

## **Talking Heads: What are the four biggest issues for pension schemes in 2009?**

With market turbulence a certainty for most of 2009 thanks to the continuing economic crisis, what challenges can schemes expect to face, asks **Pensions Week**.

### **The independent trustee: Peter Askins, Independent Trustee Services**

1. The first of the four big issues is a general one – “Calm down dear!” We all know things are going to get worse before they get better, but getting hysterical about every tiny gobblet of financial information or hint of a trend doesn't help. Most of the people giving the advice cheerfully went along with the herd in the first place.
2. My second builds on the first – a reasonable approach to the timescales for repayment of deficits. It is in no one's interests to drive otherwise viable companies to the wall by saddling them with unsustainable repayment plans devised in a much more favourable economic climate.
3. On that theme my third is that the government and Pension Protection Fund (PPF) recognise that during this once-in-a-hundred-year event major fluctuations in the rate of the levy would, in a period of record levels of insolvency, be bound to lead to even greater calls on the PPF. Instead of doling out public money to the banks, supporting viable businesses by some form of guarantee or underpin to the PPF would be a better use of public money.
4. Finally the government and the regulator need to hold their nerve on the simplification agenda. Would anyone describe the recent consultations on section 75 debt and risk-sharing as simplification? What we need is genuine reform that will reduce the cost of pension provision.

### **The investment consultant: John Belgrove, Hewitt Associates**

1. The challenging economic outlook will lead many trustees to reappraise their sponsor covenant strength and revisit their schemes strategic return goals, risk tolerance and anticipated recovery periods. From the sponsor viewpoint, expect the next wave of DB closure to existing members, not just new entrants. Politically, this is more achievable when people are more worried about jobs than pensions.
2. The extreme market turbulence and surprise corporate casualties of 2008 will give rise to heightened demand for risk auditing and monitoring services. Best practice will become more intense, there will be deeper analysis at the portfolio level, and trustee workload will increase even further.
3. Liability-driven investment strategies delivered strongly in 2008, so appetite for this framework may accelerate further. The demand for strong medium-term asset allocation advice should continue. Ironically, there is a real risk of being overcautious as investors dive for cover. DC members in particular will need persuasion to keep contributing.
4. Due to trustee governance limitations, complexity challenges, demand for value for money and the need for speedy decision-taking, some trustee boards will delegate more implementation aspects to investment professionals than they previously have.

### **The actuary: Deborah Cooper, Mercer**

1. Covenant – most trustees rely on the employer to provide information to determine its covenant and must ensure they have evidence to support the view they have formed. If the employers covenant remains strong, they might be able to wait to see whether the market recovers, but the wrong judgment risks under-mining members security.

**2. Pace of funding** – nearly all DB schemes have ended 2008 less well funded than anticipated, with employers less able to afford contributions. Trustees must consider how to address this – demand increased contributions now, risking the employers future viability, or wait to see if the employer survives to pay increased contributions in the future?

**3. DB investments** – trustees of DB schemes need to consider the schemes investment risk profile, given the schemes maturity and the employer's covenant. Risk mitigation strategies might lock schemes into their current funding level, but some trustees and employers might prefer that their exposure to any further investment falls is reduced.

**4. DC investments** – some active members of DC schemes face bleak retirements unless they have time to address falls in their fund values. Those close to retirement will want to review the options available, including deferring drawing their pension. Good communication can help members understand their expectations.

### **The DC consultant: Steve Herbert, Origen**

**1. Scheme costs** – the costs of running many DC pension schemes are likely to be reviewed. It would not be unexpected to see employers again consider the trust versus contract scheme debate, as contract-based schemes often carry both lower charges and less ongoing administration, both of which may be appealing to organisations at this time.

**2. Tax breaks** – the potential cost savings of salary sacrifice will probably encourage more employers to actively consider this as a scheme feature. When used responsibly, this feature encourages employers to retain and improve schemes, and employees to save more for their own retirement.

**3. Advice** – following the economic collapse of 2008, employees are likely to be confused regarding their pension scheme investment decisions. Some may switch away from investments linked to the stock market, in effect crystallising the losses of last year. Given the long-term nature of pension saving, such moves may be a mistake for many.

**4. Planning for personal accounts** – in the current climate, 2012 seems a long way off, but if anything, the need to forward-plan for the introduction of personal accounts is even more important. Early action by employers will enable costs and workload to be more evenly spread.

### **The fund manager: Mitesh Sheth, Henderson Global Investors**

**1. Two of the major investment issues of 2008** were the lack of liquidity across asset classes resulting in the inability to trade assets and the fact that all markets and asset classes correlated on the way down. As the markets look likely to remain turbulent during 2009 and 2010, trustees will need to find liquid investment strategies, such as currency and interest rates strategies.

**2. Pension funds will need to look at how well positioned they are to exploit/invest in the best opportunities** resulting from the financial crisis and recession, including how to avoid (or short) the worst. This will require diversification into new/complex asset classes with attractive risk-return characteristics.

**3. Schemes must look at how effective their decision-making been.** Have they suffered from artificial constraints? Have they found themselves jumping on bandwagons too late and in crowded trades? Schemes must look at quality of investment advice as well as their own decisions in both asset allocation and manager selection. This may lead to radical changes in their governance models.

**4. Pension funds must look at their investment strategy in a more holistic and integrated way,** as function of covenant, funding, governance, assets and resources.