European Pensions

Summer 2023

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France

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Investment trends

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European Pensions
AWARDS 2023

6 July 2023

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Editor in Chief
Francesca Fabrizi
+44 20 7562 2409

Editor
Natalie Tuck
+44 20 7562 2407

Associate Editor
Laura Blows
+44 20 7562 2408

Deputy Editor
Jack Gray
+44 20 7562 2437

News Editor
Sophie Smith
+44 20 7562 2425

Commercial
John Woods
+44 20 7562 2421

Camilla Capece
+44 20 7562 2438

Lucie Fisher
+44 207 562 4382

Design & Production
Amanda Scope

Accounts
Marilou Tait

Circulation
perspectivesubs@dynamail.co.uk
+ 44 1635 588 861

Management
John Woods, Managing Director
Mark Evans, Publishing Director

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www.europeanpensions.net

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5 Maidstone Buildings Mews,
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How to solve a problem like longevity

In the few months since the last edition of *European Pensions,* pensions have hit the headlines around the world as France was gripped by widespread protests against plans to increase the nation's retirement age from 62 to 64. Retirement age rises are nothing new in Europe, with most countries having to reform their pension systems due to ageing populations, but none experienced quite the level of discontent that was seen in France. Protests turned violent in places and Bordeaux town hall was even set ablaze as the French people rose up in opposition. However, despite their protests, President Macron bypassed the National Assembly to pass his government's pension reforms and it seems like the French population will have to live with working longer. Most European countries have had to deal with ageing populations, and there are a variety of reforms that can be enacted to address the issue. Our feature on page 24 looks into the issue of longevity and pension system sustainability in more detail.

One country that seems to have a grip on maintaining a sustainable pension system is Denmark, which is often ranked amongst the best in the world for its retirement provision. However, there are always challenges to be overcome and improvements to be made, as our feature on page 18 discusses. We also hear from Danish pension association Forsikring & Pension about some of the issues affecting the Danish pension system on page 21.

"IT SEEMS LIKE THE FRENCH POPULATION WILL HAVE TO LIVE WITH WORKING LONGER"

While pension professionals from across the continent are dealing with these long-term issues, last year threw up plenty of short-term challenges as the war in Ukraine, economic decline and the aftershocks of the Covid-19 pandemic created a difficult investment environment. It was hoped that 2023 would be different, and while the situation appears to have improved, banking crises and rising interest rates have posed their own challenges. We delve into the investment landscape and trends in more detail on page 34 as the pensions sector looks to recover from the widespread losses experienced last year.

Whatever happens, we know that pensions are long-term saving vehicles and short-term bumps can be ironed out over time, but the industry, governments and regulators need to continue to be proactive in solving problems like longevity and sustainability.

Jack Gray, Deputy Editor

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

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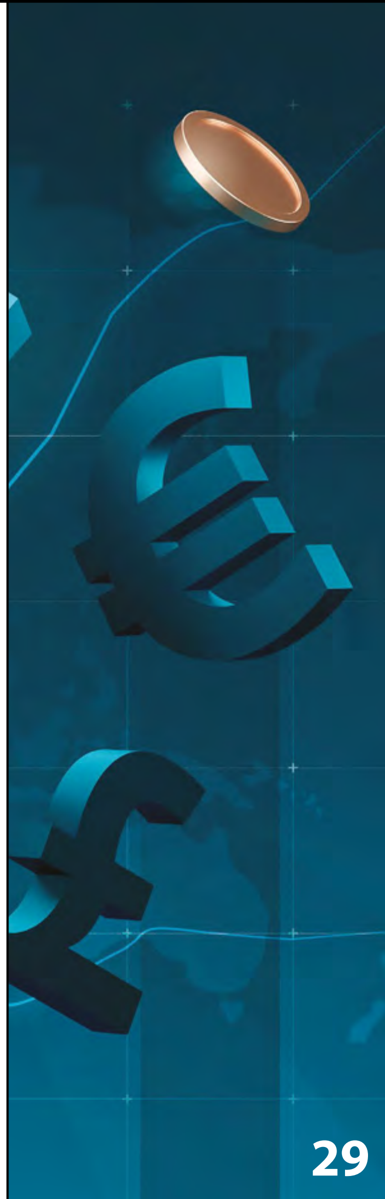

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ESAs propose amendments to 'extend and simplify' SFDR

INDUSTRY CONSULTATION TO RUN UNTIL 4 JULY 2023

Written by: Jack Gray

The three European Supervisory Authorities (ESA) have published a consultation on amendments to the delegated regulation of the Sustainable Finance Disclosure Regulation (SFDR).

The European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA) have proposed changes to the disclosure framework to try and address issues that have arisen since SFDR's introduction.

They are seeking feedback on amendments that aim to extend the list of universal social indicators for the disclosure of the principal adverse effects of investments on the environment and society.

Furthermore, the ESAs have proposed refining the content of other indicators for adverse impacts and their definitions, methodologies, calculation formulae and the presentation of the share of information derived from investee companies, sovereigns, supranationals or real estate assets.

The proposals also include adding product disclosures on decarbonisation targets, including intermediate targets, the level of ambition and how the targets can be met.

Alongside these proposals, the ESAs are seeking feedback on further technical revisions to the SFDR delegated regulation by improving the disclosures on how sustainable investments do not "significantly harm" the environment and society.

They have also proposed simplifying pre-contractual and periodic disclosure templates for financial products and making other technical adjustments, including on the treatment of derivatives, the definition of equivalent information, and provisions for financial products with underlying investment options.

The consultation is open until 4 July 2023, and the ESAs will organise a joint public hearing and consumer testing during the consultation period.

Once all the feedback has been considered, the ESAs will produce a final report and submit it to the European Commission.

In related news, the European Parliament has voted in favour of amendments on the Corporate Sustainability Due Diligence Directive (CSDDD) in the Legal Affairs Committee.

One of the amendments to the CSDDD that was adopted was to give investors and asset managers the duty to engage with investee companies on human rights violations and negative environmental impacts in their value chain.

Members of the European Parliament voted in favour of the amended CSDDD text, which included the investor duty to engage, with a majority of 19 in favour, three against and three abstentions.

The European Parliament plenary is expected to endorse the position on the CSDDD in June.

The Dutch Federation of Pension Funds welcomed the vote on CSDDD, stating that it was in favour of giving investors increased responsibility within the directive, and has previously expressed this to members of the European Parliament (MEP).

It called on MEPs to adopt the article that included the role of investors in engaging on human rights and environmental impacts.

Negotiations between the European Parliament and Council of Ministers will begin once the article has been adopted.

"Since 2018, most of the Dutch pension sector has signed the International Responsible Investment Agreement together with the Dutch government, NGOs and trade unions to implement the OECD guidelines," the Dutch Federation of

Pension Funds stated.

"Dutch pension funds have embedded due diligence in their policies, contracts with asset managers and their engagement policies.

"The sector also works with NGOs, trade unions and the government on joint engagement to address negative impacts in high-risk sectors."

Climate and sustainability concerns have not been the only recent areas of focus, as the three ESAs have also called for vigilance from financial institutions, national supervisors and market participants in the face of mounting risks.

In their *Spring 2023 Joint Committee Report* on risks and vulnerabilities in the EU financial system, the EBA, EIOPA and ESMA noted that EU financial markets remained broadly stable despite the challenging macro environment and recent market pressure in the banking sector.

However, while there has been recent growth following a period of high inflation and tighter financial conditions, the economic outlook was "uncertain" and inflation may remain elevated for longer than expected, the ESAs stated.

They pointed to the collapse of three US banks and the emergency merger of Credit Suisse and the Union Bank of Switzerland (UBS) as evidence of the continued uncertainty, sensitivity of the European financial system to shocks and the potential risks relating to the end of low interest rates.

"Asset prices were highly volatile over the past months with market liquidity fragile," the report stated.

"Sharp movements in prices triggered sizeable margin calls and put some market participants under liquidity strains, notably non-financial corporations and non-bank financial institutions. High levels of uncertainty and imbalances in the supply and demand of liquidity are a drag on the financial system's resilience against further external shocks.

"In addition to these risks, geopolitical tensions, environmental threats and an increase in the frequency and sophistication of cyberattacks further complicate the risk landscape."

Given this, the ESAs urged financial institutions and supervisors to be prepared for a deterioration in asset quality.

They warned that the broader impact of policy rate increases and rises in risks on financial institutions and market participants should be considered in risk management.

Furthermore, liquidity risks arising from investment in leveraged funds and the use of interest rate derivatives should be closely monitored, according to the report, while financial institutions and supervisors were also urged to monitor the impacts of inflation risk.

"The strong regulatory frameworks that underpin the resilience of the financial sector are to be maintained, including by faithfully implementing the finalisation of Basel III in the EU without delay and with as little deviation as possible, and by avoiding further deviations from EIOPA's advice on the Solvency II review," the ESAs stated.

News in brief

■ PMT, PGGM and MN in the **Netherlands** are investigating the possibility of a joint pension management company, a joint statement has revealed. In this context, pension fund PMT would shift its mandate for pension administration for more than 1.4 million members to a joint organisation within PGGM pension management. However, the plans are not expected to have any consequences for the investment mandates deposited with MN Asset Management.

■ Three Eastern European funds that were suspended due to the war in Ukraine have now been deregistered from the **Swedish** premium pension fund market, the Swedish Pensions Agency (SPA) has announced. The SPA has taken over the management of the fund shares, confirming that the intention was to later redeem the fund shares to recover as much value as possible for pension savers and pensioners.

■ The Pensions Regulator has assessed and authorised the **UK's** first collective defined contribution pension scheme, the Royal Mail Collective Pension Plan. Pensions Minister, Laura Trott, highlighted the news as a "landmark moment", suggesting that this is "just the beginning".

■ A group of 17 investors, including **Sweden's** AP7 and **Denmark's** PensionDanmark, have written to Tesla's board to call for a review of the company's corporate governance. The group, which together own more than USD 1.5bn in Tesla shares, stated that it believed that the board showed signs of not representing the shareholders' interests to a "sufficiently high extent".

French state pension age set to rise to 64 despite protests

FRENCH PRESIDENT, EMMANUEL MACRON, SIGNED HIS PENSION REFORMS INTO LAW; OPPOSITION BILL TO BE DEBATED ON 8 JUNE

Written by: Jack Gray

The state pension age in France will increase from 62 to 64 after French president, Emmanuel Macron, signed his government's pension reforms into law on 14 April.

The reform navigated its final hurdle after key aspects of the bill, including raising the state retirement age, were approved by the nine-member Constitutional Council hours before it was signed into law.

The reforms were mostly approved by the Constitutional Council, the highest constitutional authority in France, although some of the details were rejected.

In particular, one aspect that was rejected would have encouraged companies with more than 1,000 employees to employ workers aged over 55.

Despite this, the majority of the bill, including the increased state pension age, was approved, and the council rejected opposition calls for a referendum.

The reforms, especially raising the age at which people can retire and claim the state pension, have proven deeply unpopular with the French public and sparked nationwide protests over recent months.

Macron previously described the reforms as essential to make the nation's pension system more affordable, with the system forecast to run at a deficit in its current state.

However, French trade unions have said that they will continue to oppose the reforms, after the recent May Day protests attracted large crowds, with estimates ranging from hundreds of thousands of people to 2.3 million turning out in opposition to the government's changes.

The changes have also proven unpopular with opposition lawmakers, with Macron invoking Article 49:3 to push through the reforms, bypassing the National Assembly, in March.

The proposed pension age reform process is scheduled to start in September, reaching 63 years and three months by 2027 and hitting the target age of 64 in 2030.

The amount of time working needed to receive a full pension will rise from 42 years to 43 and a guaranteed minimum pension income will be introduced.

This income level will be set at no less than 85 per cent of minimum wage for new retirees.

Public sector workers in mentally or physically demanding jobs will keep the right to retire earlier than the wider workforce, but their retirement age will rise at the same rate.

The government also announced that differing retirement ages and pension benefits for certain workforces, such as rail workers, would end.

Whilst the law has now been signed in by Macron, the French parliament is set to debate a bill by the opposition Liot party to repeal the pension age reforms on 8 June.

French trade unions have also continued to show discontent with the recent reforms, with a further round of protests against the decision to raise the retirement age scheduled for 6 June.

Spanish parliament approves pension reform

SPANISH WORKERS' PENSION CONTRIBUTIONS SET TO INCREASE TO ADDRESS THE RISING NUMBER OF RETIREES

Written by: Jack Gray

The Spanish parliament has approved the government's proposed reforms to the country's public pension system that will see workers' pension contributions increase to address the rising number of retirees.

The reforms, which have received support from the European Commission, aim to increase the amount of money in the public pension system to sustainably deal with the ageing population.

According to estimates, the number of retired people in Spain is set to rise from 10 million to 15 million by 2048.

Most of the financial burden is expected to be put on the highest earners and employers.

Spain's parliament approved the changes on 30 March, with 179 to 104 votes.

The leftist coalition government pushed through the changes, despite resistance from the conservative opposition.

The reforms are expected to include a gradual 38 per cent increase in the maximum contribution level between 2024 and 2050, with the current level at €4,495.50 per month.

They are also expected to include a rise in the social security costs on companies for higher earners.

The intergenerational equity mechanism will gradually rise, while recipients of the minimum pension will see their pension income rise to 60 per cent of the national median income between 2024 and 2027.

The Spanish government is also planning to increase non-contributory pensions to 75 per cent of the poverty threshold of a single-person household by 2027, while measures aimed at reducing the gender pensions gap will also be introduced.

Two of Spain's main trade unions gave their backing for the proposals earlier this month.

The agreement between Minister of Social Security, José Luis Escrivá, and the leaders of the trade unions CCOO and UFT was made on 15 March, with Escrivá stating that the reforms would help ensure the sustainability of the public pension system.

In related news, the latest data from Inverco saw the volume of assets in the individual pension system in Spain increase by €509m to €82.6bn in March 2023.

Inverco noted that the increase was primarily driven by improved portfolio revaluations due to an uptick in the financial markets.

Although financial markets experienced volatility in the middle of March, stock markets returned to a "much more positive" place at the end of the month.

This improvement eliminated the €482m fall in individual pension assets seen in February, thanks to the additional positive returns at the end of March.

Inverco stated that returns in the medium to long term were positive, with individual pension schemes expected to achieve an average annual return of 2.5 per cent over the next 26 years.

In the medium term (10 and 15 years), the pension schemes were forecast to achieve an average annual return of 2.7 per cent and 2.2 per cent respectively.

According to Inverco's estimations, contributions totalled €117m in March, while benefit payouts totalled €219m.

This resulted in net payouts of €102m, slightly higher than the net payouts experienced in February.

Inverco's data is from a sample of 860 individual pension schemes, covering around 7.35 million members.

Dutch Senate debates Future Pensions Act

THE SENATE IN THE NETHERLANDS DEBATED THE FUTURE PENSIONS ACT A WEEK LATER THAN PLANNED

Written by: Jack Gray

The Senate in the Netherlands held a debate on the Future Pensions Act on 22 and 23 May, a week later than planned.

According to the Dutch Federation of Pension Funds, the Senate is aiming to vote on the act on 30 May.

The new members of the Senate are then due to be installed on 6 June.

The Senate debated the Future Pensions Act a week later than previously intended due to an international obligation of the Socialist Party senator on the originally agreed date.

If passed by the Senate, the new law is expected to come into force on 1 July 2023, with pension funds having until 2027 to switch to the new pension rules.

The House of Representatives voted in favour of passing the new law in January this year.

The Future Pensions Act includes a package of new pension rules that aim to lay the foundations for an updated pension system, which will shift focus from DB- to DC-style pensions.

To achieve a majority in the House of Representatives, the main amendments and motions of the Green Left and the Labour Party were adopted.

These include three amendments on reducing the number of workers who would not be accruing a pension, with workers to begin accruing a pension at age 18 instead of 21 under the law, while the waiting time has been eliminated, and a quantitative reduction target to halve the number of workers not accruing a pension by 1 January 2028 was introduced.

A motion requesting the government develops a new early retirement scheme for labour-intensive professions after the current one expires in 2025 was also introduced, alongside an amendment to allow a collective benefit scheme for the solidarity contract and an amendment on broadening the default method for converting pension entitlements in the current system to personal pension assets in the new system.

Confidence in the pension system has also remained stable in the Netherlands despite recent market volatility.

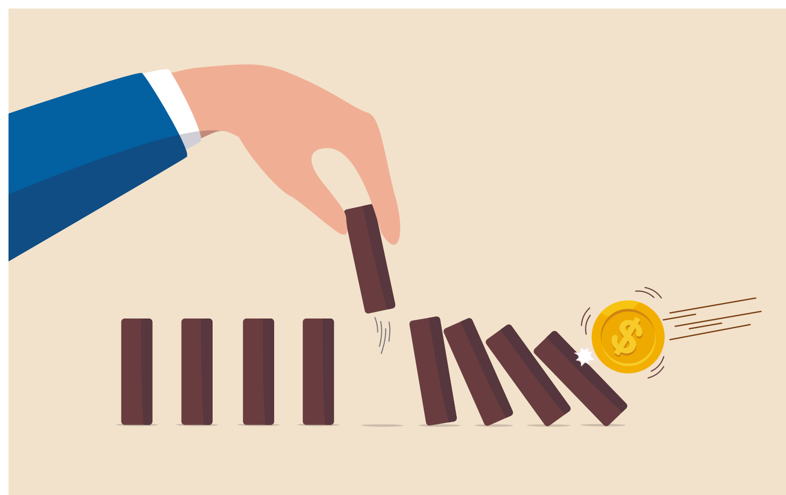
Research from De Nederlandsche Bank revealed that 62 per cent of Dutch people are fully or mostly confident that pension funds will be able to meet their pensioner commitments.

Overall, 52 per cent of respondents had a fair or very high level of trust in financial institutions. The remaining 48 per cent had little or no confidence in Dutch financial institutions.

Dutch households' confidence in insurers and banks also remained at similar levels, although the proportion of people concerned about banks going bankrupt increased slightly, from 34 per cent to 38 per cent.

Responding to the report, Dutch pension fund PFZW said that it considered the stability in people's confidence in pension funds as "positive", especially given the recent problems at banks in the US and Switzerland.

"We want to take care of pension concerns for all participants, whether you are working and accruing pension or already enjoying your pension," it stated.



Alecta CEO Magnus Billing steps down over American bank losses

THE BOARD SAID THAT THE DECISION AIMS TO HELP RESTORE TRUST IN THE COMPANY FOLLOWING RECENT LOSSES

Written by: Jack Gray

Alecta has announced that its CEO, Magnus Billing, has stepped down from his position with immediate effect following losses of SEK 19.6bn due to the collapse of three American banks the pension company had invested in.

In March, Alecta incurred losses of SEK 19.6bn when three American banks (Silicon Valley Bank, Signature Bank and Silvergate) in its portfolio collapsed amid a banking crisis in the US.

Following further discussions, the board decided to relieve Billing of his duties to help restore trust in the company.

Alecta deputy CEO, Katarina Thorslund, was appointed acting CEO, and the recruitment process to find a permanent CEO will begin immediately.

In the meantime, Ingrid Blonde will support the organisation as working chair of the board.

Since Alecta announced the losses, its management and board have worked to isolate the losses and work through the processes within asset management to understand how the situation arose, the pension company stated.

Its first step was to make an assessment as to whether the current investment decisions were within the framework and mandate established by the board.

This assessment has been shared by the board and it said it welcomed the Financial Supervisory Authority's review of the course of events.

Alecta stated that the losses had seriously damaged confidence in its asset management and its recent decisions on measures to strengthen capital management have the support of the board.

Ann Grevelius took over as acting head of equity on 20 April and a strategic review of how Alecta will conduct equity management has already begun.

The work is expected to be ready in principle for the board to make a decision on before the summer.

Following the losses, the board came to the conclusion that Alecta needed new leadership to implement changes in asset management and restore trust.

"We would like to thank CEO Magnus Billing for the solid work he has put in during his time at Alecta for the good of the company and the customers," commented Blonde.

"At the same time, Alecta now needs to look ahead and forcefully implement the necessary changes."

Danish pension company Velliv also recently parted ways with its CEO, Steen Michael Erichsen, after revealing that a private investment did not meet the company's guidelines.

Erichsen had been CEO for 15 years and his resignation was made in mutual agreement with Velliv's board.

The agreement was made as the board was of the opinion that Erichsen had "made a disposition in relation to his private savings which is not compatible with the position".

The pension company has not gone into further detail as to the exact nature of the private investment.

Velliv chief commercial officer, Morten Møller, will fulfil the role of acting CEO until a replacement is found.

Commenting on the news, Velliv board chair, Anne Broeng, said: "It is with regret that we have to say goodbye to Steen Michael Erichsen. In his 15 years as CEO, Steen Michael has helped drive colossal development. Velliv has thus been named pension company of the year four times in five years. We acknowledge the great effort and wish Steen Michael Erichsen the best in the future."

2022 the 'worst investment year' for pension investors since financial crisis

LAST YEAR WAS THE WORST INVESTMENT YEAR FOR PENSION INVESTORS SINCE 2008, RESEARCH FROM ETK HAS REVEALED

Written by: Jack Gray

Last year was the worst investment year for pension investors since the financial crisis in 2008, according to international analysis by the Finnish Centre for Pensions (ETK).

ETK assessed 24 of the largest pension investors across nine countries and found that the average nominal return was -8.4 per cent over the year, while the average real return was -14.7 per cent.

The average real return of the pension investors in 2008 was -15.7 per cent.

"Russia's war in Ukraine, high inflation and the rapidly tightening monetary policy of central banks darkened the economic outlook and hammered pension investors both in the stock and the interest rate markets," explained ETK liaison manager, Mika Vidlund.

Finnish pension investors performed above average with an average real return of -11.5 per cent, while Sweden's AP6 had the best result out of the investors surveyed with -6 per cent.

According to ETK, Danish and Dutch pension investors were hit the hardest, with its analysis finding that the real return of Danish pension fund ATP, whose portfolio consisted mainly of long-term, interest-bearing securities, was almost -38 per cent in 2022.

Meanwhile, the Netherlands' ABP and PFZW had average real returns of -25 per cent and -29 per cent respectively.

The real return of Norway's Government Pension Fund Global was -13 per cent, with its result being improved by the weakening Norwegian krone in relation to other main currencies.

However, ETK noted that poor results in the bond markets and the shrinking investment assets of pension investors were compensated by nearly equally high reductions in pension liabilities.

This means that the solvency ratio was not compromised due to a single weak investment year.

"The very harsh investment year of 2022 has affected, in particular, the average five-year return which, for some actors, fell into the negative," said ETK special adviser, Antti Mielonen.

"Long term, however, the return has remained at a moderate level."

He also pointed out that the real return of earnings-related pension insurance companies and industry-wide pension funds over a period of 15 years was around 3.5 per cent, while the average real return of buffer funds was found to be 4.5 per cent. In particular, the highest real return was 6.1 per cent, generated by the Danish Industriens Pension, while the highest return of the Finnish pension investors was 4 per cent, generated by the Seafarer's Pension Fund.

"Investing pension assets is a long-term activity," Mielonen continued. "That's why we have now added a return comparison of a period spanning 15 years.

"Depending on the allocation of the investment portfolio and other factors, the fluctuation in returns may be large from one year to another, which is why short-term returns may be unduly emphasised from the point of view of pension investing."

The international comparison of investment returns made by ETK covered 24 pension investors across nine countries, including large investors from northern Europe, North America and Asia.

The comparison included eight pension investors from Finland.

SPA urges govt to consider inquiry on public pension system improvements

THE SPA URGED THE SWEDISH GOVERNMENT TO CONSIDER LAUNCHING AN INQUIRY INTO HOW THE SYSTEM CAN BE IMPROVED TO REFLECT VARIOUS CHANGES IN THE BROADER PENSION SYSTEM

Written by: Jack Gray

The Swedish Pensions Agency (SPA) has stated that it believes there are good reasons for the government to appoint an inquiry to evaluate the public pension system in Sweden and make suggestions for improvements.

It said that the various parts of the public pension system have changed and increased in number in recent years, which has resulted in contradictions and the system not always reaching the desired groups.

The SPA therefore urged the government to consider launching an inquiry into how the system can be improved.

Its report, *A new pension system?*, assessed the current system's development and presented alternatives.

"The aim is to contribute with the basis for a discussion about the choice of path," explained SPA head of analysis, Ole Settergren.

"There are good reasons for evaluating today's pension system in a public investigation."

In the report, the SPA noted that people's income during their working life determines the size of their pension to a lesser extent than initially thought.

Looking at the general pension as a whole, the report said that there were large groups of society that were covered by a system that resembles a national pension system, rather than a system based on earnings.

Iceland lowers minimum investment in domestic assets

THE ICELANDIC PARLIAMENT HAS AGREED TO AMEND THE LAW ON PENSION FUNDS' MINIMUM INVESTMENT IN DOMESTIC ASSETS, WITH THE MINIMUM WEIGHT SET TO BE LOWERED IN STAGES

Written by: Jack Gray

The Icelandic parliament has agreed to amend the law on pension funds' investment in domestic assets, with the minimum weight of domestic assets to be lowered in stages from 50 per cent to an expected 35 per cent of assets.

On 1 January 2024, the minimum level of domestic assets in a pension fund portfolio will decrease by 1.5 percentage points to 48.5 per cent.

This 1.5 percentage point reduction will take place on 1 January each year until 2027.

After this, the annual decrease will be 1 percentage point on 1 January each year until it reaches 35 per cent on 1 January 2036.

Parliament also agreed that pension funds were not obliged to sell foreign assets if they exceed the maximum set out in law due to changes in the exchange rate of the Icelandic króna or price increases on foreign property markets. In those cases, pension funds will not be allowed to increase foreign assets or currency risk.

Furthermore, from 1 April 2023, funds have been required to provide new members with information on the main rights they accrue upon payment of premiums, alongside information on the structure and policy of the pension fund.

Pension funds are permitted to publish a statement to members on a website where electronic member identification is required.

"The pension funds welcome these changes and especially the authorisation to publish statements electronically and the increased authorisations for foreign investments," the Icelandic General Pension Fund stated.

News in brief

■ The **Institutional Investors Group on Climate Change** (IIGCC) has announced the launch of the Net Zero Engagement Initiative (NZEI), which aims to support investors in aligning more of their investment portfolio with the goals of the Paris Agreement. By achieving this, the IIGCC hopes the NZEI will help scale and accelerate climate-related corporate engagement. So far, 93 investors have signed up to the initiative and 107 companies have been sent letters.

■ The majority (86 per cent) of **US** public sector pension scheme managers are confident that their schemes are well hedged against inflation, although worries about possible risk scenarios have persisted, according to research from Ortec Finance. In particular, the research found that managers still have concerns about the risk of stagflation, with 48 per cent very concerned and 50 per cent quite concerned.

■ **Swedish** pension fund AP7 has published its updated Climate Action Plan, which outlines how it will contribute to achieving net-zero carbon emissions by 2050. In the updated plan, several time-specified goals have been set up for AP7's active ownership and investments *[see page 24]*.

■ At least 96 per cent of **Finnish** earnings-related pension assets have been invested in line with the UN's Principles for Responsible Investment (PRI), analysis from Tela has found. According to the analysis, Finnish earnings-related pension providers invested a total of €238bn in assets as of the end of 2022, with at least €229bn being invested in line with the PRI system.

US President vetoes bill on ESG factors

US PRESIDENT JOE BIDEN VETOED A REPUBLICAN BILL THAT WOULD HAVE PREVENTED ESG-BASED INVESTMENT DECISIONS

Written by: Sophie Smith

President Joe Biden vetoed a Republican bill that would have prevented pension fund investment decisions on environmental, social and governance (ESG) factors, in the first veto of his presidency.

The bill, which looked to overturn a Department of Labour ruling that made it easier for fund managers to consider ESG issues, was passed by the Senate in a 50-46 vote on 1 March.

However, the White House confirmed the President's intent to veto the bill shortly after this, with White House press secretary, Karine Jean-Pierre, stating that the bill "would jeopardise the retirement and life savings for police officers, firefighters, teachers, and 10s of millions of retirees all across the country".

Commenting in a Twitter video, Biden stated: "I signed this veto because the legislation passed by the Congress would put at risk the retirement savings of individuals across the country. They couldn't take into consideration investments that would be impacted by climate, impacted by overpaying executives, and that's why I decided to veto it."

A vote in the House of Representatives fell short of the two-thirds majority needed to undo the veto, in a 219-200 vote.

Canadian pension funds face scrutiny

NATION'S LARGEST PENSION FUNDS QUERIED ON CHINA HOLDINGS

Written by: Sophie Smith

Representatives for some of Canada's largest pension funds appeared in front of the Special Committee on Canada-China Relations in May to discuss their investments in China in light of recent geopolitical tensions.

During the hearing, Ontario Teachers' Plan executive managing director, Stephen McLennan, confirmed that the fund has reduced its investment activities in China and paused further private investments, after assessing the post-Covid-19 environment, recent regulatory changes in China, and the continued deterioration of Canada/China and US/China relations. However, Canada Pension Plan Investment Board senior managing director and global head of public and corporate affairs, Michel Leduc, defended the group's holdings, arguing that exposure to Chinese markets gives access to "one of the largest and fastest growing economies".

Diary dates 2023

The latest events occurring across the European pensions market

PENSIONS AGE NORTHERN CONFERENCE
21 June 2023
Park Plaza, Leeds
Aimed at pension managers, trustees, FDs, CIOs, advisers, and all those working in the pensions sector, this one-day event offers delegates the opportunity to learn and network alongside their peers, and hear from industry experts on topics across the DB and DC space. Covering a range of aspects related to pension provision, delegates can be sure that this conference will offer them the updates they need to manage their schemes going forward.
pensionsage.com/northernconference

EUROPEAN PENSIONS CONFERENCE
6 July 2023
London Marriot Hotel Grosvenor Square
Returning to London again this year, this conference brings together thought-leaders and pension funds from across the European pensions sphere to discuss some of the major opportunities and challenges facing funds operating in Europe today. With a series of pension fund panel discussions covering a wide range of topics, this event promises to offer delegates a chance to learn from their European peers, hear about trends and new practices in the marketplace and connect with friends old and new.
europeanpensions.net/conference

PENSIONS AGE AUTUMN CONFERENCE
14 September 2023
The Waldorf Hilton, London
The Pensions Age Autumn Conference, now a firm favourite in the UK pensions sector, offers pension funds and those working in the pensions sector the opportunity to learn and network alongside their peers at one of the busiest times in UK pensions history. This one-day conference will offer delegates the up-to-date knowledge and guidance they need to help them run their pension schemes and meet their members' needs, whether that's in the DB, DC or hybrid space.
pensionsage.com/autumnconference

Not to miss...

PLSA INVESTMENT CONFERENCE 2023
6-8 June 2023
Edinburgh
plsa.co.uk/events

PMI PENSIONS ASPECTS LIVE
21 June 2023
London
pensions-pmi.org.uk/events

EC AND ECB ANNUAL JOINT CONFERENCE
7 June 2023
Brussels
finance.ec.europa.eu/events

PLSA ANNUAL CONFERENCE 2023
17-19 October 2023
Manchester
plsa.co.uk/events

Appointments

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 jack.gray@perspectivepublishing.com

MIRA KAUPPI

Finland's Ilmarinen has appointed Mira Kauppi as its finance and risk management director. In her new role, Kauppi and her team will be responsible for Ilmarinen's finances and risk management, as well as operational planning and monitoring. Kauppi succeeds Matias Klemelä, who has moved to Ilmarinen's investment organisation's allocation team as a strategist.

MORTEN BORGE

The Norweigan Ministry of Finance has appointed Morten Borge as a member of Folketrygdfondet's board of directors. In addition to this, Siri Teigum was reappointed as chair and Tørres Trovik as board member, while Einar Westby and Trond Døskeland will leave the board. All of the appointments were for a four-year term. Folketrygdfondet is the investment manager for the Government Pension Fund Norway.

ARJAN BOL

Aon Netherlands has appointed Arjan Bol as chief commerical officer. Bol joins from Mastercard, and has experience in sales, marketing, product management, operations and IT in the financial services industry. Alongside Bol, Aon has appointed Marnix Zwartbol as chief technology officer. He brings 27 years' experience to the role, covering asset management, institutional accounting and global risk solutions.

PETER STENSGAARD MØRCH

Danish pension company PensionDanmark has announced that Peter Stensgaard Mørch will become its CEO in August 2024 after a period of adjustment. Stensgaard Mørch is permanent secretary at the Danish Ministry of Finance and will initially join PensionDanmark as deputy CEO on 15 August 2023. Current CEO, Torben Möger Pedersen, will step down on 1 October 2023, with Claus Stampe to act as interim CEO.

BJÖRK SIGURGÍSLADÓTTIR

The Icelandic Prime Minister has named Björk Sigurgísladóttir deputy governor for financial supervision. She has worked in financial supervision for the past 15 years, first at the Financial Supervisory Authority and then at the Central Bank of Iceland after the merger of the two at the beginning of 2020. She has also served on a large number of committees relating to financial supervision. Her appointment is for a five-year term.

Appointments

MADS KAAGAARD

Danica Pension has appointed Mads Kaagaard as its new managing director. Kaagaard joins from PFA, where he has been since 2016, working in a number of different areas, most recently being responsible for products and development. He succeeds Søren Lockwood, who was appointed managing director in February 2022. Lockwood will continue at Danica Pension until Kaagaard joins, before retiring.

JENNY GUSTAFSSON

Swedish AP Funds have appointed Jenny Gustafsson as head of the AP Funds' Council on Ethics. Gustafsson was recruited by AP1, AP2, AP3 and AP4, and will be responsible for continuing the development of the council's activities. She has many years' experience in sustainable investment, having previously worked with AMF and Handelsbanken, and has engaged in advocacy work in areas such as climate change and human rights.

KENNETH WILSON

Isio has announced two senior hires in its Scotland actuarial team. Glasgow-based Kenneth Wilson joins the senior management team as principal and brings 20 years' pensions experience to the role, having previously worked at Aon, where he was responsible for delivering actuarial, secretarial and governance services. Colin Dobbie has also been appointed as a senior consultant, joining from Barnett Waddingham.

FEKKO EBBENS

Neuberger Berman has named Fekko Ebbens as head of institutional Benelux. Ebbens joins from UBS Asset Management, where he was most recently global head of institutional client coverage. Prior to this, he was with Lombard Odier Darier Hentsch, where he covered institutional business development. Current head of Benelux, Cas Peters, will step into a senior adviser role and will continue to provide guidance to clients.

BENJAMIN LUCAS

Amundi has named Benjamin Lucas as chief executive officer, Amundi Technology. Lucas joins Amundi from KPMG, where he spent three years, most recently as UK head of asset management and the global head of asset management consulting. Prior to this, he held roles at EY and Alpha Financial Markets Consulting. Lucas is also a member of Amundi's executive committee.

CAROL YOUNG

The UK's Universities Superannuation Scheme (USS) has announced that Carol Young will succeed Bill Galvin as group chief executive. Most recently working as NatWest director of reward and employment, Young is expected to begin work at USS in September this year, while Galvin will continue to lead the organisation until then. Young has been with NatWest since 2014, previously spending almost five years as Heineken UK head of pensions.

COUNTRY SPOTLIGHT | DENMARK

The path to a sustainable future

Recent reforms to the system have addressed challenges posed by an ageing population and lack of private pensions, but additional issues remain unresolved

WRITTEN BY NIAMH SMITH, A FREELANCE JOURNALIST

Denmark has consistently been named as one of the best countries to retire in Europe, largely due to its pension system, which has attracted attention for its flexible and financially robust structure.

The Danish pension system consists of both private and public programmes – a compulsory state pension, a supplementary occupational pension and an optional private pension are available to the population.

The mix between tax-financed, pay-as-you-go public pensions and funded labour market pensions in the system has proven a very robust solution to several issues. Yet the Danish market is not without its challenges.

Ageing population

As in most developed countries, the biggest problem facing the Danish economy and its pension system is the challenge posed by an ageing population.

The country's total population of 5.82 million consists of 1.27 million people aged between 60 to 79 who are either in retirement or soon will be, according to Statista.

As a result, the workforce as a percentage of the Danish population is expected to diminish significantly over the next few years, creating a shortage of workers.

WTW Denmark co-CEO, Lars Christensen, explains that the elderly population's deteriorating health issues have also ramped up the pressure on public expenses and has contributed towards a shrinking workface.

"The important question is how we can secure a healthier workforce in the coming years, where we can address health issues in a more detailed and pre-emptive way than we do today," says Christensen.

To combat the challenges presented by an ageing population, Denmark's recent pensions reforms aim to keep workers in work for longer and help stabilise the economy.

Like many countries in Europe, one option has been to change the age of retirement. In 2022, the pension system's retirement age for both men and women was increased from 65 to 67 and upcoming changes plan to increase this again to 69 in 2035.

PensionDanmark, a labour market pension fund with €40 billion assets under management, chief economist, Tove Birgitte Foxman, praises the increased retirement age for effectively incentivising workers to stay in work for longer and for helping to address the lack of a workforce challenge.

The retirement age increase also reflects the country's growing life expectancy – currently 82 in Denmark – that is allowing more people to work later in life, he explains.

"Denmark has chosen a model where the retirement rate is indexed to increases in longevity," says Birgitte Foxman. "The mechanism is a cornerstone, at the same time securing sustainable public finances and labour supply."

"THE LEGISLATION CHANGES ALL THE TIME, WHICH WEAKENS THE DANES' TRUST IN THE SYSTEM. FOR INSTANCE, MANY YOUNG PEOPLE BELIEVE THE NATIONAL PENSION SCHEME WON'T EXIST WHEN THEY RETIRE"

Despite receiving praise, many experts argue the upcoming increase to the retirement age must not discriminate against the large number of seniors suffering with medical conditions.

The current pension system excels at supporting customers with a short-term illness as it provides a floor under every person's income to protect against unexpected life circumstances, says Sampension, a public pension scheme with €43 billion assets under management, head of market and customer advisory, Anne-Louise Lindkvist.

"The system is a supplement to the public health system, for example, helping pension customers get back to work fast in connection with short-term illness," she says.

However, Forsikring & Pension, a trade association for insurance companies and pension funds, deputy director, Karina Ransby, explains that to successfully continue increasing the retirement age, a system is required to support those physically unable to work due to persisting health problems, which are common in the elderly.

"We're in favour of this increasing retirement age. But if you aren't able to work, because you are run down, you should have some kind of pay, which right now is the big topic in the Danish parliament," says Ransby.

Retiring without saving

Many Danes do not have a workplace pension scheme and have not set aside additional savings for their retirement, and this is creating another problem for the Danish pension system.

Less than 5 per cent of workers have their own private pension. That group typically consists of self-employed workers and those without a collective agreement, says Ransby.

Although the percentage is small,

the place of private pensions remains an important issue, one yet to be adequately addressed or resolved by the Danish government, according to Ransby, who explains that a commission last year suggested that those who do not save should pay 3.3 per cent of their income into a pensions savings account.

However, this is viewed as an ineffective solution as 3.3 per cent is widely accepted as an insufficient amount to support a senior during their retirement years. "We're very keen on solving this problem for the 5 per cent who don't have their own pension savings. How do we get them to start a pension account?" asks Ransby.

Issues remain

Even though recent and upcoming changes to the Danish pension system have been commended, many commentators insist issues remain, which must now be addressed.

Akademiker Pension, a public pension provider with €17 billion assets under management, chief of membership, Vibeke Aagaard, praises the pension system for being "very flexible in accommodating changes in working life".

However, many pension schemes have urged the Danish government to amend the system to grant seniors greater flexibility in the way they choose to work. Sampension is one of these, with Lindkvist arguing the system should make it easier to work part time as a senior. She suggests the system should provide pensioners with the option to temporarily stop receiving their pension and return to work if they wish.

Ransby agrees and is critical of the current inflexibility in a system that stops many pensioners who want to work again from pausing their pension. "If you figured out that it was too boring or you are still too fresh to retire, it should be possible to pause your pension then work for a few years and then start your pension again," she says.

Introducing a change to the pension system to allow seniors to return to work in a more flexible way would also help reduce the workforce shortage created by an ageing population, adds Ransby.

Greater flexibility in the retirement system would not only benefit pensioners, argue supporters of the reform, it could also benefit savers under the current retirement age.

"It is worth considering increasing the flexibility for contributions so that people can plan their contributions according to life circumstances, and maybe to provide the opportunity for people to withdraw part of their savings along the way to support, for example, a career change," says Lindkvist.

Customers have also demonstrated an increased preference for sustainable investments, leading some pension funds to introduce climate policies.

This is another preference that could feature in a more flexible retirement system.

Birgitte Foxman suggests the government incentivise pension funds to introduce and adopt sustainable investment policies to this growing investor demand. "Some Danish pension funds have been pioneering the inclusion of ESG into their investment policies, and we would like to see this trend continue and be enforced over the coming decades – not least with respect to climate and national security issues," she notes.

Too much change?

While the recent changes to the Danish pension system are welcome, some observers believe the pace of regulatory change is making it difficult for many customers to keep up.

Lindkvist explains that even though the reforms are succeeding, the system has become so complex that ordinary people are struggling to understand it.

"The legislation changes all the time, which weakens the Danes' trust in the system. For instance, many young people believe the national pension scheme won't exist when they retire," she says.

The pace of change needs to slow down, concludes Lindkvist, and the pension system must be simplified and become more transparent to allow customers to understand how reforms will affect their retirement income.

GUEST COMMENT

Workers without pensions risk decline in retirement income

F&P's Karina Ransby, **highlights potential improvements to the Danish pension system**

WRITTEN BY FORSIKRING & PENSION DEPUTY DIRECTOR, KARINA RANSBY

Denmark has been ranked as having one of the best pension systems in the world, largely due to the large number of Danes who have supplementary private savings. However, not everyone has their own pension savings. Nearly 100,000 workers have no savings, and others have saved only a small amount. They largely consist of the self-employed and workers who don't have an employer-sponsored pension. They risk a decline in income as retirees if they do not save and only have the public state pension to live on.

Another group without their own savings are people outside the labour market, such as disabled pensioners and social assistance recipients.

They are characterised by relatively high replacement rates even without having their own pension savings, as the transfer income received while employed is roughly the same level as the income received from the state pension, including supplements, etc.

Those who have not saved for their pensions are more expensive for society in terms of public pensions. To encourage more people to save for their pensions, parliament introduced mandatory pension savings of 3.3 per cent of the public benefit for transfer recipients from 2020. This can be a way to start a pension savings plan. We want a flexible system so that if people want to save more, they can do so with a pension company, and they can also get insurance, especially for loss of earning capacity.

The Danish Pension Commission

While we have one of the world's best systems, there is always room for improvement. Parliament established a Pension Commission a few years ago. It is an independent commission of five prominent economists who examine our system and make recommendations.

In May 2022, it recommended the introduction of mandatory savings for the groups of workers and self-employed individuals who do not save for their pensions themselves, or save only to a very limited extent. The proposal follows on from the new mandatory pension scheme for transfer recipients, and the new government will look further into the possibilities of mandatory savings.

The Pension Commission also proposed to soften the increase in the retirement age. Its proposal would mean that state pension age in 2045 would be 70.5 years instead of 71. In the longer term, the difference will be greater. It is a good idea that the official retirement age increases in line with our increasing life expectancy. This ensures that we can have a stable Danish economy in the future. Unlike in other countries, there have not been significant protests against the rising retirement age in Denmark, as long as there is a possibility for physically worn out individuals to retire early.

The commission also proposed to increase the personal pension deduction and made a series of proposals to reduce offsetting.

Some of the proposals have already been enacted into law, and Forsikring & Pension (F&P) is working to ensure that more of the proposals will also be adopted, so that we can continue to strengthen our pension system. This includes making it more flexible to combine pension and work, for example, by allowing individuals to pause their annuity pension. F&P would also like to see the pension deduction near the retirement age raised to improve the incentive for retirement savings.

INTERVIEW

Making an impact

WRITTEN BY SOPHIE SMITH

Environmental, social and governance (ESG) factors have become an increasing focus for European pension schemes in recent years, and Sweden is no exception, with increasing pressure for funds to ensure that they are investing in line with savers' desires.

In addition to legal requirements in this area, previous research from Kantar Sifo and AP7 has shown that Swedes think that AP funds should take into account the environment and ethics when managing pensions, with a quarter suggesting that AP funds should do so regardless of the effects on pensions.

Despite this, the analysis found mixed views on how the capital sector can contribute to ESG, as about a third (34 per cent) of savers were doubtful as to the impact that pension funds can have on the environment.

Yet Swedish pension funds are keen to show that they can make an impact, with Sweden's AP7 recently outlining how it intends to contribute to achieving net-zero carbon emissions by 2050 in its updated Climate Action Plan.

With ownership in more than 3,000 companies around the world, AP7 acknowledged that it is within its interest that a transition that reduces climate risk occurs, and not just in its equity portfolio.

Taking the lead

Given this, the updated plan included several time-specified goals for AP7's active ownership and investments.

The fund also prioritised certain companies, after revealing that just 4 per cent of the companies in its total portfolio, corresponding to 10 per cent of managed capital, account for 70 per cent of carbon dioxide emissions.

Sophie Smith **sits down with AP7 active ownership manager,** Emma Henningsson, **to discuss the scheme's updated Climate Action Plan and its key areas of focus for the upcoming year**

This has not been the only recent ESG update from the fund, as AP7 also signalled its intent to place an additional focus on boards' responsibilities for climate change during the upcoming voting season.

Having already tightened its voting policy for companies in the Climate Action 100+ in 2022, the fund is now tightening those requirements even further in an effort to ensure companies with a high climate impact are taking the necessary steps against climate risk.

Putting the plan into action

Following these updates, Sophie Smith sat down with AP7 active ownership manager, Emma Henningsson, to hear more about the fund's upcoming plans.

Can you tell us a bit more about what prompted the decision to tighten your requirements ahead of the AGM season and the steps the fund has taken so far in line with this?

As a universal owner with a mission to generate pensions to our five million savers over the long term, we focus our strategy on managing systemic risks such as climate change. We believe that boards in high-emitting companies have a responsibility to shareholders and other stakeholders to make sure the company mitigates its climate risks and transitions its business to align with a net-zero pathway.

Using our vote is our most

far-reaching tool to influence our portfolio companies. We vote at over 4,000 meetings each year and have an ambitious climate stance which results in support for many shareholder climate proposals. As part of our Climate Action Plan launched in 2022, we have been further developing our voting policy in order to reach more companies through core agenda items such as board re-elections.

We are using our votes to indicate dissatisfaction with board members in companies with insufficient transition plans, something we started to implement last voting season and have now extended in scope and expectations. We primarily target the board members that have responsibility for climate reporting and climate strategy.

More broadly, how does AP7 weigh up whether to influence companies via exclusions or to influence through owner control?

We strive to mitigate climate risks in the real economy, and we do not achieve that by selling our shares on a secondary market. We need to actively use our influence as owners to compel companies to develop and implement a credible climate transition strategy. We have a number of tools in our toolbox, but we do not believe that selling shares in listed companies would automatically make the company transition.

The fund has also supported specific action against Tesla around corporate governance. Can you tell us a bit more about how AP7 is looking to engage on the topic of governance?

We will focus on board accountability in our thematic work going forward, exploring this topic from AP7's perspective as a government pension fund and universal owner. Hopefully we will have a lot more to say on this question in a year or two. But we will clearly have a stronger focus on boards and board members' responsibility for material sustainability issues.

And how does the fund measure the impact of its ESG efforts, particularly in light of the targets set out in its Climate Action Plan?

So we have two types of targets – activity goals and result-oriented goals. The activity goals hold us accountable to something within our control – our active ownership activities towards high-emitting portfolio companies, such as voting and engagement. This measures the actions that we can take to incentivise companies to increase their climate ambitions and actions.

The result-oriented goals look at the proportion of companies that are undertaking credible transition work, which we evaluate using publicly available data from investor initiatives, such as the Transition Pathway Initiative and Climate Action 100+.

We use indicators such as whether the company reports its emissions and has set credible targets. Our goal for 2025 is that 50 per cent of companies will have credible transition work underway, increasing to 100 per cent by 2030.

Are there any other specific areas that AP7 is looking to address, such as biodiversity or water issues, and how is the fund looking to make change?

We work on two fronts:
1) Developing industry norms and standards – in the case of nature-related risks, this is done through our work in the Task Force on Nature-related Financial Disclosures (TFND). We are one of two asset owners that are active members of the TNFD, so we are heavily involved in the development of this disclosure framework for organisations to report and act on nature-related risks including water, biodiversity and climate change.
2) Active ownership, such as engagement with high-risk companies through Ceres Food 50 and other initiatives, and through voting actions. This year we will use our votes to mark dissatisfaction with companies that have a high risk of deforestation in their supply chain and which lack fundamental measures to manage this risk. Where possible we vote against relevant board members, otherwise against other core agenda items. In addition we also collaborate with academia to develop a better understanding and tools for investors (e.g. FinBio).

"USING OUR VOTE IS OUR MOST FAR-REACHING TOOL TO INFLUENCE OUR PORTFOLIO COMPANIES"

PUBLIC PENSIONS

Finding a way out

As France continues to be rocked by pension protests, many other European countries have been considering how they can ensure the long-term sustainability of their own pension systems, while avoiding a similar backlash. Sophie Smith **reports.**

WRITTEN BY SOPHIE SMITH

Protests have continued across France after President, Emmanuel Macron, signed his pension reforms into law on 14 April, with the French state pension age (SPA) set to increase from 62 to 64.

The reforms navigated their final hurdle after the key aspects of the bill were approved by the Constitutional Council hours before it was signed into law. But the changes, particularly the increase in SPA, have proven deeply unpopular and sparked nationwide protests.

Yet despite the backlash, Macron has repeatedly stressed the need for change, arguing that the reforms are essential to make the nation's pension system more affordable, with the system forecast to run at a deficit in its current state.

This is not an isolated view, as the European Commission previously stressed the need for change in the French pension system, with public pension expenditure estimated at 14.6 per cent of GDP, the third highest in the EU.

Pressure for change is also growing, as Finnish Centre for Pensions (ETK) senior adviser, Antti Mielonen, points out that life expectancy in France is high, with further improvements expected down the line despite the negative downturn prompted by Covid-19.

And whilst increasing the SPA has not proven popular, Mielonen warns the alternatives, raising contributions or increasing state debt, may not win much more public support.

Now Pensions head of DC pensions, Stefan Lundbergh, agrees, stating that most, if not all, of the levers available to improve financial sustainability are unpleasant for savers, who will either have to pay more, receive less, or retire later.

France is not the only country having difficulties in passing pension reforms, as Mielonen admits that raising retirement age is not something people are cheering about, with particular similarities in Switzerland. ”People may not at all be against the pension reforms suggested by the government, but they are against government’s other political solutions,” he says.

In fact, PensionsEurope CEO, Matti Leppälä, says that financial sustainability more broadly is a common concern across the European pension systems, pointing out that EU member states were asked to reform pension systems to ensure the sustainability of public finances within the framework of the European semester.

Lost in the crowd

The UK also recently made headlines with potential changes to its SPA *[see boxout],* whilst the Spanish parliament has introduced a number of pension reforms aimed at addressing the rising number of retirees *[see page 9]*.

And whilst the UK and France have focused on SPA changes, the reforms in Spain look to increase workers’ pension contributions.

Spanish union CCOO said the changes will lay the foundations of the public system for at least the next two decades, with general secretary, Unai Sordo, highlighting the reform as a “historic agreement”.

Despite the so far positive reception in Spain, Mercer partner, global DB segment leader, Graham Pearce, says that raising company contributions to pension plans increases labour costs, and can act as a deterrent to invest in a country.

Looking at whether this could be an option for European pension systems more broadly, Mielonen also points out that rates are high in many countries already. However, he admits that some countries, such as Germany and the Netherlands, have circumvented this by increasing the share of tax revenues in the financing of pensions.

With all of these factors at play, it can seem like there is no route forward to ensure financial stability for future generations without placing a burden on older savers.

There are some options to help soften the blow though, as Pearce points out that an automatic increase in retirement age, based upon expected life expectancy or healthy

Failed intentions?

NOW PENSIONS HEAD OF DC pensions, Stefan Lundbergh, highlights the Swedish pension system as a best practice example when it comes to generational neutrality, explaining that financial sustainability across generations was an important factor in the system’s design, as well as being separate from the state budget.

“It’s extremely difficult to get politicians to do something like that, even if it’s the right thing to do,” he adds.

Yet despite the intergenerational strengths of the Swedish pension system, the Swedish Pensions Agency (SPA) recently encouraged the government to appoint an inquiry to evaluate the public pension system and make suggestions for improvements, in light of “fundamental flaws” in the existing system.

In particular, the SPA raised concerns that the lifetime income principle determines the size of the pension to a lesser extent than intended.

“We are not in a desirable situation in Sweden today,” SPA head of analysis, Ole Settergren, stated. “The lifetime income principle has been put out of use due to the political interventions of recent years.”

Lundbergh says that the report highlights the importance of maintaining and evolving the pension systems as society evolves, describing the report as an attempt to create a debate in Sweden on how to adapt the pension agreement from 30 years ago to make it more future proof.

However, in a seminar on the research, LSE professor, Nicholas Barr, argued it would be a shame if Sweden gave up a well-functioning system. Given this, he argued that Sweden should look to increase pension contributions and reform basic protection, rather than look to introduce a basic uniform pension that is the same for everyone.

Whether the necessary changes will be made is yet to be seen, however, as Uppsala University professor of political science, Joakim Palme, said that she has “given up hope for the future in terms of the pension debate, because no one seems to be able to make the necessary decisions”.

life expectancy, as seen in Sweden, can make changes in retirement age less unpopular, as any shift is in line with a previously agreed formula.

Braced for change

Indeed, Lundbergh says that not only can this provide an out for politicians, with change occurring on a status quo basis, it should also encourage small incremental change, rather than a large increase or jump.

And the benefits of such an approach are already being demonstrated, as Leppälä cites recent projections by the European Commission, which revealed that member states utilising automatic adjustment mechanisms would all experience a decline in pension expenditure in the future.

Those countries that have already adopted similar approaches have also provided some lessons learned.

Mielonen, for instance, says that experiences from other countries have shown that linking retirement age 1:1 to life expectancy seems to be too severe, as this would raise the retirement age too quickly, as well as change the proportion of retirement in relation to working life.

"A better target would be to keep it stable," he says, noting that the Netherlands and Denmark, for instance, slowed down the pace of increases in retirement age from 1:1.

However, Pearce warns that this type of mechanism can also bring unintended consequences, with Portugal recently seeing its pension age fall by three months (to 66 years and four months) as a result of the extraordinary mortality rates seen amid the pandemic.

And given the unequal impact across society, Phoenix Insights director, Catherine Foot, warns that linking the SPA to longevity predictions is not an adequate policy response to the affordability challenge of the system.

"Similarly," she says, "many people fall out of work because of ill

Avoiding the problem

CONCERNS AROUND A potential state pension controversy recently made headlines in the UK, as the government contemplated bringing forward an increase in the state pension age (SPA) against the backdrop of the French protests.

These concerns may be well placed, as research from Penfold found that 67 per cent of Brits disagree with raising the SPA, while nearly a third (28 per cent) of Gen Z and Millennials would protest the SPA being raised.

And with industry experts warning that an increase in SPA could mark 'political suicide', it is perhaps unsurprising that the government later shelved its apparent plans to bring forward the increase.

PensionsEurope CEO, Matti Leppälä, agrees with this decision, pointing out that the UK will already have one of the highest state pension ages in the OECD when it reaches 67 in 2028.

"Healthy life expectancy, and the gaps between years of life in healthy and unhealthy

conditions, need to be taken into account when deciding state pension age to ensure that the single age is set fairly across generations," he says.

But political motivations may also play a factor, as the UK government confirmed that a further review to reconsider the rise to age 68 is expected within two years of the next parliament.

And despite life expectancy increases stalling in recent years in the UK, Phoenix Insights director, Catherine Foot, says that it remains likely we will see an acceleration of the SPA increase at some stage.

"What is critical is that alongside any rise in the state pension age," she adds, "there is a package of measures committed to that seeks to ensure that those who aren't able to remain in work are supported."

Now Pensions head of DC, Stefan Lundbergh, suggests that an automatic link with longevity could also prevent this becoming a political issue again in future.

However, Lundbergh warns that change is needed soon, warning that otherwise, it could be a case of too little, too late.

"WE NEED TO MAKE POLICIES GENERATIONAL NEUTRAL SO WE ALL SHARE THE BURDEN AND BENEFITS TOGETHER, BECAUSE WE CANNOT KEEP PLAYING GENERATIONS AGAINST EACH OTHER"

health and disability years, and in a significant number of cases, decades before reaching SPA. This group faces higher risks of poverty in later life with an ever-increasing SPA, so reforms to the system are needed to ensure they are not left behind."

ETK liaison manager, Mika Vidlund, however, says that although some countries have found a universal increase somewhat problematic, solutions are emerging.

"Finland and Denmark have recently established early retirement options for people with long careers either in physically or mentally arduous jobs," he notes, explaining that such measures could also increase the popularity of the reforms.

Lundbergh remains wary of this route though, warning that it can often prove difficult to determine which careers should be deemed worthy of an exclusion.

In practice, WTW senior international benefits consultant, Valentina Rocchi, also notes that more countries have opted to link the benefit level, rather than pension age, to longevity predictions, some more explicitly than others.

Indeed, according to the OECD, more than half the OECD countries have elements in their mandatory retirement-income provision linking pension benefits to life expectancy.

Creating a future proof system

However, Rocchi warns that although restoring the balance in these ways seems sensible, it needs to be done thoughtfully, considering affordability and phasing-in to allow savers time to adapt to the changes.

"The risk is that these changes only introduce temporary stability," she continues. "The other problem is that it creates unfair distribution of capital between the young and old – there is no guarantee that the young workers today paying high contributions for the current pensioners will receive equivalent pensions when they retire."

Foot says that affordability is only one part of the picture, arguing that effective state pensions need to be sustainable, but also adequate in value to those receiving them, and fair in terms of both who pays for them and who gets access to them.

Rocchi also says that equity and fairness across generations will face increasing scrutiny: "There needs to be a balance in the state systems to ensure that both workers and retirees 'pay' a fair price for increasing longevity and lower birth rates."

"We need to make policies generational neutral," Lundbergh agrees. "So we all share the pain and burden together, the old and the young, because we cannot play generations against each other."

Alongside intergenerational issues, Vidlund says that a wide consensus is needed to ensure long-term political sustainability of any reform.

However, whilst Lundbergh acknowledges the importance of cross-party support, he says that, at times, politicians need to be bold enough to push change through, even where it might not prove popular, as recently seen in France.

"I would like politicians to stand up and do what's right, because we face a massive challenge in dealing with changing demographics. It's not just pensions, but also how we're going to fund our society," he says.

In fact, Lundbergh says that politicians may be underestimating savers, arguing that a candidate that makes the difficult choices could be seen as a real leader, rather than simply another candle in the wind.

But with further protests scheduled in France for June, and an opposition bill aiming to repeal the recent reforms, tensions over this issue seem set to persist. For the time being, others will have to wait and see if a clearer way out is revealed.

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CURRENCY FOCUS

Finding opportunities

Active currency hedging

Mesirow Currency Management senior investment strategist, Uto Shinohara, outlines the benefits active currency hedging can provide to European investors

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Moving to the fore

Currency management has moved to the fore due to changing monetary policy, and geopolitical and banking crises. Lynn Strongin Dodds explores the opportunities this presents to pension funds

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Shielding your investment:

The power of active currency hedging

Mesirow Currency Management senior investment strategist, Uto Shinohara, **outlines the benefits active currency hedging can provide to European investors**

WRITTEN BY MESIROW CURRENCY MANAGEMENT
SENIOR INVESTMENT STRATEGIST, UTO SHINOHARA, CFA

European pension plans invest their assets broadly, distributing them geographically across the globe, in order to access the most compelling opportunities. With only about 55% of assets from pension funds invested domestically, just under half of assets reside in international investments according to the *ECB Economic Bulletin* issued in July 2020. At the higher end of the spectrum, the Netherlands' long-standing tradition of favouring international investment is evident through the 91% of Dutch assets invested abroad as of 2020 (according to *OECD's Pensions Markets in Focus*). With international investments materially impacting the portfolio, managing currency risk becomes an important consideration.

Euro Fluctuations and Currency Risk

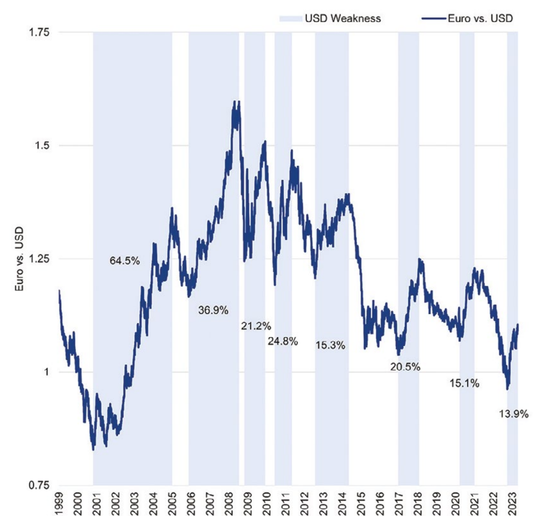
Since its introduction in 1999, Euro has experienced numerous structural movements that have meaningfully impacted international investments. With the United States accounting for a large percentage of international assets due to the country's leading economic presence, substantial market share, ample liquidity, and political stability, the movements of Euro vs. US dollar are highly influential on portfolio outcomes. The following chart displays the path of EUR-USD since the inception of Euro, with shaded regions representing periods of US dollar weakness, i.e., when USD investment returns have suffered due to movements in the underlying currency. Sustained, high magnitude episodes of US dollar weakness have occurred, ranging from over 60% in the early 2000s to the current episode that began in late September 2022, registering close to 14% so far.

As a result of currency impact, investments in US securities can face substantial headwinds. Although the EUR-USD relationship is marginally in US dollar's favor over the past 20+ years, double-digit currency losses over periods as long as 4-years present significant drags on performance, especially as the time horizon to evaluate investment strategies have tilted shorter. While long-term returns have netted to marginal US dollar strength over the time period, the annualised risk from the currency exposure measured at over 9%, i.e., uncompensated risk.

Active Hedging Benefits

While passively hedging currency exposures reduces currency risk in the portfolio, this approach applies a blunt instrument when compared to the benefits of active risk management. There is lost opportunity when currencies rise, and there can be an inherent carry penalty from the instruments typically used to hedge, notably FX forwards and futures.

Passive hedging is naïve, in that all currencies exposures are typically managed identically. With central bank policies differing among regions along with other area-specific drivers evolving over time, their movements against Euro are not uniform.



The chart on the right displays spot movements of the 3 largest exposures typically found in international portfolios over a 6-month period last year. While Sterling and Yen exhibited similar weakness relative to a stronger Euro, US dollar gained substantially over the same timeframe, with passive hedges against Sterling and Yen netting positive cashflows while those against US dollar produced strongly negative cashflows. Different views on different currencies create opportunities. Active hedging provides a means to hedge against episodes of currency weakness while enhancing returns by participating in currency gains at a currency-specific level.

For European investors, carry has historically been a structural cost for passive hedgers. In an MSCI-weighted normalised portfolio of the 6 largest exposures, the carry-penalty to fully hedge the portfolio has been -1.80% annualised since 2005 through Q1 2023. A thoughtful, strategic active hedging program can help offset the carry penalty while managing currency risk in the portfolio.

Insights & Outlook

The strong influence of central bank policy on currency movements last year has continued into 2023, as the ECB and other central banks balance sustained inflation against recessionary pressures. The Fed's hawkish push in 2022 drove US dollar higher relative to Euro with a comparatively slow-moving ECB. As the ECB began closing the policy gap vs. the Fed in the latter part of 2022 into 2023, Euro has been resurgent, rising in tandem with the lowering interest rate differential between regions.

For European investors with international portfolios, active hedging can navigate this changing backdrop with more flexibility than a passive hedge while having the potential to be compensated for the currency risk inherent in global investments. As central banks reach their terminal rates and consider cutting rates, policy divergence across regions will continue to drive FX markets this year, creating active hedging opportunities. Improving risk appetite and China's reopening has been Euro-supportive, putting pressure on currency exposures. With FX volatility increasing from the historical lows in 2020 and 2021, a currency hedging policy with a dynamic, active element can help steer the portfolio through the turbulence.

Source: Mesirow, Bloomberg

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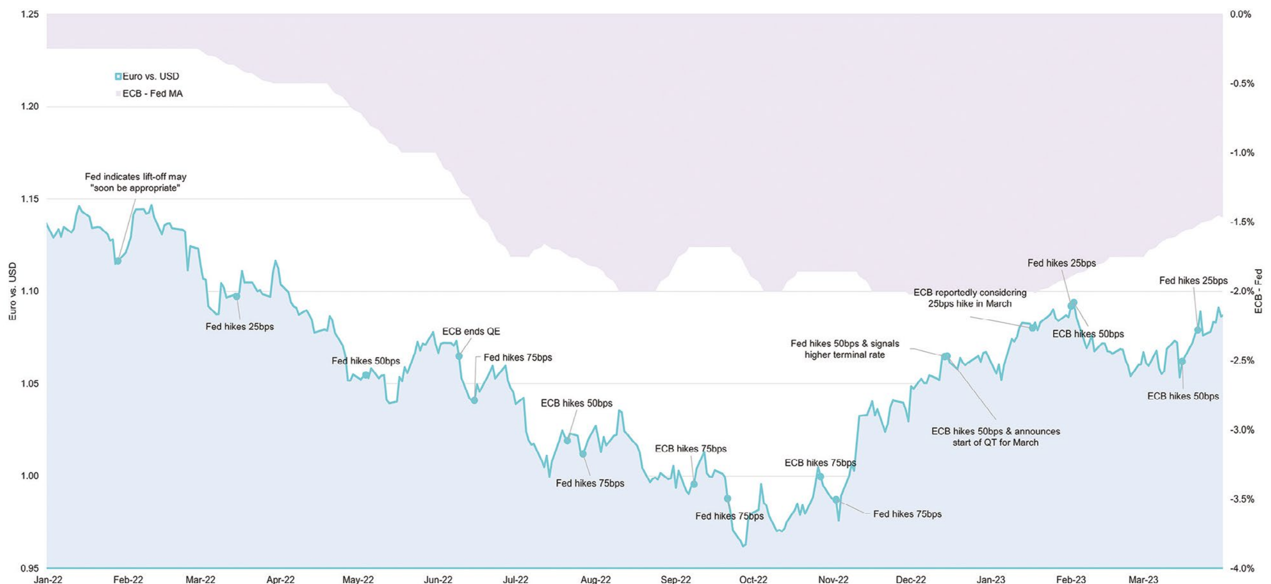

Source: Mesirow, Bloomberg. 20D centered moving average of interest rate differential between the ECB and the Fed.

INVESTMENT

Moving to the fore

Currency management has moved to the fore due to changing monetary policy, geopolitical and banking crises. Lynn Strongin Dodds explores the opportunities this presents to pension funds

WRITTEN BY LYNN STRONGIN DODDS, A FREELANCE JOURNALIST

Foreign exchange (FX) has always been a feature of European pension funds, but it has not been at the forefront for a few years. Activity had been muted due to a benign economic backdrop but diverging monetary policies, a banking crisis and increased geopolitical risks has pushed FX higher on the agenda.

It is particularly important for those schemes at the larger end of the scale with a hefty chunk of assets exposed to the vagaries of FX markets. Mesirow currency management CEO, Joseph Hoffman, cites the 2022 OECD *Pension Markets in Focus* report, which shows the share of assets in foreign currencies in European pension funds ranged from about 10 per cent to over 50 per cent.

"Currency management took a back seat until last year," says Mercer partner, strategic risk management: Europe zone leader, John O'Brien. "Given where yields had been, pension funds and corporates had been more focused on the core building blocks needed to manage liability risks and improve funding levels. However, there is more attention now that yields have risen as schemes are better hedged and can focus on other risk-reward trade-offs."

Opportunities

In the immediate aftermath, the US dollar went into a tailspin as fears of a repeat of 2008 spread. The result was that the popular EUR/USD currency pair surged to a one-month high in mid-March after breaking through the downtrend line from February to $1.0638. In the first four months of the year, the dollar dropped from a 20-year high last September as investors adjusted for the likelihood that the US Federal Reserve was near the end of its tightening cycle, while peers including the European Central Bank became more hawkish.

Markets are pricing in the Fed cutting rates in H2 2023 but, despite the economy slowing, there are still

pockets of strength, which is making investors hesitant to get too bearish on the US currency for now.

Hoffman notes that the movement of the dollar is of particular importance to European pension funds given it is their largest foreign currency exposure: "The fact that the greenback has been appreciating over the past decade, investors may want to consider a higher hedge ratio to capitalise on a reversion."

He believes tighter central bank policy, combined with unexpected events such as the ongoing war, has "created more opportunities in the currency market for investors looking to either actively hedge their currency risk or use currency as a source of alpha and diversifier".

Hoffman notes that investors can either passively hedge their currency risk, with the primary objective of reducing or eliminating the volatility created by the currency exposure of their underlying assets, or actively hedge their currency risk, which can minimise currency volatility while enhancing returns.

The strategy, of course, depends on a scheme's journey plan and asset allocation, according to Hymans Robertson chief investment officer, David Walker: "For example, open funds or schemes with longer time horizons are more likely to have higher exposures to equities and asset classes where they will invest globally to maximise their opportunity set. When investing globally they will then have an active decision to make around whether to accept this currency exposure, leaving it unhedged, or seek to hedge the exposure to a pre-agreed level."

Walker says: "When funds are investing in fixed income and credit assets classes, where the returns are focussed on the delivery of a series of income and capital payments, the vast majority of our clients are likely to hedge all of the exposure to reduce the risk currency movements could have on return."

In general, Walker notes, currency management is primarily used to reduce risk by hedging exposures back to a pension fund's base currency. The diversification benefits of retaining some currency exposures are considered when investing in asset classes such as equities where the fund sets a pre-agreed hedging level, which provides a balance of risks and retains some level of exposure.

As for individual strategies, one popular option, notes Russell Investments global head of currencies, Van Luu, is to use FX forwards as part of a currency overlay to hedge out currency risk from long-only assets. "Pension funds can use the existing infrastructure for their return seeking currency strategies and no upfront capital is required."

By selling an appropriate amount of foreign currencies forward, hedging creates positions that move opposite to the currency exposures in the underlying portfolio.

Share class hedging is also fashionable. It aims to reduce the impact of exchange rate fluctuations between the fund's base currency and the investor's preferred currency of exposure.

Look-through hedging combines elements of both portfolio overlay and share class hedging by hedging the fund's asset currencies at a share class level.

The path ahead

Looking ahead, Hoffman believes that pension schemes will be taking a more active stance. "Over the past year, investors experienced significant declines in both equities and bonds," he adds. "Bonds have historically played the role of a diversifying asset class to equities. Given that the relationship between bonds and equities collapsed last year, we believe investors will look for alternative sources of return, which could lead to greater adoption of currency as an asset class."

He notes that currency-for-return strategies have historically had low to negative correlations to other asset classes, including alternatives. "Unlike other alternative investments, currency strategies are very liquid, with $7.5 trillion traded daily," he says. "This makes them a flexible and cost-effective option."

Luu agrees, noting that between 2017 and 2020, active currency management was lacklustre because there was little currency volatility. "However, after the pandemic, there was more divergence in interest rates and more pronounced trends that emerged," he adds.

Another trend gaining traction is outsourcing, which is not surprising given the current backdrop of increased complexity, reduced margins and more stringent regulations. It is well established in the back office, but many front office operations are increasingly being hived off to a third party.

The first step, according to Mercer partner, head of investments, wealth Europe, Eimear Walsh, is to look at the total cost of ownership to determine which is the best option: "They need to have a good understanding of the risks and should be open minded about how they approach it. However, at the trustee level, there is typically little appetite for the scheme to second guess currency markets and they are happy to delegate active currency management to a fiduciary or underlying asset manager."

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The right direction?

As European pension funds continue to operate in the shadow of global uncertainty, high inflation and climbing interest rates, we ask what investment strategies are currently in favour across the continent

WRITTEN BY FRANCESCA FABRIZI

Investment strategies at play among European pension funds are rarely homogenous, with investment teams not only having to adjust their decisions according to local pressures such as their own pension regulations or reform, but they are having to consider more than ever what's happening in the global economy.

"The current environment, and mostly the changes in the interest rate environment, have driven many of the conversations we are having with pension funds over the past few months," says WTW head of investment, Europe, David Cienfuegos. "Some funding positions have materially changed from what they were a year ago, and that has forced pension funds to reconsider whether their investment strategy is still the best strategy for them today."

State Pension Fund of Finland CEO, Timo Löyttyniemi, agrees that the economic situation is front of mind: "The biggest theme for us during the past two months has been what's happening in the US banking industry, and what the consequences of that will be for the future of financial markets overall."

Alongside this, he adds, the fund is keeping a close eye on the actions of the central banks. "Everyone is expecting inflation rates to come down, but central banks are hesitant and they need more data in order for them to change their policies."

One key impact of the rise in interest rates, says Löyttyniemi, is the attractiveness of fixed income. "Now that interest rates have risen, all fixed income investment securities are more attractive in general, government bonds included, which is a phenomenon of this year and last; and that's healthy for investment markets and healthy for investors because fixed income securities also provide hedging at times of turmoil in the market."

As a result, fixed income investments, especially investment-grade credit and sovereign bonds, says Aviva Investors head of Europe, Torben Dunkel, are "back with a vengeance" after "years of insufficient yields for the majority of institutional investors".

In the context of corporate credit investments, he adds, the decarbonisation and transitioning towards a net-zero carbon emissions economy is also gaining traction with institutional investors.

Additionally, says Dunkel, investors are considering the opportunities in real assets, with a preference currently for private debt strategies, especially real-estate debt and, with further margin improvements, infrastructure debt. "Institutional investors are also considering value-add/core+ real estate equity, to profit from the markets dislocation," he notes.

These trends, explains Dunkel, are being driven by the fundamentally changed interest rates regime, whereby markets rapidly adjusted to the inflation spike and require adequate compensation. "In that sense, they are a common sense asset allocation trade for investors, which also helps to address the denominator effect in investors' portfolios, where available quotas for private market investments have already been widely used."

Dunkel believes these trends also offer tactical and opportunity-based investing, "for investors looking for attractive relative value across the spectrum of opportunities, which has been made available by the rapid rise of assets' individual discount rates, alongside the rise of the risk free rate".

LGIM head of Europe, institutional, Volker Kurr, also notes the comeback of fixed income as an asset class in general and especially for EUR investment grade. In addition, self-indexation respectively customised indices have become much more popular, he comments, with the benefit of capturing the ESG framework of investors in a very cost efficient way. "We also note that the strong demand for private markets has come down over the past 15 months," he adds.

Again, Kurr notes the impact that interest rates are having on investment decisions: “We have seen the fastest rise in interest rates for decades, if not centuries, with double-digit negative performance in 2022 across many asset classes including fixed income. The flip side is that fixed income may be very attractive going forward.”

Many pension funds, he continues, have target returns of three to four per cent per annum over the cycle. “End of 2021 asset classes like EUR investment grade had an expected return of below 1 per cent.

“Currently, it is around 4 per cent, which means that a conservative asset class can deliver expected returns and make its comeback as a core asset class.”

In terms of equities, he continues to see the trend to indexing “and a substantial demand for strategies that help investors decarbonise their portfolios”.

Regional differences

In terms of differences between regions, DACH, Italy and Spain, notes Kurr, are traditionally regions where allocations to fixed income are preferred, whereas regions like the Nordics traditionally have a very high equity allocation. Additionally, he remarks, the Netherlands and the Nordics are leading in ESG: “As a result, many investors develop specified sustainability objectives under an enhanced regulatory framework.”

Countries going through pension reform however, like the Netherlands, are also likely to be re-visiting their strategies, says Cienfuegos: “If you have a pension scheme in the Netherlands at the moment, and you’re moving from DB into some sort of DC, likely to be collective DC, what you’re figuring out is, is my current investment strategy aligned to what I will need after the transition to the new system? Will the way in which I design an investment strategy be materially affected? Is my liquidity profile today in line with the liquidity profile that I might need in a DC environment? Those are the considerations.”

“THE BIGGEST THEME DURING THE PAST TWO MONTHS FOR US HAS BEEN WHAT’S HAPPENING IN THE US BANKING INDUSTRY, AND WHAT THE CONSEQUENCES OF THAT WILL BE FOR THE FUTURE OF FINANCIAL MARKETS OVERALL”

The pension reform in the Netherlands, says Kurr, could, for example, lead to LDI refinement, buy-and-maintain/active credit and a wider appetite for illiquid/alternatives.

Pointing specifically to the Nordic and Benelux region, investment trends are arguably not as clear as they may have been a few years ago, where everyone was looking at private markets, argues Franklin Templeton institutional sales director, Remco van Dijk.

There are clear exceptions, he adds, with the large pension funds, both in the Nordic and Benelux regions, still looking at private markets, yet this is being done more selectively. “Real assets, and mainly infrastructure, remain to be a topic of interest.”

On the private debt side, van Dijk continues to see interest, yet more, he argues, "from a barbell-perspective i.e. senior debt or (dis) stressed debt, where a few years ago, pension funds were more looking at core, middle-of-the-pack exposure".

Infrastructure, says van Dijk, is very popular from a risk/return perspective, mainly because of the inflation protection the asset class tends to offer, "and where applicable, (dis)stressed debt seems to be popular from a market timing perspective".

In public markets, specifically, he notes that the 'income' in fixed income is back, with more focus on investment grade credits, quite often with a keen eye on short(er) duration.

"Then within the equity allocation, if there is any demand, it focuses on emerging markets equity. In the Nordic region, we also see demand for climate change (article 9) funds."

Finally, in the Netherlands, explains van Dijk, regulation, sustainability and fee pressure also play a big role in investment decisions. "To give an example, regarding equity investments, active management is more expensive than passive management. Also, tracking error, is considered a 'risk' from a regulation perspective. Finally, pension funds have extensive ESG policies in place. Because of these three elements, the starting point is quite often a customised benchmark, replicate this passively."

There are also regional differences when it comes to passive versus active. "In public markets, in the Benelux, equity allocations are still mainly passive. Large fiduciary managers work with benchmark providers to build their customised benchmarks, which are replicated passively."

In the Nordic regions, however, equity allocations are still active allocations. "Here, there's more emphasis on thematics like climate change."

Looking ahead

Going forward, one major trend in the DB space, says Cienfuegos, is likely to be a transition from growth specific assets, to a focus on cashflow-generating assets, given the current funding levels compared to a year ago.

"If you are very far from your funding position and you need to incorporate into your portfolio assets that will allow you to close that gap, that's a different strategy to a position where you are looking for the type of cashflow profiling that would allow you to be more aligned to the needs of your membership and your scheme.

"That's one of the biggest changes that we're going through at the moment – how you actually transfer from, for example, a heavy, private-equity driven, alternative space portfolio to a more diverse, more cashflow-driven composition of your private markets exposure."

Finally, he concludes, ESG runs like a red line through every single conversation. "For many pension funds, the overall sentiment is, we are at a point of high uncertainty, therefore, protecting capital and having more resilient portfolios is our priority, but they acknowledge that there might also be opportunities that, selectively, they're going to pursue."

Will the conversation then focus around other aspects? Absolutely, he adds: "Big Dutch, German or Spanish pension funds are thinking, with my allocation to equities and investment grade, how are my mandates designed? Am I able to have an impact?

"They're revisiting what the equity allocation looks like, the mandate that they have with the managers. They're revisiting the credit, investment grade credit, traditional, plain vanilla portfolio, how it looks, and what the objectives are, because they probably have a new roadmap to be more impactful. That's the general theme.

"If you take it to the extreme, the net-zero pledge is a big contributor to some of these considerations. Some large pension funds who committed to that net-zero pledge are still figuring out what their portfolio needs to look like in order to meet those objectives, what the carbon journey needs to be, for them to not negatively impact their members."

Futureproofing 13 million Dutch pensions

Federation of Dutch Pension Funds chair, Ger Jaarsma, **looks ahead to the Netherlands' transition to the new pension system**

WRITTEN BY FEDERATION OF DUTCH PENSION FUNDS CHAIR, GER JAARSMA

With the Dutch Future Pensions Act close to having Senate endorsement and thus becoming law on 1 July 2023, it's the right moment to look ahead to major tasks and important choices for pension funds. But first, let me reflect on the reasons for conceiving the Future Pensions Act in the first place.

The Netherlands faces the common demographical fact of an ageing population. While pensioners made up only 13 per cent of our population in 1990, right now 20 per cent are 65 years or older. Moreover, 5 per cent of the total has passed the age of 80. The number of senior citizens continues to rise, and this phenomenon will abate only slightly beyond 2040. This raised questions on the sustainability of the system.

Then there's the job market. Younger generations are often self-employed and those in the more conventional jobs are increasingly wondering what their financial future will hold, if and when they reach the then-pensionable age. Given the improved life expectancy we have already shifted this age from 65 to 68 in the recent decade, without noticeable upheaval.

Pensioners once upon a time expected their monthly income to increase if the economy performed well. Alas, the current system focuses heavily on maintaining a solid financial foundation. In practical terms, this meant for a lot of pension funds that, while interest rates were low, no raise was possible from September 2008 to December 2022. A sizeable majority of pensioners experienced no appreciable improvement of income for a stunning 15 years.

The Future Pensions Act aims at maintaining a solid financial perspective for pensioners of today and beyond 2040. This entails moving to a hybrid DC system that bears characteristics of individual and collective DC systems.

Most, if not all, 166 Dutch pension funds eagerly await the Dutch Senate's verdict on this proposal, but realising the enormity of the operation, they are also busily preparing for it. Individual datasets of roughly 10 million workers and 3 million pensioners are being checked. When faults are found they must be rectified before the transition, which must be set between 1 January 2024 and 1 January 2027.

Each Dutch pension fund chooses their transition date based on assessments of their executive administrating organisation. They are now engaged in connecting pension administration even more firmly to asset management, to inform workers and pensioners of their expected income or pension raises – which become more likely than in the past 15 years – and possibly pension cuts, since the new system allows more risk either way.

But more choices need to be made. Trade unions and employer associations are heavily involved in pension fund governance. Four years ago, they delivered the broad foundation for the new law, agreeing on a long-awaited Pension Accord. On many lower levels they now face important decisions as well. Even opting out is a possibility. Smaller pension funds might decide not to go along in the transition; they must decide how to best serve their participants' interests in an alternative manner. Over the years we have seen insurance companies take over smaller pension funds.

Major improvements have already been realised in communication between funds and participants, but a still better performance is necessary. While most workers tend to shy away from the subject, their pension funds must nevertheless inform workers continually on choices, inquire their risk preferences and communicate on progress towards a more transparent system.

In scope and size, this is a unique operation, involving the redistribution of a phenomenal €1,500 billion. Still, Dutch pension professionals look ahead with cautious optimism, the consensus being that while time is rather short, the transition can be executed properly.

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SPEAKERS INCLUDE:

Jana Bour, ESG Policy & Advocacy Manager, EPRA (European Public Real Estate Association)

Francesco Briganti, Secretary General, CBBA-Europe

Philippe Dutertre, Finance & Investments Director, Ag2R La Mondiale

Evalinde Eelens, Executive Board Member, BPF Particuliere Beveiliging; Board Member, BPF Schilders; Board Member, PostNL corporate pension scheme

Snædís Ögn Flosadóttir, Managing Director, Pension Funds EFIA and LSBI

Alistair Jones, Managing Director, Business Development and Head of ESG, Leadenhall

Matti Leppälä, Secretary General/ CEO, PensionsEurope

Timo Löyttyniemi, Chief Executive Officer, The State Pension Fund of Finland

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

Hedwig Peters, Pension Fund Board Member of multiple Dutch pension funds

Jan Petersson, Senior Portfolio Manager, AP4 fund

Falco Valkenburg, Vice-Chairperson, EIOPA OPSG

Thierry Verkest, Partner, Aon & Actuary and Risk Manager of Several Pan-European Pension Funds

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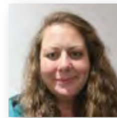


Emma Weston-Green, Scheme Secretary, Royal Mail Collective Pension Plan

DEFINED BENEFIT

Creating a safety net

Jack Gray assesses the risk that weak employer covenants pose to Irish pension funds and the potential impact of IORP II

WRITTEN BY JACK GRAY

Risk management in Irish defined benefit (DB) pension schemes has shot up the agenda for trustees and scheme managers as compliance with the IORP II Directive became a requirement at the end of 2022. One of these key risks that needs to be addressed but could be being overlooked is that of a weak employer covenant.

While compliance with IORP II is likely to improve management of this risk, Irish DB schemes may feel more vulnerable than their counterparts across the Irish Sea due to the lack of a safety net, as the UK has with the Pension Protection Fund (PPF), and no claim on insolvency through the Section 75 debt. Few DB schemes in Ireland are self-sufficient, and therefore rely on future employer contributions to meet members' benefit payments.

Although the recently improved structure around risk management in Ireland does not specifically address covenant risk, the expectation is that covenant risk management will improve as processes and governance get better as a whole. However, there are some concerns that some trustees see covenant risk as something that is not immediately impacting their schemes, and therefore that they could be underprepared if there was a big insolvency or a wider corporate event.

Level of risk

In the UK, large corporate insolvencies at BHS and Carillion were a catalyst to an improvement in covenant risk management, and in awareness that events like this can happen and have a huge impact on members of affected DB schemes. However, this kind of event has not been seen in Ireland in recent times, and while there is no guarantee that they will happen, the lack of a safety net and tighter regulations could mean Irish DB scheme members are more vulnerable than those in the UK.

"Employer covenant is fundamental to the risks faced by DB pension plans," states Aon Ireland head of wealth solutions, Mairead O'Mahony. "Although funding levels have improved in the past decade, very few schemes are fully self-sufficient, and therefore most of the 500 or so Irish funded DB schemes maintain a reliance on future employer contributions for the provision of accrued benefits.

"In Ireland, unlike the UK, we don't have an explicit requirement to assess employer covenant assessment given we don't have a PPF or 'debt on the employer'." However, O'Mahony continues, there is clearly an implicit requirement as part of robust governance framework, and she expects that some judgement around employer covenant will form part of trustees' Own Risk Assessment (ORA) under the new IORP II regime.

"There is a wide range of factors that affect the risk covenant presents to any given scheme," notes WTW Ireland senior consultant, Deirdre Coyle. "These factors include the balance of funding powers, the employer's financial position and prospects, the scheme's funding position and the progress it has made on its de-risking journey, and the scale of the scheme relative to the employer, amongst other things."

Coyle explains that, as the profile of DB schemes in Ireland widely varies, the reliance placed on employers also differs, as does the risk presented by employer covenant to the schemes and ultimately to members.

Cardano managing director, Matthew Harrison, adds that while the regulator recognises that covenant is an important risk to manage, it is more concerned with schemes getting the governance framework right around having a risk manager and risk management framework for all risks in place, rather than specifically pushing covenant risk up the agenda.

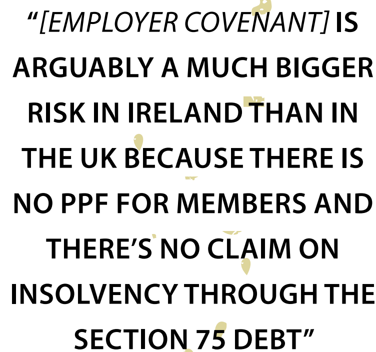
"In the UK, it's just about to

become a legal requirement to consider employer covenant under the regulations," he continues. "It's quite some way from that in Ireland but, fundamentally, it's arguably a much bigger risk in Ireland than in the UK because there is no PPF for members and there's no claim on insolvency through the Section 75 debt. So, you are more exposed to the ongoing ability of your sponsor to sit behind the risks because your backstop is less robust than in the UK."

Furthermore, Harrison highlights that in Ireland there is a theoretical ability for the sponsor to walk away from the scheme, which he says is "pretty theoretical" because it would be reputationally damaging for an employer to abandon their scheme. "In a way, you have trustees going: 'What is the point of looking at covenant?' because in theory their sponsor could walk away," Harrison notes.

"But on the other side of the coin, you've got them setting 15-year journey plans, which inherently assume this won't happen. The employer has the potential to walk away, then the trustee sets a plan that assumes that that doesn't happen and takes 15 years of exposure to that sponsor. There's a real juxtaposition in that."

Despite the concerns, Irish Association of Pension Funds (IAPF) CEO, Jerry Moriarty, states that while covenant is always a risk, the



closure of a lot of DB schemes in the past 15 years and the restructuring of many others mean that it would be reasonable to say that remaining employers have committed to their scheme for the long term.

Risk development

As schemes mature, the nature of covenant risk can change. While it may be expected that more mature schemes will be less affected by covenant risk, there are factors that develop that can pose different challenges to trustees.

"There are a number of key factors affecting how covenant risk will develop for a given scheme," says Coyle. "Broadly it would be expected that DB pension schemes will de-risk as they mature and therefore risks should diminish.

"However, while trustees have some control over their own de-risking strategies, they remain exposed to external factors affecting success in implementation and are also exposed to various corporate developments that can affect the affordability of associated funding for any de-risking and the ability to absorb shocks."

She adds that while there are many examples of supportive employers that are positively engaged with trustees to de-risk, for some schemes the pace of improvement in member security is slower, in such a context that the trustee must negotiate such improvements and any required funding with the employer. For these schemes, there is greater reliance on covenant and therefore greater exposure to covenant risk.

Furthermore, there are risks that the corporate strength of the employer could diminish and the scale of the pension scheme relative to the employer strength could change for the worse.

"Factors which would increase employer covenant risk are a

"ACROSS THE BOARD, IT IS LIKELY THAT THERE WILL BE A TREND FOR GREATER USE OF COVENANT METRICS, AND MORE FORMAL AND MORE DETAILED COVENANT DISCUSSIONS WITH THE EMPLOYER"

declining financial position or outlook for the sponsoring employer, or increasing funding cost/ deteriorating funding position of the scheme," says O'Mahony.

"The maturing of the scheme, particularly where it is closed to new members and future accrual, could mean that it is increasingly viewed as a legacy problem which may increase employer appetite to de-risk the plan, or to settle the benefits via an enhanced transfer value exercise or a bulk annuity purchase."

Moriarty adds: "As schemes mature, there is a danger they become less connected to the employer, particularly if they have been closed for some time and most members are not current employees. There is more focus on matching liabilities for mature members which may reduce the overall level of risk as well."

Additionally, the risk of employer insolvency could be on the increase. Cardano Advisory director and specialist pension covenant adviser, Michael McElligott, notes that while there has been very little insolvency due to the Covid-19 pandemic thanks to government support, he is seeing a knock-on effect with the rising interest rates and increased cost of living.

"We are expecting in the UK to see more insolvencies, and the

picture is broadly similar across the water," he comments. "Not having many insolvencies means that there haven't been high-profile failures we can highlight in Ireland, which would show that members don't get much protection on insolvency and they don't have a claim on insolvency."

Lack of safety

The PPF in the UK can provide some solace to members of DB schemes with insolvent sponsors, but this is not the case for Irish DB scheme members. Moriarty says that the IAPF believes there should be some form of protection in place, "and this would also allow for a more fundamental examination of how the Minimum Funding Standard works".

However, as DB schemes generally have higher funding levels and significantly reduced accrual relative to previous decades, O'Mahony, believes it is unlikely a PPF-like entity will re-emerge as a government priority in the coming years.

"Focus at the government table in recent times has been on the creation of a long-term savings vehicle to help support the increasing cost to the exchequer of the state pension as our population ages," she notes.

Coyle points to other "limited" safety nets that are in place, such as the Pensions Act, which stipulates that the state is obliged to pay an amount related to protecting broadly 50 per cent of the main benefits of the scheme, or for pensioners a pension of €12,000 if higher.

"In practice, the minimum funding requirements are designed to minimise situations where schemes are so badly funded that this scheme kicks in and – other than a pension insolvency payment scheme – there is little available to address the other 50 per cent of benefits," she continues.

"There is also the added issue that the statutory funding standard is not one which would necessarily deliver the same benefits which members had previously expected, especially for those who have not yet retired.

"So, in Ireland it is not a perfect picture. Trustees are very aware of this issue and would generally seek to mitigate the risks. However, trustees don't necessarily have control over all the outcomes and ultimately some pension scheme members may not receive the benefits they expected should the pension scheme and/or employer fail."

IORP II impact

Although there appears to be a lack of a safety net for members compared to the UK, the IORP II Directive should provide some solace. The Irish Pensions Authority required trustees to meet the directive's requirements by the end of 2022. IORP II details that Irish pension schemes must have risk managers in place and to prepare an ORA to outline the risks the scheme faces, which can include covenant risk. McElligott explains: "We think, based on what we've heard from risk managers, they will be asking trustees what evidence they have to show they have appropriately assessed the employer covenant. They'll be kicking the tyres a bit more.

"We've come along quite a bit in the past 12-18 months. Take-up for independent covenant advice is still low, but as the risk managers become more embedded, we feel like more and more schemes will have a closer look at employer covenant in the coming years."

Moriarty notes that while not a formal requirement, trustees and scheme managers will be reviewing and monitoring employer covenant as part of their risk management processes.

"As there is a more structured risk management process now in place, it has formalised the attention paid to all aspects of risk, including employer covenant," he adds. "Separately, improved funding levels, resulting from increasing interest rates, have opened up the further opportunities for managing those risks."

Coyle concludes that there is no change for some schemes as covenant considerations were already included in the risk management framework operated by the trustee prior to IORP II.

"However, the formal requirements of IORP II, the appointment of a risk manager to co-ordinate the operation of the risk management framework and the preparation of an ORA by the trustee is likely to result in a levelling-up of the approach to covenant assessment across DB pension schemes," she states.

"Across the board, it is likely that there will be a trend for greater use of covenant metrics, and more formal and more detailed covenant discussions with the employer."

RISK

Ask the industry:

Amid rising inflation, ongoing conflict and geopolitical tensions, and increasing regulatory considerations in different countries, *European Pensions* asks: What is the biggest risk facing pension schemes in Europe?

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Without a doubt, the combination of sticky core inflation and a deepening of an expected recession in Europe is the scenario that provides the most headwinds for bond and equity markets, and consequently for pension schemes in Europe. To fight prolonged high core inflation, the European Central Bank must continue its policy of rate hikes, currently at 3.25 per cent. AXA IM expects an increase to at least 3.75 per cent, holding on well into late 2024. Bonds might go sideways. Hopefully, economic growth will not be affected too much by increased financing costs and a deepening of the expected recession can be avoided. However, depressed earnings expectations will not be good for the equity markets.

MARTIN SANDERS
AXA IM Netherlands, head of pension investments

While the industry faces many issues ranging from geopolitics, regulation and climate, in my view the biggest risk ultimately facing the industry is retirement adequacy. This is a nuanced topic and touches on a wide array of topics: The shift from defined benefit to defined contribution pension schemes and the transfer of market and longevity risk to individuals; the potential for inflation to erode the purchasing power of retirement savings; gender disparities among pension savers and the disproportionate retirement adequacy impact faced by women; ageing demographics around Europe and potential political resistance to the necessary reform needed to balance sustainable financing with intergenerational equity; and a shortage of the support needed from governments and employers to encourage future retirees to make prudent choices in a defined contribution world.

JOHN O’BRIEN
Mercer partner, strategic risk management, Europe zone leader

Adapting to a changed environment is probably the biggest challenge for schemes. After years of, mostly, positive returns we are now facing a more uncertain period. We have quickly gone from being concerned about how long interest rates would remain low to wondering how high they will now go. Dealing with the increasing impact of regulation and legislation also brings challenges and adds costs. For members of schemes, particularly pensioners, inflation is the biggest risk as it can seriously erode the value of their savings. As DC is becoming a much bigger part of pension savings throughout Europe, we need to focus on ways of improving member outcomes and, particularly, of providing adequacy and security in retirement.

JERRY MORIARTY, IAPF CEO

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The 2020s have turned out to be a decade of both short-term and long-term/structural crises in a number and complexity we have not seen for a long time. Examples of this are geopolitical and political turmoil, the evolving problems in some banks in the US and Europe, and how this is handled by the authorities and the sector itself. Given the nature and the combination of these crises together with further regulation, it is difficult to precisely assess their impact on European pension schemes. But in the shorter run (the next two to three years) they tend to point at lack of growth and continuing low interest rates (in a longer-term perspective). Although there are still plenty of good return possibilities we may expect more volatility, and we'll probably not see the tailwind from declining interest rates that have helped stabilise returns up over the past 15-20 years.

TOM VILE JENSEN
Insurance & Pension Denmark deputy director

We are living in turbulent times, which, unfortunately, appear not to be of short duration. A couple of thoughts about inflation from the member's perspective. Inflation has been affecting pension scheme costs: running investments and providing the surrounding services is now more expensive. Pension scheme administration and technology services fees experienced an indexation of about 8 per cent in the past year. This not marginal increase is affecting, maybe not so evidently, the costs sustained by members, such as management and membership fees. Inflation also means that incoming contributions have a reduced 'real value'. Adjusting (increasing) the contribution rates is a complex exercise for the employer and the member itself. Again, the value of the members' pension accounts is negatively impacted by this rising inflation.

MARTINO BRAICO
Previnet senior manager

There are several risks facing pension schemes in Europe due to rising inflation, geographical tensions, regulatory initiatives and new reforms. Annual inflation, growth outlook and growing demands from members to divest from assets which do not fit with environmental, social and governance strategies are just a few examples of those risks.

However, rapidly ageing populations is one of the main risks European countries face. According to data from Eurostat, life expectancy at birth has been increasing over the years, reaching 80.4 years in 2020.

Despite a slight decline in the following year due to the pandemic, these figures are expected to continue to rise in future years. Combined with low fertility rates in some parts of Europe, in particular southern Europe, there is increasing pressure on European countries' state pension systems; many may seek to raise the minimum retirement age as one solution.

Rapidly ageing populations is an issue for private sector DB pension schemes as well, which need to make their assets work more to face higher liabilities as more people live for longer.

TIFFANY TSANG
UK Pensions and Lifetime Savings Association head of DB, LGPS and investment

SCAMS

A coming storm?

The increasing cost of living across Europe may have made pension scheme members more vulnerable to scams. But are industries, associations and governments doing enough?

WRITTEN BY PETE CARVILL, A FREELANCE JOURNALIST

The cost-of-living crisis continues across Europe. A conflagration of circumstances, including the war against Ukraine, the lingering impacts of financial support during the coronavirus pandemic and supply chain issues, continue to impact the continent. A few months ago, it was reported that food prices across the European Union had risen by an average of 18.4 per cent year on year.

This issue stands at the forefront of people's minds. In January, the European Parliament conducted its *Eurobarometer* survey, in which 93 per cent of respondents said they were concerned about the cost-of-living crisis.

It is against this background that many pension holders may look to buttress their incomes by gambling with their pots for better returns. These are actions underpinned by legislation allowing people to dip into their retirement savings.

DWF partner and pensions legal expert, Marcus Fink, says: "There will be people who can promise you ready cash as part of a transfer package. But the rules are fairly complex and it's possible for even an intelligent person to be confused and hoodwinked into transferring benefits, getting cash, and then ending up with a sizeable tax bill."

In 2020, Crowe and the University of Portsmouth released a report called *The Nature and Extent of Pensions Fraud.*

That report said: "In recent years, the pension liberation reforms have stimulated an increase in frauds targeting those with pensions. This has, in turn, led to an increase in the action by authorities to tackle this problem. However, the media focus on 'pension liberation frauds' has masked a range of opportunities for fraud in the wider pensions sector. These include frauds by those running pensions schemes, inappropriate investments, and the targeting of pension schemes by external fraudsters, sometimes those involved in organised crime. These risks have received less attention."

Defining a pension scam or fraud

A pension fraud or a pension scam, writes financial firm Fidelity, essentially targets pension scheme members to part with their hard-earned money and can happen in several ways.

"Fraudsters," writes Fidelity, "might ask their victims to transfer their pension pot into either non-existent or non-genuine schemes set-up to defraud people of their investments. Or they might offer them cash incentives to gain early access to their pension benefits – referring to them as a pension loan."

It is tricky to determine what impact the cost-of-living crisis is having on pension scams. It is recent and many scams slip beneath the radar, with cheated pension holders embarrassed or ashamed of their naivety. Europol said it had no statistics on this, nor had it done any work in this area.

The European Insurance and Occupational Pensions Authority (EIOPA) says similar, writing in a statement: "EIOPA closely monitors risks to pension holders, as can be seen in our annual consumer trends report. We are currently working

on the 2023 edition of the report where we are looking into the impact of inflation/cost-of-living crisis on pension holders. As we are still in the data gathering and analysis stage, we are not in a position to conclude whether there has been an increase in pension holders losing money through fraud during the cost-of-living crisis."

"We are definitely seeing more," said People-tech founder, Saq Hussain. "There are scammers approaching people with offers of better returns and then there are 'advisers' telling those under 55 how they can access their pension pots."

There are extensive examples on the continent. In November, Germany's Deutsche Renterversicherung (DRV) warned of 'dubious telephone calls' using number spoofing to pose as the pensions body. The calls, said the DRV, were threatening and warned people that they had to quickly make arrangements to transfer money, with "talk of pension cuts or garnishments, sometimes other sanctions" if a refusal to pay was made.

It was not the only one. In July, Germany's Federal Network Agency said it had received over 7,500 complaints about the 'Europol' ploy in the previous month. This scam surfaced over a year ago, leading to a reported 22,000 cases. This number, it advised, was underreported. Within Bavaria, it was estimated that the damages from this came to more than €2.5 million.

> **"IT'S POSSIBLE FOR EVEN AN INTELLIGENT PERSON TO BE CONFUSED AND HOODWINKED INTO TRANSFERRING BENEFITS, GETTING CASH, AND THEN ENDING UP WITH A SIZEABLE TAX BILL"**

The German version of *The Local* described the fraud process: "The scam starts with a phone call, which, when answered, plays an automated message saying that the police are waiting on the line. Users are then asked to press 1 to continue and those who follow the request are connected to a fraudster claiming to be from Interpol, Europol or the German Federal Criminal Office (BKA). The scammers impersonate officials and tell their victims that they are involved in serious crimes or are victims of a crime, such as identity theft, and urge them to provide personal information and make payments."

And in April, the BBC reported on a network known to the police as the Milton group and its offshoots that targeted through social media those of pension age, subsequently bilking many for thousands with promises of inflated investment returns.

The BBC wrote: "From their first phone call, victims can be directed into regulated companies or sometimes unregulated, offshore entities. Some victims who signed up to regulated brands within the Milton group are directed by their

broker to place high-risk trades likely to lose the customer money and make money for the broker. Some victims are instructed to download software that allows the scammer to remotely control their PC and place trades for them. And according to former employees of Milton group brands, some customers think they are making real trades, but their money is simply being siphoned away."

Much of the money taken, it seems, came from liquidated pension pots.

The way forward

Fidelity lays out several factors indicating a probable pensions scam: Unexpected contact, unrealistic offers and promises, persuasive and time-sensitive sales tactics, unusual investment opportunities, offering early access to pensions, and impersonation of firms and 'government' schemes.

Hussain says that there has been a shift by pension providers to tackle these sorts of scams at the point at which a pension pot gets liquidated.

He says: "Providers have become more mindful and are asking questions when they have members looking to access funds. But the problem is not just scams, but terrible investments. I've seen people persuaded to transfer money into property schemes in Europe that have never gotten off the ground and the venture has then fallen apart."

There are also cross-border issues if someone in one European country is persuaded to take their pot and invest in another nation. Such cross-border moves may end up being flagged and paused in the home country, even if the ultimate decision is made by the pension holder.

"The pensions admin team," notes a WTW spokesperson, "have strong due diligence in place for members when it comes to processing their pensions transfers etc, but beyond that I don't think we have much sight of pension scams and certainly no analysis across the region."

The question, then, is what – if anything – is being done at the higher levels around Europe? That would be something to put to the funds themselves, along with the regulators.

However, it was hard to find any evidence, any trace, of concerted efforts around Europe. EIOPA states it had not published any advice for those wishing to avoid pension scams or frauds during the cost-of-living crisis. But given that it will have a better idea in the future what the cost-of-living crisis is doing to pension holders, it may know more later this year.

GUEST COMMENT

Pension funds need to avoid a derivatives clearing meltdown this summer

New EU rules will hit hundreds of pension funds across the continent when they take effect in June, warns OpenGamma's Jo Burnham

WRITTEN BY OPENGAMMA RISK AND MARGINING SME, JO BURNHAM

Record-breaking temperatures may be forecast across the continent this summer, but no financial institution is set to feel the heat more than EU pension funds. As of 18 June, EU pension schemes will need to clear transactions within the scope of mandatory clearing under the European Market Infrastructure Regulation. But what does this mean in practice?

Clearing houses, which sit between counterparties looking to trade, have long required upfront cash or collateral (initial margin) from when a trade is entered, to reduce risk. These new rules mean hundreds of pension funds that have previously never had to clear will be forced to in less than one month's time. EU-based pension funds will have to clear their interest rate derivatives, creating operational headaches, including potentially smaller netting sets across clearing houses, leading to higher costs and reduced capital efficiency, with pension funds having to post more margin collateral.

When it comes to the central clearing of interest rates derivatives, this is going to create a need to access cash, as pension funds will have to pay variation margin. They could also have to post additional cash during the trading day to cover potential losses when the value of assets are fluctuating. Portfolios are normally 'receive fixed rates', so in a rising interest rate environment they will need to pay more variation margin. With euro interest rates around 4 per cent, the cost of financing the additional margin is around 10 times the cost expected when the date for ending the pension fund exemption from clearing was set.

There is a growing expectation that there is potential for a liquidity squeeze, which could hit the larger pension funds. Consequently, these are the firms in most need of cash. They can access cash from the market in a short period, but it's about being able to efficiently generate that cash in a time of stress on the same day. There are very few places where this can be done. That's one point where repo clearing could become beneficial. With cleared repo, pensions funds will at least be facing a reliable counterparty. As a result, they are going to get best price and quick turnaround in terms of generating cash for variation margin.

While clearing will be beneficial if all these operational issues are overcome, there is still a question mark over whether banks that provide clearing services have capacity on their balance sheets to cope with a barrage of pension funds looking to clear. While many firms have clearing agreements, clearing brokers offer little certainty over the limits they are prepared to offer to any business, retaining the right to pull access to their services with as little as one or two months' notice.

This presents a problem for EU pension fund managers doing large volumes of non-cleared OTC trades. For the EU, this will put additional pressure on liquidity, especially in the higher interest rate environment.

With less than a month to go at the time of writing, pension funds need to work out how to not only post margin, but how to optimise it across their counterparties to avoid a big blow to returns. Ultimately, whether firms are clearing repo or rates, what they are getting, assuming these operational issues are ironed out, is certainty and opportunity to benefit from the enhanced stability and credit outcome of facing a clearinghouse. Whether enough pensions funds can overcome these operational hurdles is another matter.

In their own words...

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

On European pension funds' views on how to tackle greenwashing

"Investors in the Netherlands and France are the most adamant that fines should be imposed [for failure to tackle greenwashing]. All the Dutch and 97 per cent of the French investors were in favour, while a much lower proportion of UK and Nordic respondents agreed."

Justina Deveikyte, Cerulli director, European institutional asset management research

On facilitating loans for sustainable African projects

"With this agreement, Dutch pension funds, ILX and the ADB, join hands to increase investments in the SDG and climate goals on the African continent. A very welcome step, as the challenges in achieving the SDGs, and the need to integrate the global climate commitments in African countries' development pathways, are more urgent than ever."

Kitty van der Heijden, Dutch Ministry of Foreign Affairs director-general for international cooperation

On Dutch govt's discussions on the Future Pensions Act

"We understand that there is a lot of criticism of the law, but we also think that the point of no return has been reached. *[This]* doesn't mean that we think all criticism should be put aside. Some points are justified and useful to take with you. Such as, for example, the entry into service and the survivor's pension. And we also agree that it is still difficult to follow, but that has its reasons and backgrounds. It is therefore important that participants are well informed and guided through the transition."

FRANK DRIESSEN
Aon Netherlands CEO

On 2022 being the 'worst' investment year for pension funds since 2008

"The very harsh investment year of 2022 has affected the average five-year return which, for some actors, fell into the negative. Long term, however, the return has remained at a moderate level. Depending on the allocation of the investment portfolio and other factors, the fluctuation in returns may be large from one year to another, which is why short-term returns may be unduly emphasised from the point of view of pension investing."

ANTTI MIELONEN
Finnish Centre for Pensions special adviser

On the Nordic gender pensions gap

"We can see in the analysis that the low pension gap in the Nordic region is particularly due to high labour market participation for women and a large spread of labour market pensions. There is still a wage gap in all countries, which pulls the other way, just as the fact that women are working part-time to a greater extent also contributes to increasing the gap. However, these differences cannot explain why Danish and Icelandic women fare better relative to the other Nordic countries."

KARINA RANSBY
Forsikring & Pension deputy director

On the Swedish income pension system's surplus

"Even when we count on a pessimistic scenario, the assets exceed the liabilities during the entire projection period of 75 years, this is because the retirement ages are raised in line with the increasing life expectancy."

ERIK GRANSETH
Swedish Pensions Agency analyst

On Sweden's Alecta's losses after American banks collapse

"The losses in the three American banks account for a small part of Alecta's capital and the impact on the customers' pensions is very limited. But it has seriously damaged the customers' trust in Alecta and our share management."

Magnus Billing, Former Alecta CEO

On Torben Möger Pedersen's plans to step down as PensionDanmark CEO from 1 October

"Having taken part in the foundation of PensionDanmark, becoming the first employee and the CEO for more than 30 years, I have decided to pass on the baton. It has been a great honour and joy together with our skilled employees to be handed the task to develop PensionDanmark."

Torben Möger Pedersen, PensionDanmark CEO

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