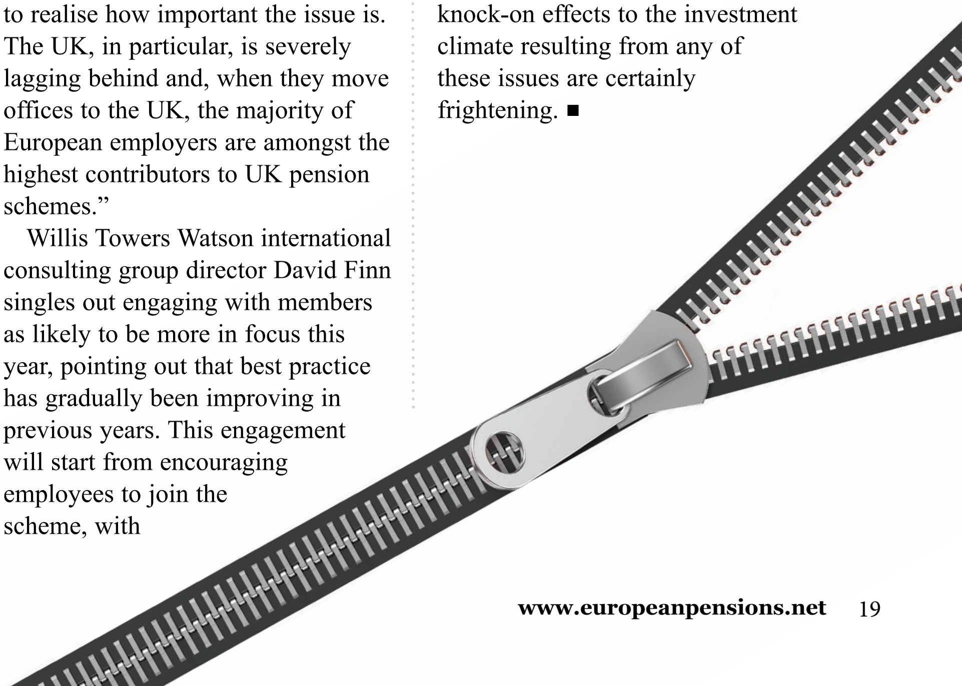
She says: "The Dutch have been on the front foot with their defined benefit schemes, and others will start to realise how important the issue is. The UK, in particular, is severely lagging behind and, when they move offices to the UK, the majority of European employers are amongst the highest contributors to UK pension schemes."

Willis Towers Watson international consulting group director David Finn singles out engaging with members as likely to be more in focus this year, pointing out that best practice has gradually been improving in previous years. This engagement will start from encouraging employees to join the scheme, with the emphasis on explaining what the scheme provides and their long-term importance, as well as ongoing understanding of investment choices, the lead into retirement, and the form to take benefits in at retirement.

"There's a lot of focus on different modelling tools to help with ongoing investment decisions, asset allocation decisions and how much to save. We are getting an increasing number of requests in this area," he comments.

Cardano head of innovation Stefan Lundbergh observes that the populists are gaining ground in the political arena in all countries and fears that if any were to get in at elections this year it could have consequences for pensions because "funded pensions are an easy target to raid for those wanting to do populist reforms".

However, once one strays into the area of political risk there are a number of other issues that seem even more frightening still. As yet there seems no hint of a solution to the problems posed by mass immigration or by the so-called Islamic State. Brexit could also occur in 2016, and rumblings in North Korea could assume a whole new dimension. The potential knock-on effects to the investment climate resulting from any of these issues are certainly frightening. ■



INVESTMENT

A bumpy road

As global stock markets continue to react and recoil to heavy falls, Peter Carvill **lines up some investment predictions for 2016**

WRITTEN BY PETER CARVILL, A FREELANCE JOURNALIST

The door on 2016 has opened to a landscape of uncertainty and change. Amidst a host of issues, many investors and pensions funds are thinking ahead and recalibrating their investment strategies.

The general prediction for the world's economy is that it will expand in 2016, if only marginally. A recent report from Willis Towers Watson, *Global Investment Committee: Secular Outlook 2015*, found that economic recovery in major economies had been 'uneven' and that across these sectors only a 'sluggish recovery' had been observed.

Scotiabank's *Global Forecast Update* gives a number of reasons for this: the slowdown in the Chinese economy, underperformance across Europe and in Japan, weaknesses in the commodity and manufacturing sectors, high debt burdens across the private and public sectors, an over-supply in the majority of commodity markets, and geopolitical strains.

Yet despite this, Willis Towers Watson found some reason to be celebratory, outlining that the global economy's mediocre growth stands in contrast to the changes witnessed in the financial markets.

The right approach

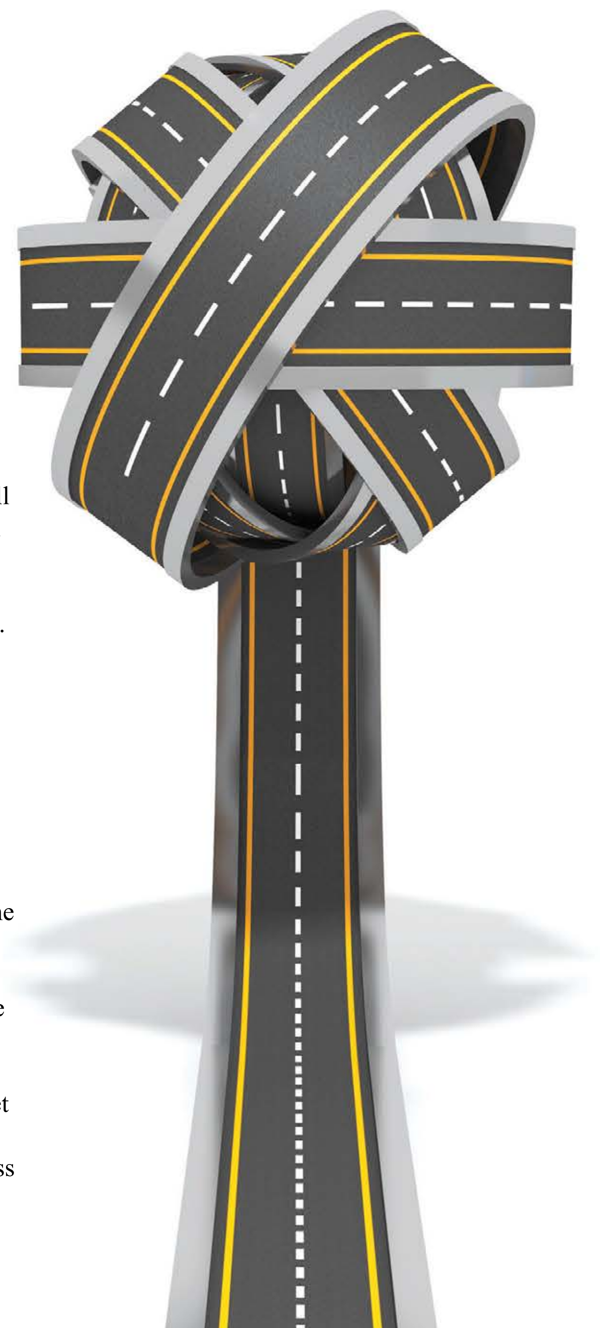
This discord leaves investors in a tricky place, raising questions about how they should allocate their investments this year.

Natixis Global Asset Management, in its *2016 in Focus* says the current market is one that favours active institutional management and that the assets likely to perform best this year will be equities, alternative investments, and stocks, while fixed-income returns will be suppressed by monetary policy and interest rates.

Pinsent Masons head of pensions research Raj Sharma says that one asset class expected to perform well in 2016 is infrastructure. "There will be more opportunities coming up in projects that are being built from scratch and the question of whether pension funds want to invest in that. It's a case of what it is that you're building because putting up streetlights is one thing while building a nuclear power plant is another. The opportunities are in things such as brownfield sites. We think there are opportunities there, whether they are in renewables, transport, or other infrastructure. The other opportunities are in property and real estate. For some people, that's an alternative to infrastructure where you can create steady, long-term cash flows."

According to Natixis Global Asset Management director and head of UK and Ireland institutional business Euan MacLaren: "From the point of view for institutional investors we are going to see outflows in the traditional bond markets and a drop in high yield. Where is that money going? I think we will see a switch or continuation to fixed-income but more towards unconstrained and the global macro side. On the asset side, I think we will see more money allocated institutionally. Equities look attractive after the high volatility of recent years."

Not every asset class is due a



boom year, though. Sharma says that 2016 for gilts and bonds will look the same as 2015, adding that investors will be looking at their portfolios and looking to diversify more. “I think the areas that may fare not so well,” he adds, “are the hedge funds and private equity investments because they seem to have suffered a lot last year with redemptions. The fee structure, too, has come under a lot of focus. I think active management itself will also come under a lot of scrutiny.”

The fortunes and failings of individual asset classes will take place against macroeconomic trends exerting pressure on the markets. In collating data for *2016 in Focus*, Natixis found that 42 per cent of respondents believed market volatility was the biggest risk to investment performance in 2016, concluding: “After a year in which we saw 56 days with 1 per cent movement in the S&P 500 between 1 January and 31 October, it should be no surprise that this weighs heavily on the minds of investors.”

The same report found over half of respondents named geopolitical events as the most likely cause for market volatility, coming in the wave of terrorist attacks across the Middle East and Europe, the ongoing Syrian refugee crisis, and the forthcoming US presidential election.

“Geopolitics does have a growing impact on the volatility of the markets,” says MacLaren, “not just from recent events, but from the whole of last year and this year. It has always been around but impacts have been on the daily volatility of the markets. But the fundamentals underpinning those markets remain strong.”

China

A more worrying development has been the slowing of the Chinese economy. Natixis reports that 49 per cent of respondents thought that the issue would have an impact on volatility. They may have good reason to be worried: the main index in Shanghai lost 19 per cent of its value in the first fortnight of the year, and was accompanied by double-digit falls in Frankfurt and Tokyo, and drops of 8 per cent and 9 per cent in London and New York.

“With China,” MacLaren comments, “we’ve had three or four years where price has divorced itself from the fundamentals of the underlying market, making pricing expensive. We’ve had a bubble and now we’re getting the correction. It’s the same as we’ve seen in Europe, but in a negative way. Consequenty, we see a lot of value in European equities in 2016.”

MacLaren adds: “China’s had a period of exceptional growth and I think this is a correction. Ten years ago, the average GDP in China was $1,000. Now, it’s $10,000. If growth is at 5 or 6 per cent, that’s still a good rate. Looking at where they came from, they’re still growing, only it from a much higher base.

QE

Another issue on the horizon is the QE programmes put into place around the world. The Indiana Business Research Center recently released *Financial Markets 2016: The Groundhog Forecast*. The effects of the US QE programme, the authors opine, had ultimately been lower growth: “When the Fed started QE, it was argued that the lower interest rates would jumpstart business investment, encourage economic growth, and the wealth effect from higher asset prices would increase household consumption. What we have seen is the weakest post-recession recovery of the modern era. From the perspective of finance, this outcome isn’t surprising. When stock and bond prices get bid up higher than they would without QE, their expected returns will be lower. With lower expected returns, businesses conserve cash and scale back investments; consumers save more and reduce spending. The net result is lower growth.”

The report’s authors added: “As investors, we face a serious challenge: How do we manage our portfolios in a QE world? One thing we have learned is that buy and hold is actually a pretty good QE strategy. Over the past five years of QE, the average return to the S&P 500 is about 14 per cent per year. This is well above the historical average of about 10 per cent. Our guess is that global QE will be a force at least through 2016. However, we need to be diligent in looking for signals suggesting the phase-out of QE strategies.”

Oil

Another key issue for investors has been the long-dropping oil price. Recently, the international benchmark of Brent Crude fell 2.4 per cent per barrel, characterised as being close to its lowest point in the last 12 years. On a longer timeline, the price of oil has dropped three-quarters in the last 18 months due to an over-supply in the US in tandem with falling demand from Asia and Europe.

“The laws of supply and demand will come back there,” says MacLaren. “It’s a fact of life. It’s an economic foundation. What we’ve seen are some defaults. But it does mean there is opportunity there for companies that are not so highly leveraged. But they’re starting to look attractive in the market.”

There can be little doubt that 2016 will be an interesting year for pension funds with regards to their investments. Where the markets will lead the industry cannot be predicted with 100 per cent accuracy. But what is likely is that there will be a bumpy road ahead. ■

Transition management

Reading the changing landscape

BLACKROCK'S TRANSITION MANAGEMENT TEAM IN EMEA CO-HEADS JUSTINE ANDERSON AND PETER LOEHNERT SHARE THEIR THOUGHTS ON THE CURRENT TRANSITION MANAGEMENT ENVIRONMENT

Which trends did you observe in transition management in 2015?
Last year we undertook transitions across all asset classes. However, emerging markets, both debt and equity as well as high-yield debt, stood out. These asset classes can provide additional challenges that require specialist trading teams and the right risk and investment management technology. We also saw continued interest from clients seeking a long-term, exclusive partnership that allows them to make transition management a core part of their investment process. With ever-growing focus on costs, efficiency and transparency this is a scalable solution that is increasingly attractive to many of our clients, particularly as the current environment requires investors to take a more active approach to their portfolios.

Which factors are important when evaluating and selecting a transition manager?
There are so many: size and experience of the team, longevity and track record in the industry, access to liquidity, technology and systems to name but a few. We would always encourage a client to conduct thorough due diligence.
It is crucial to come onsite to get a 'real world' view of the quality of the team and the process. It is only when you actually see the scale of an operation, meet the people, count the traders and interrogate the systems that clients can make a genuine value for money comparison and have confidence in their decision.

In evaluating cost, is there a particular area that requires greater attention?
Clients have long been aware of the need to look very carefully at the true costs of trading equities and bonds as opposed to simply comparing commission rates. An area that is still often overlooked is FX, which can be a significant component of implementation shortfall. It is so important to understand how FX is traded during a transition, what the risk contribution is and whether there are ways to mitigate that risk.
We would always advocate a multi-counterparty approach for execution. Our experience has been that this can lead to significant cost savings for clients. Given the size of the FX transactions that can occur in a transition, it is especially important to be able to source a wide range of prices and put banks into competition.

You won the European Pensions Transition Management Firm of the Year for two years in a row. To what do you attribute BlackRock's success?
Our philosophy has always been that the ability to provide transition management services at a consistently high level requires a significant commitment to the business in terms of both people and technology. BlackRock's transition management team stands out by its size and level of experience. The team has access to purpose-built multi-asset systems and to a fully connected global trading network, which is leading the way in electronic trading. For our clients, this means that they can be confident that the key elements of a transition: project management, risk management and execution, are always fully supported no matter how complex the transition or which asset classes are involved. As a result, we have been the go-to provider for complex events for many years. Clients place enormous value on the simplicity of our business model and our fiduciary approach to everything we do.

What do you think will be a key theme for the transition management industry in 2016?
Many of the themes prevalent in 2015 will continue into 2016. A new interest rate environment, increased regulation and a strong focus on broadening investment strategies will continue to drive significant portfolio change and thus the need to mitigate any impact on performance. Understanding the evolving market structure and navigating both liquidity and volatility risk will no doubt remain challenging. From a provider's perspective, it means further innovation and an even closer partnership with our clients to help them achieve their goals. ■

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Invest Europe

Protecting private equity

INVEST EUROPE'S DÖRTE HÖPPNER EXPLORES THE IMPORTANCE OF PENSION FUND INVESTMENT WITHIN PRIVATE EQUITY, VENTURE CAPITAL AND INFRASTRUCTURE

IT IS ESSENTIAL THAT EUROPEAN AND INTERNATIONAL REGULATION ON INVESTORS' CAPITAL BUFFERS AND COMPANY TAXATION DO NOT HINDER INVESTMENT OR REDUCE RETURNS

Pension fund allocations to private capital continue to strengthen thanks to the appeal of alpha, while new policy is beginning to reflect the benefits of private equity, venture capital and infrastructure funds for retirement savers. It is essential that European and international regulation on investors' capital buffers and company taxation do not hinder that investment or reduce returns.

Pension funds are the largest single investor group in European private equity and provided over a third of the €44.6 billion that European firms raised in 2014. Given the re-emergence of volatility at the start of 2016, long-term investments in private companies or infrastructure projects can look particularly appealing.

For their part, European policymakers want to tap the €12 trillion of capital held by institutional investors for much-needed investment. Private capital in its many forms is seen as part of the solution, as evidenced clearly in the Capital Markets Union Action Plan released last year, a policy initiative that aims to facilitate the connection of institutions with capital to European businesses and projects in need of investment.

The European Commission believes that venture capital and private equity funds that drive innovation and, by extension, employment and growth in small to medium-sized enterprises, are to be encouraged. Meanwhile, the European Fund for Strategic Investments hopes to use public funds as a catalyst to mobilise up to €315 billion of investment capital.

Private equity has established a strong reputation through its activities since the financial crisis. The industry invested €350 billion in some 25,000 companies employing almost eight million people between 2007 and 2015. Venture capital firms have created huge success stories in Europe, such as music discovery app Shazam and takeaway food delivery company, Delivery Hero. All this has been made possible with pension fund investment.

So, it is essential that pension funds can continue to invest in all forms of private capital and that regulation does not contain provisions or create unintended consequences that reduce pension funds' appetite for private equity, or the returns they can derive from it.

Thanks to strong arguments, proposals made in 2014 for the Institutions for Occupational Retirement Provision (IORP) II Directive do not contain any new capital requirements for investments in private equity, and are progressing smoothly through the EU negotiating process. However, at the same time, the European Insurance and Occupational Pensions Authority is working on its risk-based framework for the pensions industry, dubbed the 'Holistic Balance Sheet', which may ultimately include Solvency II-style capital requirements. As one of Europe's key financial supervisors, EIOPA has significant influence and could ultimately shape regulation affecting pension funds, savers and companies.

Invest Europe is working with partner organisations to ensure that all parties truly understand the nature and benefits of private capital. Our industry will also continue to press for the recalibration of risk weightings on private equity and other investments from Solvency II, which came into force at the start of this year.

The OECD's Base Erosion and Profit Shifting reform is also in our sights for any potential or unintended harm to private capital investment as tax authorities around the world seek to preserve their tax take. Key deliverables were published last year, though more work is needed to flesh these out with detail.

We will continue to monitor these developments closely and will work to protect the special relationship between pension funds and private equity. ■

Written by Dörte Höppner, CEO, Invest Europe

COUNTRY SPOTLIGHT SWITZERLAND

Up in the air

Switzerland's pension reform legislation is once again likely to be amended due to governmental changes. Peter Davy **explores the reasons why and analyses the state of the Swiss bond market**

WRITTEN BY PETER DAVY, A FREELANCE JOURNALIST

There will be no quick fixes for Swiss pensions. Following the elections last October, the future of the pensions reform legislation Altersvorsorge 2020 (Retirement 2020 or AV2020) is once again up in the air.

The elections saw a swing to the right, giving the conservative Swiss People's Party (SVP) the largest share of the vote and seats in the country's lower (and larger) parliamentary house, the Nationalrat (National Council). The economically right-wing Liberal Party (FDP) also saw gains.

This brings a number of potential problems to the forefront. First, the right-leaning MPs may be tempted to introduce changes such as increasing the retirement age, reducing the prospects of cross-party consensus; a survey after the election by newspaper *Basler Zeitung* found over 80 per cent of conservative MPs favoured a retirement age of 67 (as opposed to 65).

Second, the lower house is now more likely to overturn amendments to the proposals introduced before the election by the upper house, the Ständerat. Most notably, it has proposed an increase to the first pillar of CHF70 (€63.95) a month, designed to compensate for cuts to minimum conversion rate (which is used to calculate the pension members receive from their pensions savings) in the second pillar.

"They argue it will help pass the reform because people will see the benefit of more money coming from the first pillar. On the other hand, it increases the financial burden on a time when we need to be careful to live within our means," Swiss thinktank Avenir Suisse researcher Jérôme Cosandey explains.

Both houses are also working to a deadline: the proposals are partly financed by an increase in VAT, which includes a temporary component of 0.3 that expires at the start of 2018. A referendum is needed by May 2017 to maintain this and use it for pensions.

"If everything goes smoothly the second chamber will make its amendments and then the first chamber has to approve that. We cannot allow a lot of ping-pong, though, because it is a very tight schedule – one of the tightest we have," Cosandey states.

Effectively, both houses must pass the proposals by the end of this year or early next.

The big question for Swiss Association of Actuaries (SAV)

THE SWISS SYSTEM OF GOVERNANCE HAS A LOT OF BENEFITS BUT DEALING WITH CHANGE IS PROBABLY NOT A STRENGTH

president Klemens Binswanger is whether the reform passes as a package or if interest groups will try to split it into several smaller issues. If the latter, the negotiations could go on for years.

Ever deeper: low yield persist

As it is, even if passed in 2018, the changes will be introduced gradually, becoming fully implemented by 2024, Cosandey estimates. The challenges faced by second pillar funds are somewhat more immediate, however.

Low interest rates of recent years present a significant problem for funds that grew used to relying on high yields in previous decades.

"That is probably one of the reasons why we have such a problem today because people thought we have high yields so we don't have to worry about the higher life expectancy," says Binswanger. "As interest rates are now very low, however, they can no longer cover the costs of longevity."

How well this is recognised is open to question. Part of the problem, PPCmetrics partner Hansruedi Scherer suggests, is that the current technical interest rate used by Swiss pensions to calculate their coverage rates is, in most cases, well above the yields on long-term government bonds, which are negative (-0.23 per cent for 10-year government bonds).

"Using a market rate to calculate the liabilities rather than the technical interest rate gives you much lower figures," Scherer states.

The problem is not so much current coverage ratios, he says, but that pension fund boards continue to make decisions on the basis of the distorted view that the technical coverage ratio paints.

"The single decision is not the problem but they continue to make poor decisions and the sum of all these will mount up to a serious problem in the long term," he explains.

That is changing, however. While 2014 and the start of 2015 produced fair returns for a traditional Swiss pension fund portfolio invested in domestic bonds and equities, that changed later in the year. The Credit Suisse Pension Fund Index saw a decline of 2.21 per cent in August, and fell a further 0.93 per cent in September, wiping out gains from earlier in the year.

"The fact that Swiss government bonds are not very attractive hasn't changed but the current situation forces people to think about it even harder," Swiss investment advisory firm Siglo partner Christoph Gort comments. "Last year the excuse was that returns were still fine so they could just wait, but for 2015 the returns have not been good and that might wake up even more people."

There are two possible scenarios for Swiss bonds, Aon head of investment consulting in Switzerland Dominique Grandchamp says. Neither looks good for those with heavy investments in Swiss sovereign or investment grade corporate bonds.

First, Switzerland moves towards a Japanese-like environment and low rates persist indefinitely: "In that case you can expect your total return on these assets to move sideways and therefore actually the net return that includes your liabilities will be negative. That might slowly eat up capital, thereby putting pressure on the funding ratio," he says.

The second scenario is that Swiss bond yields start to increase, led by the US.

"That would mean, if interest rates increase above what is already priced into the bonds, you have short to mid term unrealised capital losses."

(Over a longer time horizon, of course, the higher-yielding bonds will replace lower-yielding ones reaching maturity and the total return of the asset class will turn positive again, he adds.)

Not surprisingly, many advocate big moves away from traditional bond portfolios.

"Funds need to diversify to avoid plain bonds," Mercer principal Christophe Steiger explains. "I believe plain bonds should be almost abandoned."

Going everywhere

That, however, is the easy part. The hard part is finding a replacement. There is no obvious solution.

Seeking greater yields in foreign sovereigns, for example, is challenging due to the exchange rate, with the Swiss franc stubbornly strong. "You might look at US Treasuries because they offer a better interest rate than Swiss bonds, but at the end of the day the costs of hedging the currency mean you do not get a great advantage," Unigestion head of cross asset solutions Jerome Teiletche states.

Instead, funds are not only adding to already significant allocations to Swiss real estate but also looking at the illiquidity premium – considering private equity and debt, infrastructure, and insurance-linked securities. There's also some work being done on liquid alternatives, says Stefan Haab, who runs Pictet Asset Management's institutional relationship team in Zurich.

"They are trying to achieve bond-like returns – that is, bond returns as they were in the good old days rather than in today's environment – along with bond-like risk profiles," he explains.

Progress is slower than it could be, however, in part because of the many small and mid-sized schemes that rely heavily on their trustees and do not have full-time executive staff.

"It is difficult to familiarise yourself with insurance-linked securites, for instance, if you have maybe one day a month for the pension fund," Haab outlines. "The Swiss system of governance has a lot of benefits but dealing with change is probably not a strength."

Nevertheless, there has been a gradual widening of the asset classes featuring in Swiss funds' portfolios. While some are still heavily invested in traditional bonds with 50 or even 60 per cent allocations; others have moved extensively to alternatives, Steiger emphasises.

"There used to be five or six asset classes in Swiss pension funds; now it is more like 10 or 15."

This is a move in the right direction, but it won't be enough, Gort says.

"There is one scenario where everything is fine for Swiss pensions, and that is when equities grow 10 per cent or more an annum. Then everything is okay," he says.

"In every other realistic scenario they will have a hard time to meet the target return."

That means looking at the liabilities as well, either cutting benefits, increasing retirement ages, or increasing sponsors contributions – and an increasing number of funds have already lowered the conversion rate.

For many others, however, there are hard choices ahead. ■

"CHF 71 billion of Swiss funds (are) currently managed with some kind of ESG investment"

Turning to ESG

ANOTHER AREA OF CHANGE for Swiss pensions is environmental, social and corporate governance (ESG). December saw the creation of the Swiss Association for Responsible Investments (SVVK-ASIR) by the first pillar AHV fund, the accident insurance fund Suva, and five of the largest second pillar funds. Between them, they manage over CHF150 billion (€137 billion).

The group allows the funds to develop common criteria and definitions for ESG, according to Publica deputy CIO Patrick Uelfeti.

"We saw that we all faced the same questions and it would be beneficial to everybody if we cooperated, rather than each tried to go our own way and address the same issues repeatedly," Uelfeti says, who is also president of the new association.

ESG is not new in Switzerland. Ethos, the first socially responsible investment group in Switzerland was established 18 years ago, and today has 214 members who are pension funds. It goes far further in its screening of investments than SVVK-ASIR, according to its chairman Dominique Biedermann – and not only excludes unethical stocks, but also offers engages with companies through exercising shareholder voting rights.

ESG is growing in importance, says Biedermann, with CHF 71 billion of Swiss funds currently managed with some kind of ESG investment, according to FNG, the German, Austrian and Swiss Sustainable Investment Forum.

Neverthless, Uelfeti says ESG development in Switzerland still lags some other European countries when it comes to pressure from the scheme members or public policy through legislation.

That's the experience at comPlan, the another of the founding members. Its board started looking at ESG issues last year. Pressure to do so came not from members, but from the plan sponsor, telecommunications company Swisscom.

"It's not individual members, but more a result of thinking about consistency in the action of the plan and the plan sponsor," the fund's head of asset management Roman Denkinger comments.

INTERVIEW

Considering the alternatives

PETER DAVY TALKS TO MARTIN ROTH, HEAD OF ASSET MANAGEMENT AT PENSIONSKASSE MANOR ABOUT ASSET STRATEGIES AND THE FUND'S ALTERNATIVES PORTFOLIO

Martin Roth is head of asset management at Pensionskasse MANOR, the pension fund of Switzerland's biggest department store chain. "We are a Swiss Debenhams or Macy's," he says.

It has around 8,800 active employees in the fund, two thirds of them female, and about 3,900 retirees. With assets of CHF 1.7 billion, the technical coverage ratio is 112 per cent. The fund is one of those that has made a deliberate break with Swiss bonds.

Tell me about your asset strategy?

We have just revised it, and have done so quite regularly in the last five years because of the challenging environment. Our new asset allocation as of 1 January 2016 is around 10 per cent in bonds, much lower than the average Swiss pension fund; our equity portion is about 33 per cent – more or less the same as others; similarly, we have 26 per cent in real estate; and a large part in alternatives.

What prompted the move out of bonds?

We started strongly reducing our exposure to bonds about four years ago, when we had around a 30 per cent allocation. The decision was mainly due to the asymmetric risk-return profile of them. If you look at asset allocation models, bonds may still have the lowest risk, but on the other hand the risk is not symmetric. The risk of having a very low or even negative yield in bonds is far higher than the possibility of achieving the return of 2.8 per cent we need to hold our coverage ratio steady.

What does the alternatives portfolio look like?

The main part is hedge funds, where we have 11 per cent. Two thirds of that is a stress-absorbing portfolio with exposure to macro managers, commodity managers, relative value and CTA managers. Only a third is mainly directional – mostly equity long short. We have no credits in the portfolio and the correlation to the bond portfolio is very low.

The rest of the portfolio is made up of private equity, with 3.5 per cent, where we try to achieve a premium of around 3 per cent per annum over the public markets, and also infrastructure, where we tend to invest more in the brownfield area; the goal is to be a bond proxy and generate cash flows, rather than realise capital gains.

What are the returns expected to look like compared to bonds?

Swiss bonds are currently yielding zero and we require them to return 3 per cent, so we would like to gain at least a premium of 200 to 400 basis points compared to Swiss bonds.

Are you worried by the extra risk?

It's something we looked at closely, but we didn't really increase the overall portfolio risk by a massive amount. If we had increased the equity portion significantly – as some other pension funds have done –the story might be different.

Even so, one has to take particular care about the liquidity of those investments. The liquidity of the portfolio was one of the main guidelines during the portfolio construction and manager selection. It was also one of the reasons the private equity allocation did not increase.

Would you expect other funds to follow your example?

It is difficult to say. We are a family-run business, and the board has an entrepreneurial approach to managing money. If you look at government-linked pension funds and those of listed companies, they tend to be less progressive. They are often focused on issues such as the impact of the fund on the company balance sheet or the reputational risk.

Will all this be enough to ensure an adequate funding ratio?

The required return is 2.8 per cent, but with our asset allocation model the expected return is 2.3 per cent, so there is still 0.5 per cent missing. Consequently, we are also in the process of working on the liability side, whether that is increasing the retirement age or reducing the conversion ratio. You need a balance; you cannot have a liability side where you need to earn 2.8 per cent and an asset side that brings in only 2.3 per cent.

Even though your technical funding ratio is 112 per cent?

Yes, that's typical for Switzerland. If we were to discount at the market rate we would be below 100. The technical discount rate is not something that makes the Swiss pension system very transparent. ■

INTERVIEW

All change

PETER DAVY SPEAKS TO SWISS PENSION FUND ASSOCIATION ASIP'S DR. MICHAEL LAUENER ABOUT THE AV2020 REFORMS AND THEIR IMPACT ON SWISS PENSION FUNDS

The Swiss pension fund association represents over 1,000 occupational pension funds with assets of around CHF 400 billion and 2.5 million members.

What are the key challenges of the Swiss pensions system, and how well does AV2020 *[pension reform proposals]* address them?

The key challenges for Swiss pensions are increased longevity and the low interest rates. The Swiss pension system faces big challenges. People are living longer, another baby-boom generation will soon be reaching AVS retirement age and investment income has been lagging behind expectations for years. This has tangible consequences for both pension pillars. The AVS's [first pillar] capital reserves will depreciate continuously from around 2020. Minimum statutory pension fund benefits are inadequately financed.

The aim of AV2020 is to ensure the financial sustainability of the system, both the first and second pillars, while guaranteeing the current level of benefits.

AV2020 does this very well by taking a holistic approach to the two pillars. It harmonises the reference age for men and women at 65 years for both pillars; raises the earliest retirement age for occupational benefit plans from 58 to 60; and reduces the conversion rate from 6.8 per cent to 6 per cent to take account of higher life expectancy and the interest rate environment.

How important is it that the reform is passed?

It must not fail. Many see the strength of the Swiss pension system in its combination of the state and private sector. Social security law is public law, but it is implemented through private foundations.

ASIP wants to see the second pillar revived, and thinks it is vital the solution to the pensions crisis does not see the state become overwhelming. It must give occupational pension schemes room to solve their problems through adjustments to their regulations, rather than through central legislation. AV2020 achieves that by basing its solution on both first and second pillars.

What should second pillar schemes be doing?

It's hard to speak for roughly 1,000 pension funds, but a lot have already put in place changes. Many have reduced their conversion rates, for example. That is fairly typical in Switzerland now. On the political level, compensatory measures in the LPP [second pillar] necessary to maintain level of benefits, including for the intermediate generation, will be examined.

How painful are the current interest rates for Swiss pensions?

It hurts. It hurts more or less depending on the situation of each pension fund, but it hurts, and it's persistent. Rates still remain negative. It means there are a lot of old people who gain, and a lot of active members who are paying for it.

Will the AV2020 reform be enough?

It's not enough. Even in terms of the first pillar this is expected to ensure sustainability of the system until 2030. So, even if this reform passes, a new reform will be needed after that date.

Do you see an increase in defined contribution schemes in Switzerland?

DC pensions have increased and are increasing in Switzerland, but individual accounts don't exist in the second pillar because of the collective principle.

With regard to the assets there is an amendment of the law on investing in pension plans (FZG/LFLP), which can waive the minimum return guarantees if the plan member individually chooses the investment strategy. This transfers the burden of investment risk to the plan members, so pension funds and their sponsors can remove liabilities from their balance sheets. However, it can only be offered to those on salaries of more than CHF 126,900.

What other major changes can we expect?

One significant development I see is the consolidation in the number of pension funds. Particularly smaller funds are being driven to merge due to the costs and complexity of running them, or because the employers feel they cannot cope with the stress any longer. But there are still small pension funds that are in a very good shape with regard to their governance and performance. ■

REGULATION

OTC derivatives market reform

Sebastian Reger examines the details of the reform of the regulatory regime for OTC derivative transactions and what pension schemes need to be doing to prepare for this

WRITTEN BY SEBASTIAN REGER,

FINANCE AND INVESTMENT GROUP PARTNER, SACKERS

The reform of the regulatory regime for OTC derivative transactions was considered a distant challenge for pension schemes when EMIR hit the statute books in the summer of 2012.

Until now, the changes have kept a specialist audience busy. But we are about to enter a phase in which the practical implications will have a wider impact. The next wave of changes will also have a fundamental impact on the way OTC derivative transactions are traded. Investment strategies and risk management frameworks will need to keep up with these developments.

Clearing arrangements

Once the clearing obligation applies to a particular type of derivative (such as an interest rate or credit derivative), pension schemes will no longer be able to enter into new transactions of that type unless the transaction is cleared. Having clearing arrangements in place will therefore become essential for all schemes with an OTC derivatives book.

Mandatory clearing of the first set of interest-rate swaps is just around the corner. The relevant EU regulatory technical standards (RTS) hit the statute books in December 2015, starting the countdown. The clearing obligation will be phased in depending on the categorisation of each entity. Pension schemes will be classed as ‘Category 2’ or ‘Category 3’ entities, depending on their derivatives usage.

Clearing for the first set of interest rate swaps will apply to Category 2 entities 12 months after the RTS comes into force and to Category 3 entities from 18 months after the RTS comes into force. Pension schemes will therefore have to clear interest-rate derivatives from the end of 2016 (for Category 2 entities) or from the middle of 2017 (Category 3). Clearing may be delayed until August 2017 if the relevant transaction falls within the clearing exemption for pension schemes. The exemption applies to all OTC derivative transactions that are “objectively measurable as reducing investment risks directly relating to the financial solvency of pension schemes”. But as things stand, this would just be a temporary delay.

Category 2 or Category 3?

Counterparties will be categorised during the three-month period after the RTS has been published in the EU’s Official Journal (excluding the month of publication – which means January, February and March 2016). A pension scheme will be a ‘Category 2’ entity if its aggregate month-end average of outstanding gross notional amounts of non-centrally cleared derivatives (including forex forwards, swaps and currency swaps) over this period is more than €8 billion. If it is less, it will be a ‘Category 3’ entity.

ISDA EMIR classification letter: Use of the clearing exemption

The derivatives industry body, ISDA, has published a standard letter that banks can use to gather information from their derivative counterparties in order to classify them for regulatory purposes. If they have not already done so, banks are likely to approach schemes with a request for the classification letter. Completing the letter is largely straightforward, but schemes will have to decide whether they can, and want to rely on the clearing exemption. The scope of the exemption is not fully settled and it will be up to each scheme to decide how to apply it.

New collateral regime for non-cleared OTC derivatives

Pension schemes will become subject to mandatory collateral rules for all new non-cleared OTC transactions. As proposed, these rules would:

- require the exchange of collateral.
- introduce governance requirements relating to the margining process and its legal underpin. Even for those with experience of collateralising OTC derivatives, FX derivatives are likely to have been excluded. The new regime will also now require the

collateralisation of FX derivatives, so your overall collateral needs could increase.

The new rules were originally scheduled to apply from December 2015 but implementation has been delayed. The new governance requirements are now expected to apply from September 2016, while the variation margin for all new OTC transactions is expected to be required from 1 March 2017 (or 1 September 2016 for entities in a group whose aggregate month end average notional amount of non-centrally cleared derivatives for March, April and May 2016 exceeds €3 trillion).

Managing your OTC derivatives book in the future

The OTC derivatives market is not just being reshaped by EMIR. Once it comes in the impact of the new MIFID II framework will be felt across financial markets. For the OTC derivatives markets, MIFID II will bring important changes to the way OTC derivative transactions are traded and reported.

Managing an OTC derivatives book of cleared and non-cleared transactions within the new regulatory regime will bring new challenges. The impact of various factors on a scheme's overall hedging strategy will need to be considered, including:

Regulatory compliance: Do your particular mandates require you to comply simultaneously with two different regulatory regimes, such as those in the EU and the US? There is currently no mutual recognition of EU and US regimes, meaning that compliance in one may not result in compliance in the other.

• **Collateral**: What are the potential collateral requirements in normal and stressed circumstances, including risks, costs and opportunity costs associated with funding and providing the collateral?

• **Counterparty risk**: This no longer encompasses counterparty credit risk only – while clearing reduces or removes credit risk, counterparty business risk is introduced. Access to clearing houses will be channelled through clearing members; you will be reliant on available current and future trading lines and an ongoing commitment to the clearing business. You will need to consider scenarios in which designated clearing members withdraw clearing capacity and the need to clear existing transactions through alternative providers.

• **Commercial**: What are the full costs of clearing and the pricing differences between cleared and non-cleared transactions? Is there a pricing difference between different clearing houses (currently there appears to be)? How will the MIFID II trading and transparency requirements affect your quoted prices?

• **Governance/legal**: Do you have the relevant internal processes in place to satisfy the governance requirements both imposed by your scheme rules and the new requirements? ■

SCHEME MANAGEMENT

Rise of the machines

Nick Martindale looks at why pension scheme managers across Europe are spending more than ever on technology to meet their objectives

WRITTEN BY NICK MARTINDALE, A FREELANCE JOURNALIST

Unsurprisingly, the economic downturn led to a tailing off of investment in technology by many employers and pension scheme providers. But as the global economy started to pick up, so too did spending on IT, with employers in particular increasingly aware of the administrative and engagement benefits that can be delivered by implementing effective technology.

"In recent years we have witnessed an exponential interest in technology within the pensions industry," Dalriada Trustees director Adrian Kennett says. "Trustees are gradually starting to realise that emerging technologies can facilitate more efficient pension scheme management and lower operating costs. All parties are beginning to appreciate that effective pension scheme software is bridging the divide between sponsor, trustees and advisers, helping them work towards better outcomes for their schemes."

Motivations and catalysts

Equiniti managing director for data solutions Duncan Watson identifies three motivations for spending on new technology: a response to new legislation, a current platform reaching the end of its life or support for this being withdrawn by a provider, and a desire to improve the member experience or scheme efficiency.

"Spending on technology varies depending on what change is happening at a given point of time and is largely out of a scheme's control, depending on things such as contract dates," he states. "It will vary depending on availability of discretionary spend but also on industry trends, such as the rush to embrace digital."

In the UK, the recent pensions freedoms reforms and the introduction of auto-enrolment has proved a catalyst for investment, and many other European countries are now watching this closely, Altus Business Systems sales and marketing director Howard Finnegan comments, who estimates that spending on pensions technology has increased by around 15 to 20 per cent in the UK in 2015. "Ireland is likely to implement some form of auto-enrolment in the coming years," he says. "It has become an election issue in the forthcoming general election with the main political parties.

"In the UK, as the auto-enrolment staging process begins to include small and micro employers, the real challenge for pension providers targeting these markets is how to on-board and maintain the sheer volume of new employers and members cheaply and efficiently," he adds. "The only way to achieve this is through automating the entire end-to-end process." Many employers are also starting to invest in systems offering alternatives to standard annuities, he adds, to provide more choice to those coming up to retirement.

In some ways, though, the UK remains behind other European nations, Kennett outlines. "Traditionally, countries such as the Netherlands have led the way in integrating pension scheme management with technological solutions, and this is driven in part

by a regulatory environment that focused on prudent investment risk management and high standards of pension scheme administration. Technologically, many UK pension schemes are playing catch-up."

Investment in technology tends to centre around either engaging employees or making processes effective for employers. Much of the investment to date has focused around the delivery of information but increasingly this is extending to tools designed to get employees to engage more with their pensions.

"Some of the employee benefits consultants have invested directly and created their own online experience, including mobile functionality and apps," Teamspirit managing director Kirsty Maxey comments. "Some enlightened employers have taken this a step further; for example, Kingfisher has invested in an online game to engage the younger end of their employee audience."

Staff now expect the same kind of interaction and user-friendly system as they experience in their personal lives, Xerox HR Services senior consultant Lee Cook states. "End-users expect a 'consumer grade' experience due to their daily interactions with applications such as Facebook, Amazon and LinkedIn and will quickly dismiss ineffective solutions," he says. The use of robotics – automated programmes providing advice and guidance to employees based on their own risk profile – will also become more common, he believes.

Employers

From an employer perspective, technology is helping to provide much clearer – and more connected – management information to trustees and scheme managers. "In the DB sphere, inevitably, pension issues remain board-level agenda items and there is a greater corporate focus on managing deficits," Olswang senior associate Andrew Campbell mentions. "Used effectively, technology can progressively bridge the gap

THE USE OF ROBOTICS – AUTOMATED PROGRAMMES PROVIDING ADVICE AND GUIDANCE TO EMPLOYEES BASED ON THEIR OWN RISK PROFILE – WILL BECOME MORE COMMON

between companies, members and trustees, and the use of online, shared platforms will enable stakeholders to look behind the curtain and effectively manage risk across their scheme in a more transparent, shared way."

Online systems can also help enable trustees undertake regular monitoring of scheme performance and allow members or HR teams to amend personal information, European Actuarial & Consultancy Services (EURACS) chairman Colin Mayger says.

"Trustees are increasingly using technology to monitor their funding and investment strategies in real time, and for financial risk analysis, including asset-liability modelling," he adds. "In each case trustees will want to satisfy themselves with new systems that add value, either by reducing the cost of ongoing manual administration input, or by delivering new financial analysis that improves their understanding of the risks facing their fund."

At the back-end, technology is also helping to tie together different IT packages, enabling the sharing of information that previously would have been difficult to pull together, Kennett emphasises. "Perhaps most impressively, integration between traditionally distinct systems such as administration and actuarial systems is allowing data to flow seamlessly between processes, enabling everything from automated transfer value quotations to fully automated daily valuations, based on live member data," he says.

Some schemes still have a way to go in making their process more efficient, but this is starting to change. "The biggest change for 2016 will be the transferring of data from payroll to pension providers using APIs rather than traditional manually manipulated CSV files," systemsync CMO Chris Desson suggests. "The number of errors received by pension providers using APIs will significantly reduce, as will the number of enquiries, making the whole process significantly cheaper as the staff/client ratio becomes significantly reduced."

Even the more consumer-facing upgrades can also help to indirectly reduce administration. "Even a simple change such as allowing people to save via their mobile phones and access up-to-date fund values will significantly decrease the number of calls made to call centres, while increasing the amount of assets under management," Deeson adds.

Reduced time spent managing pensions should, in theory, free up in-house pension teams and even providers to focus on more strategic elements, such as driving member engagement and communication. It is, however, important that such additional time is spent on such activities, rather than seeking savings through headcount reductions, THPA business operations manager Phil Claridge warns.

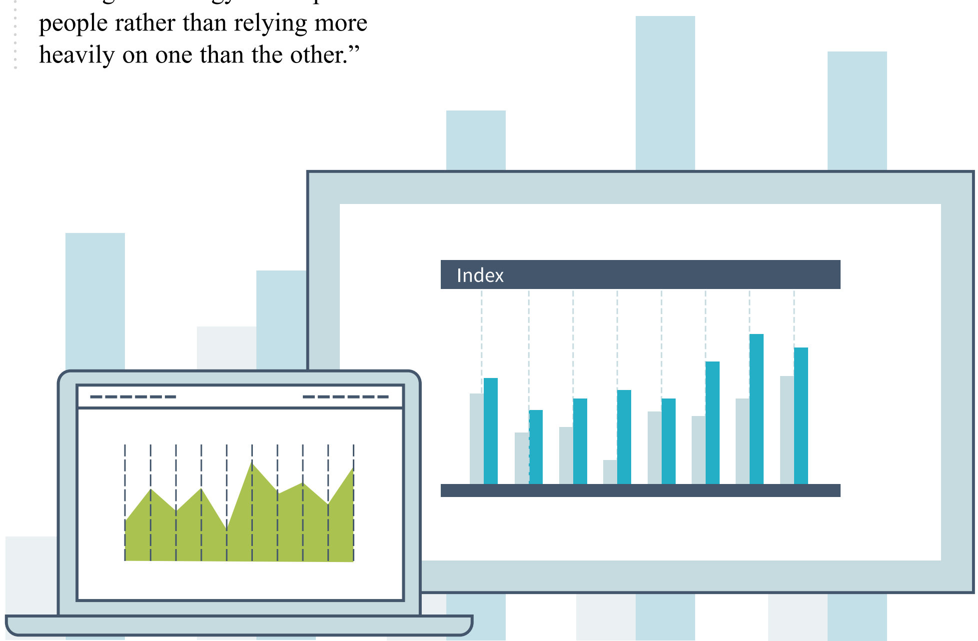
"With automation comes significantly reduced risk of inaccuracy, which again should allow providers to focus on value-added services for clients and members," he says. "However, one danger of automation is losing expertise, knowledge and experience. In our view, to provide the best possible service, it is important to have the right mix of leading technology and expert people rather than relying more heavily on one than the other."

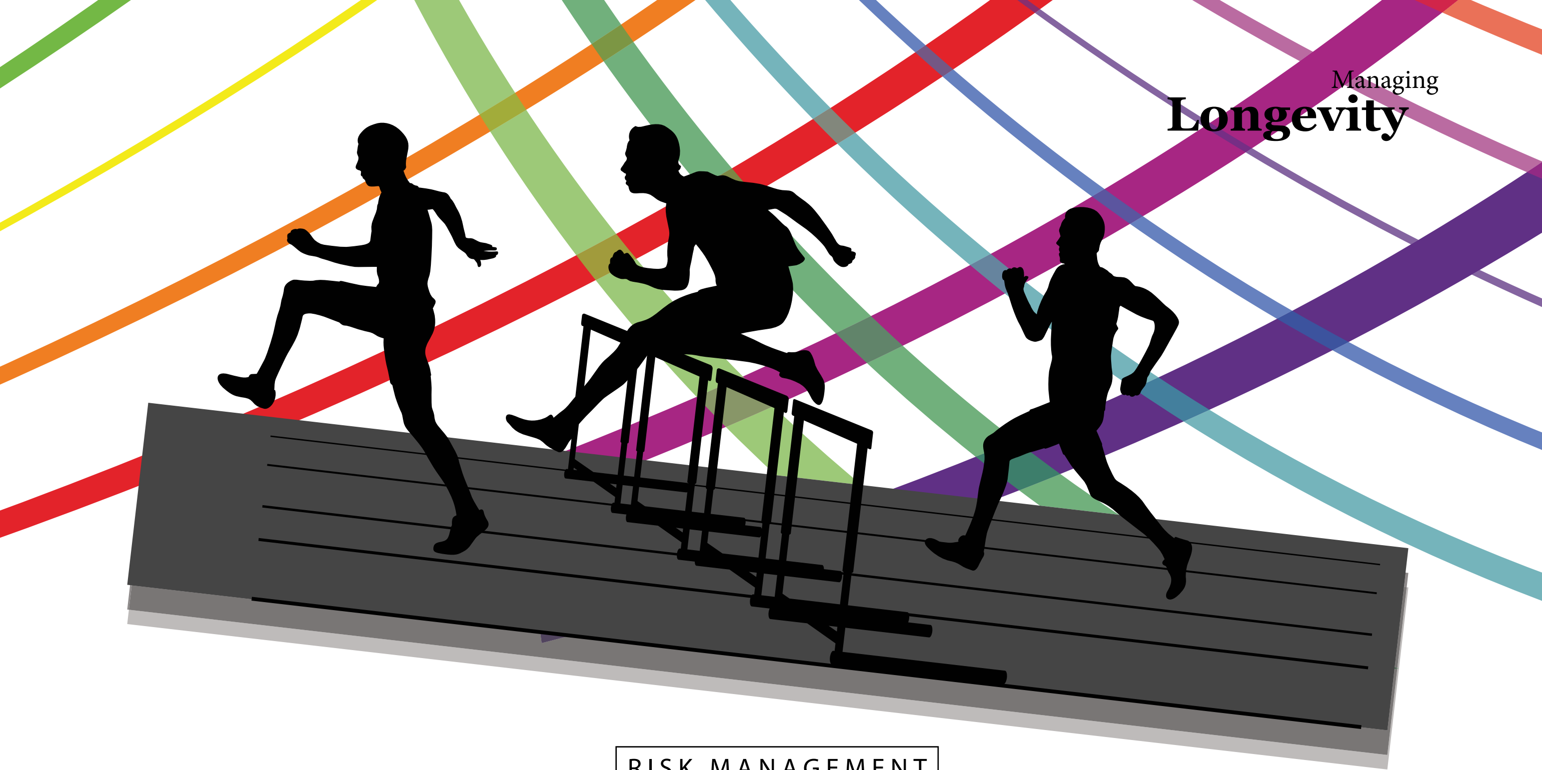
ONE DANGER OF AUTOMATION IS LOSING EXPERTISE, KNOWLEDGE AND EXPERIENCE

Legislatory changes

The amount of new legislation on the horizon also means investment in new technology is likely to continue. Mayger, for instance, points to the impact of initiatives such as Solvency II and the economic opportunities bill in France as drivers for new purchases, as well as The Pensions Regulator's new code of practice in the UK.

Yet any investment in technology is likely to be far more considered that it may have been in the past, Cook believes, with a determination not to repeat previous mistakes where costly technology investments have failed to deliver. "The technology buyers of today are more aware and better informed," he says. "Unfortunately, this clarity for many was achieved through lessons learnt when making incorrect technology choices in the past but they won't make the same error twice. The future buying demands of sponsors will be focused, precise and unequivocal to ensure that technology really delivers the outcomes and objectives for them and their members." ■





RISK MANAGEMENT

In it for the long run

Charlotte Moore explains how the UK has taken the most aggressive steps in tackling longevity risk and why the rest of Europe is playing catch-up

WRITTEN BY CHARLOTTE MOORE, A FREELANCE JOURNALIST

Spend too much time in the company of actuaries and it's easy to become gloomy about the implications of the European population living for longer. While an improved lifespan is to be celebrated, careful financial planning at an employer, personal and state level is needed to ensure millions are not condemned to living out their last years in penury.

Concerns and complications

Concerned that a number of countries were not doing enough to stay on top of this problem, the Organisation for Economic Co-operation and Development (OECD) published a report in December 2014 examining which countries were keeping abreast of the continued improvements in mortality.

OECD head of the private pensions team Pablo Antolin says: "If existing pension arrangements do not accurately reflect the projected longevity then it will not be possible to fully fund people's retirement."

It is not only that people are living for longer but that it is also difficult to accurately predict how long people will live. To avoid being caught out, longevity is something that needs to be revisited frequently to ensure forecasts are up to date.

"If annuity providers do not take future improvements to longevity into account this, along with the uncertainty of this variable, can create significant problems," Antolin adds.

The OECD compared the longevity tables established by each country's regulator along with those used by pension funds and insurance companies against four traditional models of mortality improvements.

The organisation found most countries do not use accurate longevity assumptions. Antolin argues: "The problem is that most countries are not incorporating the ongoing improvements to mortality in their tables."

The worst offender in Europe was Switzerland in the mortality tables used by pension funds. In contrast, the Netherlands, the UK and Germany scored well.

Steps taken

Within Europe, the UK has taken the most aggressive steps to address longevity issues. A number of different factors coalesced to make British pension schemes take a highly sophisticated approach to addressing longevity. A growing number of pension schemes are entering into deals to specifically transfer this risk to the insurance market.

Around a decade ago a large volume of research emerged in the UK showing just how much longer the post-war baby boomer generation were living compared with previous expectations.

"This started the conversation about how long the improvements could be expected to persist," Aon Hewitt head of risk settlement Martin Bird comments. The actuarial profession viewed this as such an important issue that it established the bureau for Continuous Mortality Investigation.

The scale of the impact of improving longevity assumptions on the UK cannot be over-stated and Mercer head of longevity swap consulting Andrew Ward states that "increased life expectancy assumptions have added around £250 billion to the value of the nation's defined benefit liabilities over the last 10 years".

COMPOUND INFLATION EFFECTIVELY DOUBLES THE EFFECT OF CONTINUED MORTALITY IMPROVEMENTS

Consensus

This focus on longevity improvements in the UK resulted in one very positive outcome: both insurers and pension schemes have reached a consensus view on modelling longevity expectations. In particular, they now agree on the rates of future improvement, based on work produced by the CMI.

In the past, there had been a fundamental mismatch between the two parties about the true cost of hedging this risk. Bird says: "Both industries are now using a similar approach to longevity and so the cost of hedging this risk looks proportionate to both parties." This has been a key factor in the development of the UK longevity risk transfer market.

While the use of the same set of assumptions by both the insurance and pensions industry has helped to establish the UK longevity market, this was not the only factor.

Quirks of the UK system have also pushed pension funds in this direction. Most UK defined benefit schemes have very strict rules governing benefit payments.

This gives pension funds much less flexibility than, for example, the Netherlands. Bird says: "In Holland, schemes are able to adjust the amount of pension being paid to reflect increases in life expectancy." This provides more 'wriggle room' – although longevity risk still needs to be addressed.

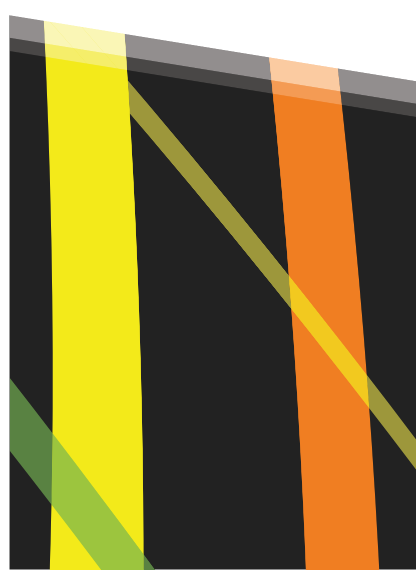
In addition, many British defined benefit pension payments are linked to inflation, which creates a double whammy.

"Compound inflation effectively doubles the effect of continued mortality improvements," Bird underlines.

The focus on appropriate funding rules has enabled UK pension schemes to actively tackle longevity risk.

"The UK regulator closely monitors pension schemes to ensure they are providing the appropriate levels of funding," Prudential Financial head of longevity risk transfer Amy Kessler points out. This debate around appropriate funding levels in the UK has led to a margin of error being baked into each scheme's funding target or technical provisions.

Kessler says: "This includes a healthy dose of longevity risk that allows much of the cost of



THERE IS CONSIDERABLE VARIATION AROUND EUROPE REGARDING THE LEVEL OF EXPERTISE, BOTH IN THE MODELLING OF LONGEVITY AND THE IMPROVEMENT FACTORS, WHICH ARE ADDED TO MORTALITY ASSUMPTIONS

mitigating this risk to be absorbed within the technical provision.” This allows both trustees and corporate sponsors to take active steps to reduce this risk.

But with an increasing focus on the use of more accurate mortality improvement assumptions, managing longevity should become a more important issue around Europe and there are hopes that more countries will progress toward the level of sophistication seen in the UK.

At the moment, there is considerable variation around Europe regarding the level of expertise, both in the modelling of longevity and the improvement factors, which are added to mortality assumptions, Bird argues.

Kessler says: “In addition, in many European countries the funding rules are not as clear cut as in the UK and those objectives may not include a margin for longevity risk.” This provides less incentive to European pension schemes to tackle this issue.

Optimism

Despite there being less incentive for European pension schemes to tackle the thorny issue of longevity risk, Kessler is optimistic more pension schemes will take steps to actively manage longevity risk throughout the continent.

The push to transfer longevity risk is likely to come from global companies, which reduce this risk for their UK subsidiary as a first step. Kessler says: “Once a company realises how much better life is with lower risk in the pension scheme, it starts to look at the other place where they can take similar steps.”

The number of countries where it’s possible to implement a de-risking strategy is rising. “It’s possible to put longevity hedging in place in the Netherlands and it’s likely that Germany, Switzerland and the Nordics will soon have their own solutions,” Kessler outlines.

Innovative longevity structures will help to grow the continental longevity risk transfer market. BT’s recent longevity swap involved the creation of an insurance vehicle in Guernsey, making it possible to transfer a large amount of longevity risk to the re-insurance market in a cost-effective manner.

Competitive pressure will also play a role. Reducing pension risk significantly reduces the volatility associated with shareholder’s equity. Kessler says: “Once one company makes this move, its global competitors will notice the improvement to their balance sheet and follow a similar strategy.”

According to Legal and General longevity risk director Joseph Lu: “Research by Grant Thornton has shown companies that reduce longevity risk see their share price increase by around 10 per cent.”

An additional push could come from new financial services regulation, such as Basel III. These rules require banks to hold capital against the longevity risk associated with their pension fund.

Holding capital against longevity risk is not economic for banks as they generally do not have any mortality risk from the sale of life insurance to offset this risk – unlike insurance companies. “As banks come to grips with this additional capital requirement, they will be incentivised to reduce their longevity risk,” Kessler concludes. ■

INTERVIEW

Defending the members

After being confirmed as EIOPA chair for a further five years last December, Gabriel Bernardino **tells** Natalie Tuck **about his achievements so far and why pension regulation is all about defending pension scheme members**

WRITTEN BY NATALIE TUCK

You have introduced many things in your first five years as EIOPA chair, such as the pension stress test, Solvency II, and holistic balance sheet proposals. What has been your proudest achievement?

During the past five years there have been a number of important milestones, both in the pensions and insurance area, addressing financial stability and consumer protection issues. I'm very proud what EIOPA has achieved so far. And indeed there was a very important point in time, back in 2013, when we had to cope with a lot of uncertainty about Solvency II, whether the new risk-based regime would be implemented or not. EIOPA's role was crucial by issuing guidelines on the preparatory phase and reassuring that Solvency II will be implemented.

Solvency II has recently been introduced and it has been said annuities may be less attractive under these new rules. There have also been fears that it could affect the pension de-risking market. What is your response to this?

Solvency II brings market-consistent economic valuations of assets and liabilities and importantly it brings a pricing of risk in a more realistic way, especially when we're talking about long-term commitments like annuities. It's very important that the pricing of these products is closer

EIOP/Frankfurt am Main

to reality. This is the only way to preserve the solvency of the companies and to ensure that they are meeting the commitments they have made to their policyholders. Solvency II brings a closer alignment of risk and capital. This could have some impact in terms of the pricing, but at the same time it is a sound element for the regime. Pretending that the risk is lower than it is in reality does not make life easier, in particular not for the stability of insurance companies and the policyholders.

Currently pension funds are not subject to Solvency II, but you have proposed a Holistic Balance Sheet, which has been met with criticism. Why is there a need for it?

Let me start by stressing one important point as regards the application of Solvency II and the Holistic Balance Sheet (HBS); we never said that we were in favour of applying Solvency II to pension funds. What we always indicated is the need for pension funds to have a more realistic valuation of their assets and liabilities and a proper analysis of their risks.

From a point of view of preserving and defending the rights of the members of the pension funds, we need to be realistic on the assessment of the assets and the liabilities and use a market-consistent approach. The HBS is precisely based on this idea. It prices the risks in the different assets that you have in the portfolios, capturing the riskiness of these assets but also incorporates all the adjustment mechanisms present in the regimes of the different countries, like the sponsor support, the pension protection funds and the reduction in benefits. It is not Solvency II.

We will only be comfortable to present a proposal to the European institutions on solvency matters after having done proper analysis and assessments. We are fine with the European Commission proposing IORP II without changes to the solvency requirements. It would have been premature to go beyond that at that point in time. We conducted a public consultation on a number of proposals on how to integrate the HBS in a supervisory regime. We also ran a quantitative assessment back to back with the stress test. We are now in the final stage of our analysis. We intend to present an opinion to the European institutions at the beginning of April on how the concept of the HBS can be integrated into the overall supervisory regime. This has nothing to do with implementing Solvency II for pension funds.

What was your reaction to the results of the first pensions' stress test?

This was the very first exercise at European level on pension funds. I am satisfied with the results and the level of engagement from all the European supervisors and the pension fund industry around Europe. These types of exercises are always an extra burden on top of the day-to-day management responsibilities. But these exercises are a very important tool, both from a risk management and supervisory perspective.

The results of the stress test have brought the numbers to the perceptions we already had. For example, the numbers confirm that one of the major vulnerabilities of pension funds is the prolonged period of low interest rates: that brings liabilities higher and at the same time the low returns are harmful on the asset side of your pension fund. The stress test also allows us to understand the potentially risky behaviour of pension funds when they 'search for yield' in this environment. It is now important to conduct an analysis of the mechanisms in place in the different member states to absorb the shocks and to deal with these vulnerabilities. As the approach is not harmonised across the countries there are a lot of different tools and mechanisms at disposal to absorb vulnerabilities. That is something we will continue to look upon. In the future we want to look at the impact these vulnerabilities have on the behaviour of sponsors and, thus on the economy at large.

You have said there are three fundamentals for improving pension provision in Europe; strong governance, enhanced sustainability and full trans-parency. What work are you currently doing to try and achieve these?

These three objectives are fundamental in the area of pensions in all our work, in advising the European Commission, in our policy work and our supervisory work. In terms of strong governance, we are very happy with the way IORP II is ongoing. We gave a detailed advice to the European Commission on the governance elements of pension funds. We are happy that our advice has been taken on board in IORP II, because it is very important to ensure reinforced and proper governance and risk management in pension funds, while ensuring due proportionality.

The stress test is very much a part of enhanced sustainability. It is also about understanding the vulnerabilities and knowing what actions can be taken in order to protect the future promises as well as transparency and clarity surrounding the pensions' contract. The element of realistic valuation rules is very important. In April we will present our opinion on solvency to the European institutions, and enhanced sustainability will be the central point.

Full transparency is in the DNA of EIOPA, on the insurance and pension side. I'm a big fan of transparency. For me this is the way modern societies need to live up to, especially in the financial sector. We need to make sure that transparency works to the benefit of all consumers, such as pension fund members or policyholders. The only way to achieve this principle is providing information as simple as possible, easily accessible and understandable. To me full transparency doesn't mean to give you as a member of a pension fund a 2,000-page disclosure, where you will see on page 147 what is really fundamental for your pension; that is not transparency.

Finally, ESMA chair Steven Maijoor has previously criticised the EU for the low budget the ESAs have to work with based on the requirements they have to meet. Are you satisfied with EIOPA's budget?

We are in the same situation. In 2015, it was very difficult because we had a reduction of more than 9 per cent in comparison to 2014, we had to prioritise and drop a number of activities. It is a similar situation for 2016; our budget is made up of contributions from the European Commission and from the EU Member States. It is always challenging to get a budget that is commensurate with the proper performance of the required tasks. Our concern is that the European legislators are entrusting us with tasks and responsibilities for insurance and pensions but we don't have the required resources to properly perform and complete them. All we can do is to highlight the issues, problems and the difficulties. We had a number of projects for 2016 in the area of consumer protection and training we had to postpone because we don't have the required resources. At our end we will continue to contribute to the discussions on the funding of the authorities. This is a structural issue and cannot just be solved on an annual basis. And we are expecting the European Commission to come up with a proposal. ■

INVESTMENT

Making history

Elisabeth Jeffries looks at what effects the first EU directive mandating non-financial corporate disclosures could have on European corporates and investors

WRITTEN BY ELISABETH JEFFRIES, A FREELANCE JOURNALIST

It has been described as historic. The first EU directive mandating non-financial corporate disclosures, due to take effect this year, breaks new ground in corporate reporting requirements. A cynic might describe it as window-dressing. Yet there is a case for lauding its introduction.

Changes

Firstly, it extends the corporate social responsibility (CSR) probe to Europe's furthest boundaries. Mandatory reporting on some environmental, social and governance (ESG) issues already exists in major economies. The UK's 2006 Companies Act, for example, requires UK quoted companies to report greenhouse gas emissions in their directors' reports. France's Grenelle II law obliges many companies listed on the French stock exchange to incorporate information on the social and environmental consequences of their activities into their annual reports. In Germany, a sustainability code known as DNK covers many of the directive's obligations.

But many of the EU's newer members or less developed countries will need to integrate the directive into their statute to introduce their first non-financial reporting rules. At the same time, companies that have withheld information will need to supply it. "It will require 6,000 companies across Europe to disclose certain ESG information, and many of these companies have never done so before," Beyond Business sustainability reporting consultant Elaine Cohen says.

The new law also makes a major leap from previous ESG reporting rules, which mainly targeted the extractive industries as part of a clampdown on corruption and bribery. Companies in the sector had to disclose more information about payments to governments. One implicit aim was to stop EU businesses from trying to bribe officials in resource-rich developing countries. The illegal sale of hardwood, for example, would then be used to fund civil conflict within that country. "In some countries, this might be the only way the local population could find out what their government was up to," an executive at a professional accounting organisation observes.

The directive broadens and strengthens the existing accounting law, which set quite high-level conditions open to interpretation. It covers a far wider range of corporate responsibility concerns than the previous legislation, as well as much national legislation. This includes bribery, human rights, employee diversity and environment.

But as a tool for greater transparency to guarantee accountability to the general public, its merit will take many years to prove. The directive originally proposed to cover a far wider spectrum of business activity, aimed at around 20,000 companies, but this intention was diluted during the legislative process.

Meanwhile, accounting processes continue to be dissatisfactory. Social or environmental impacts are most commonly buried in the hard numbers in the financial statements.

Typically, those numbers only indicate responsibility when misconduct is exposed. “The costs associated with being found out relate perhaps to general loss of reputation, reduced sales and potential litigation. Litigation risk can later turn into contingent liabilities or recognised provisions,” London School of Economics professor of accounting Peter Pope points out.

Bad news may leave a financial scar on the company’s profit and loss account despite a clean CSR report, as the emissions debacle last year at Volkswagen showed. Sales in some countries fell while the company’s share price halved. Not surprisingly, the underlying software use was not revealed in the company’s 2014 sustainability report. Any investor reading it might have found it impressive.

Dense pages printed in a literary style and interesting font suggest thought leadership and Germanic introspection. “It’s not about growth at all costs,” states one heading. An article entitled *SUVs – where emotion meets reason?* justifies its role in the SUV market through lightweighting and electric vehicle innovation.

As Cohen states, the report set high standards. The Global Reporting Initiative, a standards organisation, confirmed it included material disclosures. “Volkswagen disclosures have been consistently in line with reporting expectations and the company received recognition from many ranking and rating organisations including the Dow Jones Sustainability Index”, she says.

Clearly, the new legislation in itself will not put a stop to commercial conjuring tricks or pollution incidents. Mainstream auditing procedures may shine a bright beam on particular activity while failing to detect dark matter surrounding it. They may focus on final sales, for example, rather than operational decisions supporting them. As Pope explains, a sustainability report can well be accurate while presenting the company through a particular lens.

“CSR reports may sometimes reflect the perceptions of the board of directors, whose perspective on actual business practices might not correspond to reality because they don’t know the fine detail. Management control in complex organisations can be problematic,” he says.

Clearly, the VW case is not the first. Out-of-touch boards have been held responsible for many of the problems that emerged during the 2008 financial crash. The transparency and reliability of the non-financial statement in the management report, when it becomes mandatory, is thus likely to be compromised. The record of previous laws on disclosure also suggests compliance may be limited.

The adoption of the International

THE NEW LAW MAKES A MAJOR LEAP FROM PREVIOUS ESG REPORTING RULES, WHICH MAINLY TARGETED THE EXTRACTIVE INDUSTRIES AS PART OF A CLAMPDOWN ON CORRUPTION AND BRIBERY

Reporting

Financial Reporting Standards (IFRS), made obligatory by the EU in 2005, is a case in point. “Enforcement of IFRS in financial reporting is much patchier than policy makers had intended. It is a major problem,” Pope notes. Meanwhile, miscreant directors rarely suffer severe penalties or imprisonment.

Impact

The influence of the law is likely to be indirect, nudging companies to improve their corporate culture, creating a level playing field and raising the standards of member states with lower requirements. “The European Commission’s motivation for a directive of this kind is to protect the single market and improve its rationalisation and harmonisation,” comments an executive from a professional accounting organisation. A single accounting code will help support that objective now that CSR reporting has become commonplace.

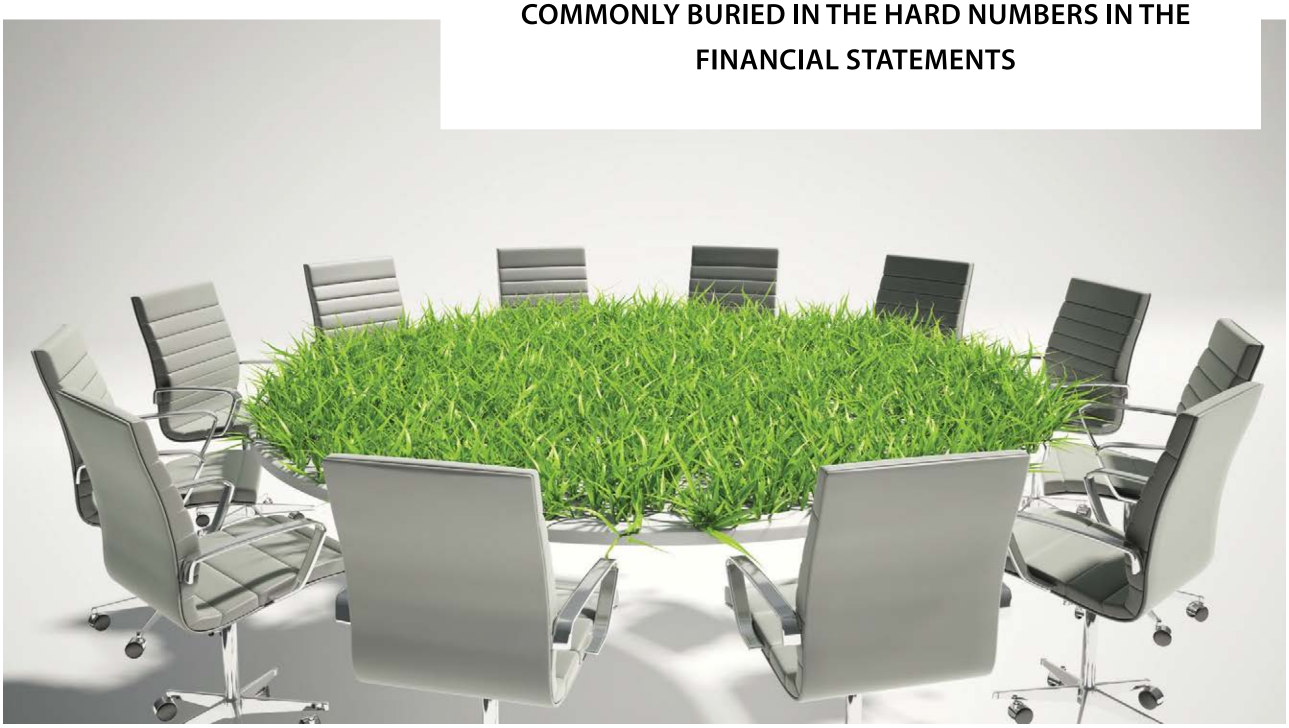
At present, CSR analysts perceive poorer performers through unsubstantiated numbers or shifting methodologies from one year to the next. “A company has many ways of communicating its activities, not just a sustainability report. In general, however, there are certain frameworks and expectations of sustainability reporting at a global level, and it’s fairly easy to note if a company is not achieving this expected level of transparency,” Cohen says. Now that non-financial reporting is to become law across the EU, it is reasonable to expect those failings to become more evident.

Activists have high hopes for methodology guidelines that are under consultation since mid-January 2016. By embedding a consistent approach, they will help investment analysts detect poor performance more easily. In a statement, the Climate Disclosure Standards Board, an organisation concerned with reporting matters, drew attention to the significance of the directive and the guidelines.

“It is a significant step forward for European and international investors who seek timely, material, comparable and forward-looking information on non-financial risks and opportunities,” the campaigning organisation stated. According to its research, failure to adopt the legislation will make such decisions more difficult and costly for investors, and will increase the risks of harming European companies’ international competitiveness.

However, non-financial reporting is unlikely to grow full teeth unless ESG matters are fully recognised as material to the business and ESG externalities are incorporated into the accounting system. ■

SOCIAL OR ENVIRONMENTAL IMPACTS ARE MOST COMMONLY BURIED IN THE HARD NUMBERS IN THE FINANCIAL STATEMENTS



INVESTMENT

Avoiding catastrophe

Lynn Strongin Dodds explains the advantages of investing in catastrophe bonds and the overall outlook for the insurance-linked securities market in 2016

WRITTEN BY LYNN STRONGIN DODDS, A FREELANCE JOURNALIST

The impact of climate change may be increasingly important criteria in the investment decision-making process but ironically it is the lack of weather-related events that has impacted the catastrophe bond market. Other parts of the insurance-linked securities (IS) market look more attractive but the risks are also higher due to the illiquidity.

This is borne out by the recent study conducted by Willis Capital Markets & Advisory, the investment banking business of global advisory company, Willis Towers Watson. The overall ILS market hit a new high of $70 billion last year, up from $65 billion in 2014. The most active part were collateralised reinsurance agreements, bespoke private transactions that are drawn up between the reinsurer and individual investors and to a lesser extent, sidecars. These are special purpose vehicles a reinsurer will use to facilitate third-party investors to participate in collateralised reinsurance deals.

Catastrophe or cat bonds, which are roughly 30% of the overall market, remain the most popular part of the market with pension funds due to liquidity. However, issuance dropped to $6.2 billion in 2015 compared to the record $8 billion

THESE SECURITIES HAD ONCE BEEN THE PRESERVE OF SPECIALIST HEDGE FUNDS AND ASSET MANAGERS ENDOWED WITH DISASTER RISK ACUMEN, BUT AS INTEREST RATES PLUMMETED THEY ATTRACTED YIELD-HUNGRY INSTITUTIONS

level of issuance the previous year. Part of the reason was the lack of headline-grabbing deals such as Citizens Property Insurance Corp's $1.5 billion bond, which bumped up 2014 numbers.

In addition, yields slid to around 5% from the loftier 10% plus levels in 2013. Overcrowding is one answer but it is not the full explanation. "Although many investors think the mass amounts of money going into asset class has pushed yields down, the main reason is the cyclical nature of the reinsurance industry whereby premiums tend to be highest immediately after a large disaster," Schroders investment director, product manager insurance linked securities Tim van Duren says.

"The last two years has been relatively quiet, particularly in the US, which is the largest chunk of the market. There was a rally during hurricane season, which is August to mid-October, but then things moved sideways."

These securities had once been the preserve of specialist hedge funds and asset managers endowed with disaster risk acumen, but as interest rates plummeted they attracted yield-hungry institutions. They are not that easy to understand though and there needs to be more education around their particular nuances.

Parametric triggers

For example van Duren notes many use 'parametric triggers' which means that the insured event is not linked to actual claims made, but rather to the occurrence of a specific and measurable incident, such as wind-speed reaching a certain level in a specific location, or the occurrence of an earthquake of particular strength in a given area. They incur losses only in the event of disasters and the performance of cat bonds and more generally ILS is linked to the frequency and severity of natural catastrophe events.

AXA IM head of ILS Francois Divet also explains that although a large proportion of the bonds issued are linked to hurricanes in the US, there are also assets exposed to earthquakes and storms. Assessing the risk and damage of these requires complex cat models and associated software as well as in-depth knowledge of the different building codes in each country.

Climate change

At the moment the effects of climate change are not really integrated into the analysis. One reason is the contradictory picture that has been painted. For example, research published last May by Florida State geography professor Jim Elsner and Namyoung Kang, deputy director of the National Typhoon Center in South Korea, found that warmer ocean temperatures, caused by climate change, may be fuelling stronger hurricanes, while at the same time, creating fewer storms.

In addition, analysts at Schroders also argued that due to various factors, including the short-term nature of ILS and reinsurance transactions, climate change's "impact on insurance-linked instruments is more limited than one would expect at first glance". Typically, a catastrophe bond offers protection over a three-year period, while private catastrophe bonds only have a one-year contract. In some cases the duration of an ILS transaction can be even less.

"Investors are not really looking at

ANALYSTS BELIEVE THAT RISING INTEREST RATES IN THE US AND ANOTHER YEAR OF BENIGN CATASTROPHE LOSSES IN THE REAR-VIEW MIRROR WILL TRANSLATE INTO GROWTH FOR THE ILS MARKET IN 2016

climate change when investing in cat bonds," Mercer principal Robert Howie says. "Climate change requires a 10-year plus view while cat bonds are typically short contracts and pricing is determined by events or lack of events in developed markets such as North America, Europe and Japan. The last major event was the earthquake in Japan in 2011 and even though there has been an increase in flooding in Europe, this is not considered a major catastrophe."

Industry participants, though believe more attention should be paid to the inherent advantages of the asset class. "At 5%, they are not a screaming opportunity but you need to take the 10,000 feet view of cat bonds," Russell Investments head of fixed income research Adam Smears adds. "Yields may be relatively low compared to historical levels but that is because risk premium is low due to fewer weather events. However, over the long term, it has a total return profile similar to high yield, which is one of the best performers of the fixed income sector but with a lower volatility experience."

For example, Swiss Re figures show that its Global Cat Bond Total Return Index, which tracks the performance of the outstanding catastrophe bond market over time, generated an average annual gain of 8.33% between 2002 and the beginning of 2015, which was slightly above the Barclays Ba US High Yield performance of 8.24% and much higher than the S&P 500 Total Return Index of just 6.54%.

Volatility and diversification

In terms of volatility, Global Cat Bond Total Return Index gave investors a much smoother ride in that it had not dipped into negative territory during the time period and only moved a little over 10% from its lowest period in 2005 to its highest point in 2007. By comparison, the Barclays Ba US High Yield index jumped around 65% between 2008 and 2009, while the S&P index shifted over 70%, having dropped a massive 40% in one year.

Other benefits often highlighted are diversification. Twelve Capital AG executive director and head of catastrophe bonds Roman Maraviev, points out that these bonds are attractive because they have a low level of correlation to other financial risks and can reduce tail risks in other parts of an investor's portfolio, whilst at the same time offering attractive potential returns.

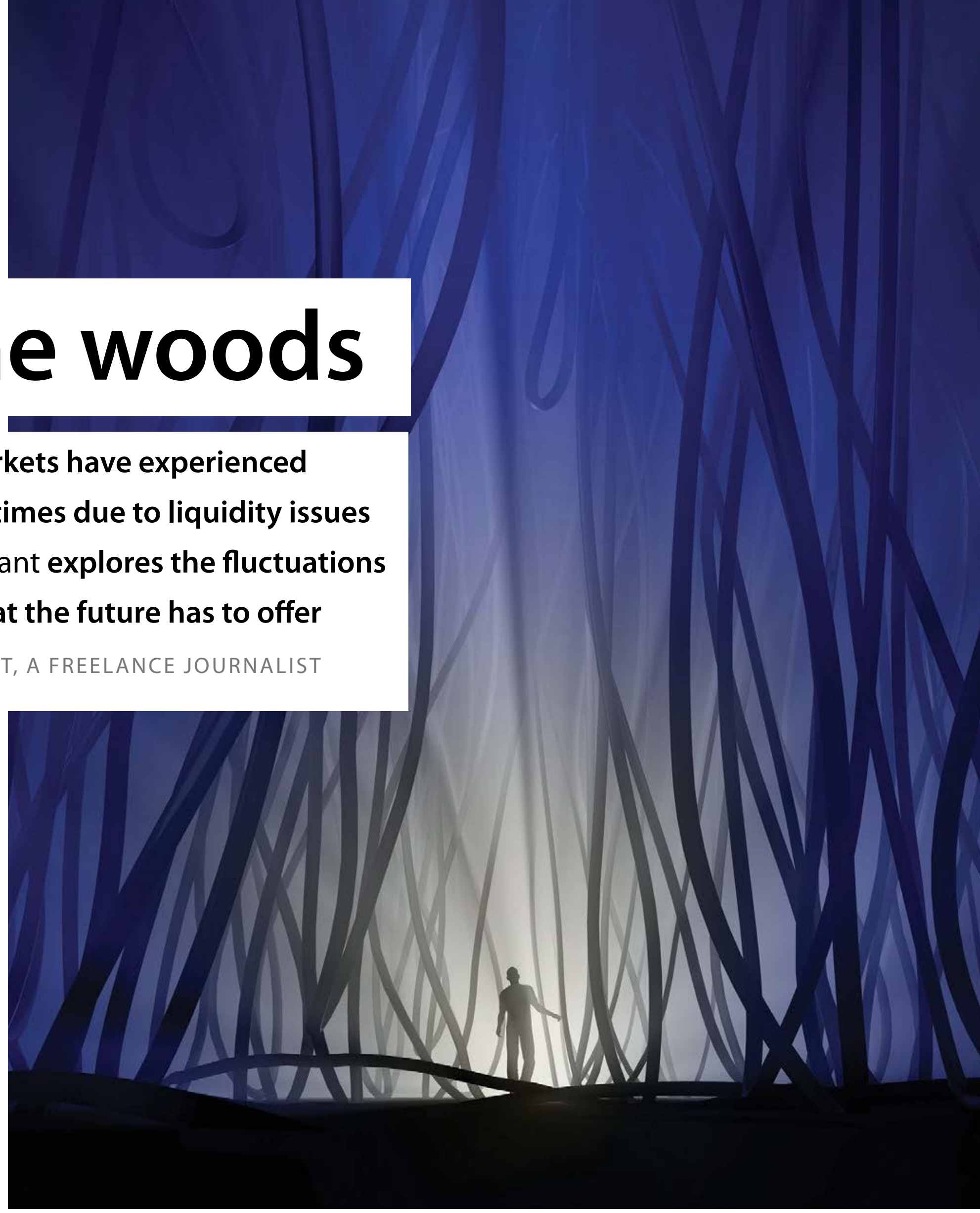
"The other differentiated feature for catastrophe bonds is that there is reduced credit risk associated with such investments, as these are all collateralised transactions where the collateral is generally invested in high quality securities such as US T-bills. Also, unlike many traditional bonds, price fluctuations based on non-quantifiable external factors such as strategic decisions from company management are of a lower concern," he adds.

Adopting a wider horizon could also improve returns. "In a lowly correlated asset class, there is a big opportunity to construct global portfolios but you need to pay attention to the underlying risk of the bond," Lombard Odier Investment Managers chief investment officer Jan Straatman says. "The modelling and analysis to do so are time consuming but it allows you to get diversification to regions with different catastrophical and geographical risks."

Looking ahead, analysts believe that rising interest rates in the US and another year of benign catastrophe losses in the rear-view mirror will translate into growth for the ILS market in 2016 but not at the same pace as previous years. The view is that established investors who have a strong grasp of the asset class, a long-term investment horizon as well as well-diversified portfolios will be the main players. They are expected to increase their allocation although overall cat bonds typically account for 1% of the total portfolio with ILS representing no more than 5%. ■

INVESTMENT

Lost in the woods



The high-yield bond markets have experienced a rollercoaster ride in recent times due to liquidity issues and falling prices. Sandra Haurant **explores the fluctuations in this asset class and what the future has to offer**

WRITTEN BY SANDRA HAURANT, A FREELANCE JOURNALIST

Pre-1980s, high-yield bonds - also known as non-investment-grade bonds or junk bonds - were reserved for fallen angels, those firms who had started out with investment-grade bonds and faced problems forcing their credit grade down. Now they are also likely to be issued by firms that have a credit rating of BBB or below at the outset.

A rollercoaster ride

The high-yield bond market has had something of a rollercoaster ride over the past few years, and the end of 2014 saw fears that problems in the US energy sector might bring about widespread defaults. But then in March 2015 there were claims that the US high yield bond market was doing just fine. Indeed, one *FT* headline cried out: "High-yield debt market defies sceptics."

At that stage, investors were turning to the US high-yield market and moving away from European high-yield bonds in search of yield. But by the summer, the picture was very different. Concerns about oil prices and further trouble in the energy market proved justified, and high-yield bonds didn't really live up to their name. They were not offering high yields at all – in fact, quite the opposite. It has been a volatile time.

"Looking back at 2015, it has been a very choppy year for high yield," AXA IM high yield fund manager Yves Berger states. "Although we should make the distinction between the US and Europe. Overall Europe did pretty well compared with the US, which was down 4.5 per cent, while Europe was up 1.8 per cent." Although 1.8 per cent is hardly anything to write home about – making high-yield bonds something of a misnomer.

The biggest problem was the energy sector. "It's a big factor for the US because it is such a big part of their universe," Berger says. "By contrast, it is only 1 per cent of our European universe so it is not a meaningful proportion." The tiny proportion of energy – the main area in which the European market is correlated with the US – has served to isolate this side of the Atlantic from the losses seen Stateside. And as the size of the energy market has increased in the US, the issues it faces have also grown.

"The notional size of energy in the high-yield market has effectively doubled over the past five years and as part of that the energy market issued a lot of bonds," CQS head of strategy and research Matthew James explains. "So the supply or net growth of the US high-yield market is a factor to consider." What's more, he adds: "What we have seen is the doubling of a higher risk sector overall. And this is a sector that just got hammered by a collapse in oil prices."

By contrast, James says, there has been very little increase in European high-yield stock in the last three years and the region is typically heavier in the financial sector with energy playing such a small part that it is pretty much name-specific. Berger cites Gazprom and Petrobras as examples.

Petrobras, the Brazilian oil company that had sold bonds on European markets among others, was downgraded in 2015 to junk status. The firm has been under pressure with falling oil prices, as well as being at the centre of political and corporate turmoil.

"Brazil as a country is not performing, and the company has had a lot of problems," Berger comments. "Gazprom, on the other hand, is a perfectly functioning company, but it is Russian, and so when Russia was downgraded, it was automatically downgraded too."

We have, then, seen a year of ups and downs in 2015 that has shaken sentiment and left investors a little reticent when it comes to the high-yield bond market. Have we come full circle to levels of concern we saw as we approached 2015? "I believe so," PiRho Investment Consulting director Phil Irvine states. "It was bad in 2015 and I don't think we are out of the woods yet."

Pricing in

The issues faced by high yield-bonds, though, are common across the asset class. But Irvine believes that the bad news is perhaps not entirely priced in at present. "The junk bond market can be split so far between those bonds issued by energy and mining companies, which have been hit by the fall in commodity prices, and the rest, which have held up pretty well."

However, he adds that, after low default rates for a number of years, there may now be contagion, due to a firm US dollar and the energy slowdown. "This is not a typically good environment for buying high-yield bonds," he says. Instead, Irvine says, the best time to buy is: "Normally when things look the bleakest in a recession. The best time to get relative out-performance of junk bonds is when the economic outlook is bleak in the middle of a recession, default risk is priced in and yields are relatively stretched."

For now, that risk is perhaps not sufficiently priced in, he argues: "Yield valuations of junk are relatively high versus corporates, but not at the all-time peaks associated with recession. It is worth noting that the redemption yield of the junk bond index can fall if companies start defaulting on payments. Selective investment in credit and high yield rather than wholesale purchases would be the best strategy *[now]*."

Indeed, direct credit has been attracting the attention of institutional investors and some argue, in certain cases, it offers a more suitable set of criteria than high-yield bonds. For CQS, which has a flexible approach to credit investment, selecting the most appropriate asset classes for each portfolio, there have been times over the past year and more where credit offered what was needed. After all, James says: "High-yield bonds offer less security than senior secured loans, which are further up the capital structure. From January 2014 to October 2015, you could buy European loans, which were more senior in the capital structure, cheaper than high-yield bonds. So you got a better security at a cheaper price. That was a trade we liked. Now, in Europe, the reverse is true and we are once again favouring high yield."

With leveraged loans come a different set of risks – at the top of the list is perhaps liquidity. "The European high-yield bond investor has more vehicles with daily liquidity, such as Ucits, while senior secured loans are in more locked-up liquidity vehicles such as CLOs."

"The liquidity concerns of loans are even more concerning than debt," Irvine argues. "I would urge any pension scheme to think carefully if they are relying on the liquidity of these 'growth assets' when combining with a leveraged liability-driven investment (LDI) approach."

Liquidity

Liquidity can also be an issue for high-yield bonds, though, as has recently become apparent when Third Avenue froze its junk bond fund in December. Much of the problem was linked to a proportion of inappropriately illiquid assets within what should have been a daily liquidity fund, Morningstar head of portfolio management, EMEA, Robin Johnson says.

Nonetheless, many argue the current climate is creating opportunities. And James can see plenty of opportunity for the flexible institutional investor. "We have for the last four to six weeks been adding to the non-energy triple C part of US high-yield bonds because we think you have the opportunity to buy assets with high yield but at very attractive prices, because they are sold by forced sellers."

Nonetheless, it is a market where caution and a full understanding of the risks is essential. "There is a reason yields are higher on bonds with lower-rated credit ratings – the risks are there and that is reflected in the grading they get," Johnson concludes. ■

In their own words...

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

On the UK being told to follow the Netherland's pensions cost reporting example

"It is encouraging to see the continual gravitation towards the issue of costs disclosure but the time has come for the industry to put thought into action and put practical measures in place to increase transparency in this particular area. We need to learn from the example of the Netherlands and create a reporting solution as good as possible, as fast as possible. The aim should be to keep learning and accept that the first iteration of cost reporting will not necessarily be perfect first time round. It should be considered a work in progress, both evolutionary and progressive. This will make implementation more successful in the long term, while ensuring pension schemes start to reap the benefits in the near future. The recognition of the positive and progressive work achieved by the Pension Federatie gives us confidence that it is possible in the UK to provide better transparency to pension funds in the very near future."

Kas Bank UK specialist in cost transparency Stewart Bevan

On trustees facing being sued if they ignore climate change in portfolios

"To produce a wholesale change in attitude, a court ruling on the obligations of fiduciary investors to control systemic climate risk will probably be needed. Because of the uncertainties in estimating future climate damage, this will not be an easy case to bring. But we anticipate that such a case will ultimately succeed."

ClientEarth CEO James Thornton

On the Norwegian Government Pension Fund Global's responsible investment policies

YNGVE SLYNGSTAD
Norges Bank Investment Management CEO
"We use our voting rights to safeguard the fund's investments. This includes voting to promote sustainable development and good corporate governance. During 2015 we voted at 11,562 shareholder meetings globally. In 2015, we began publishing our voting intentions in advance in selected cases, together with the reasoning behind them. The aim is to be clear about what we expect and where we stand."

On the UK's leading approach to tackling rising longevity within its pension schemes

PRUDENTIAL FINANCIAL HEAD OF LONGEVITY RISK TRANSFER AMY KESSLER
"The UK regulator closely monitors pension schemes to ensure they are providing the appropriate levels of funding. This includes a healthy dose of longevity risk, which allows much of the cost of mitigating this risk to be absorbed within the technical provision. In addition, in many European countries the funding rules are not as clear cut as in the UK and those objectives may not include a margin for longevity risk."

On EIOPA's first stress test results

ANDREW VAUGHAN
Barnett Waddingham partner
"EIOPA is already planning a further test to assess the impact of prolonged adverse conditions on pension scheme sponsors, the wider economy and financial stability. This will be at the forefront of many trustees' and employers' minds as they approach funding valuations under current market conditions. Many will wish to take a close look at how they are managing their pension risks."

JANWILLEM BOUMA
PensionsEurope chair
"The results based on existing prudential frameworks in each member state are in many ways different than those based on the European methodology and I am not convinced that a European framework as envisaged by EIOPA is suitable or useful."

"While pension plan liabilities have a very long-term nature, it is important that supervisory regimes are prepared to deal with these stresses in a transparent way, be it through appropriate recovery periods, the role of pension protection schemes, increased sponsor's contributions and/or benefit adjustment mechanisms."
EIOPA chairman Gabriel Bernardino

On the Irish Pensions Authority pledging a five-year plan to reform the way schemes are run

"There are good pension schemes, whose members understand their pension situation and are supported to make the decisions they need to. But there are other schemes, and it is these schemes which are our concern. Members in less well-run schemes will be less comfortable, are less likely to save, less likely to make reasonable decisions and less likely to have as good an outcome. What we must have is a pension system where pension schemes are always well run. We need a pensions system that is much more capable of providing consistently good value. The pension system should help people understand their position and clearly explain and guide and support them though the decisions they are asked to make. We also need people to be happy that the pension system is well regulated."
The Pensions Authority, pensions regulator, Brendan Kennedy

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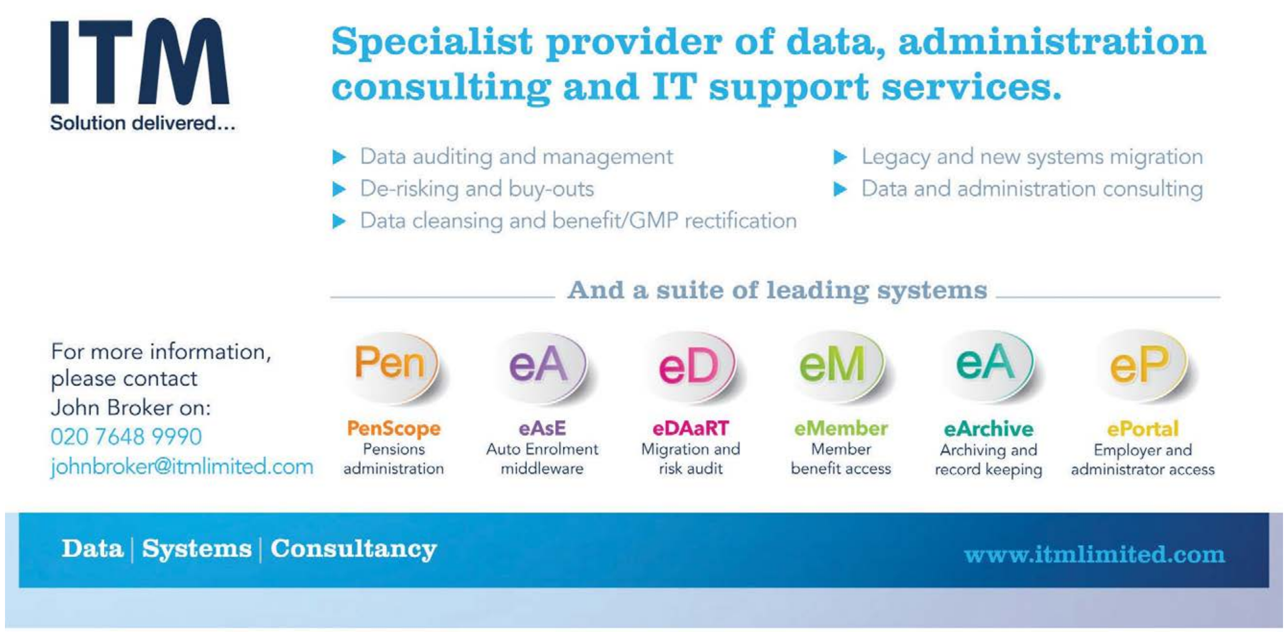

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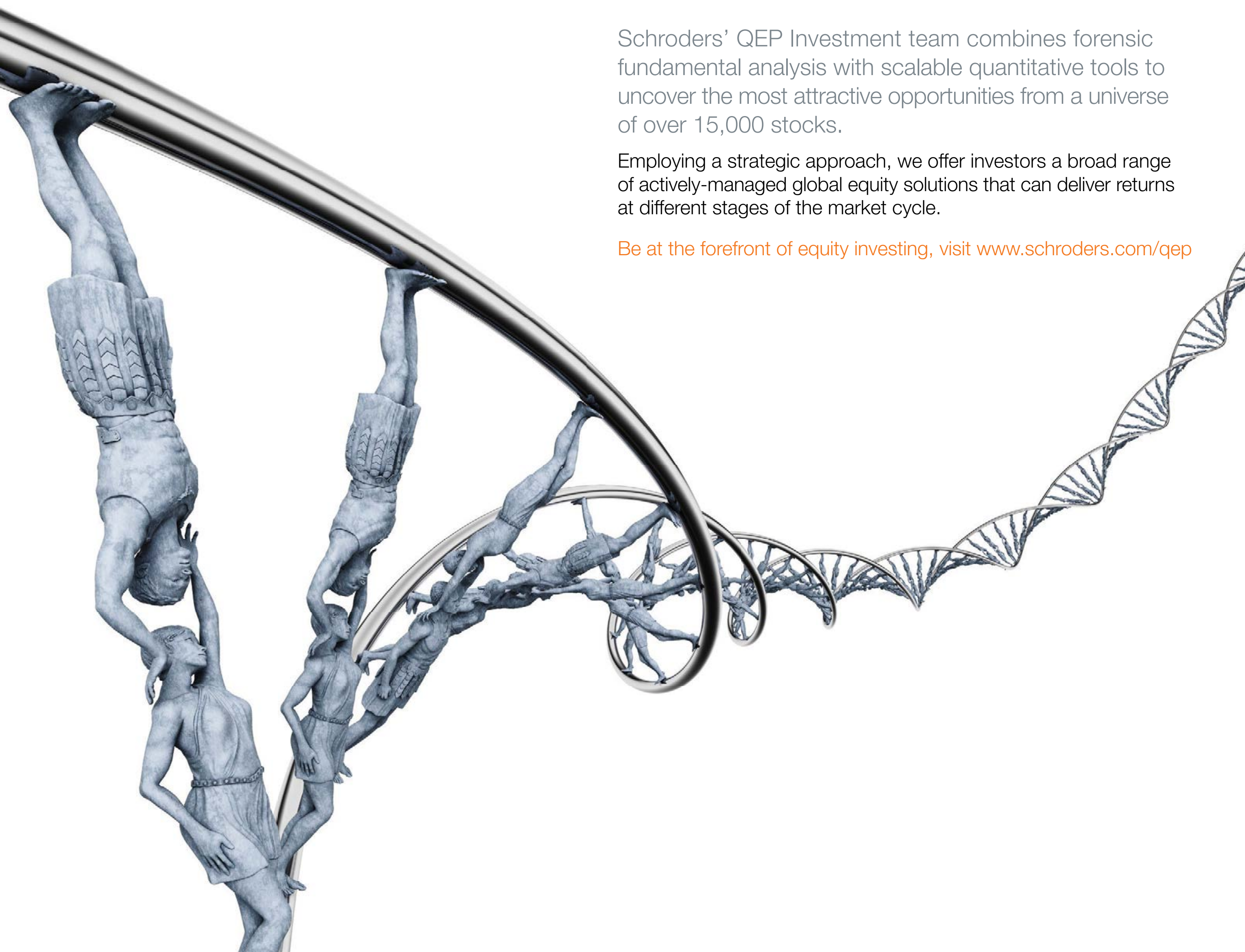

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