QUANTUM ADVISORY
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QUANTUM NEWS

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Quantum's office move

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It hardly seems like yesterday that we moved to another office to accommodate all the new recruits, both present and future. That said it's now over seven months and we are making use of the extra space and facilities that we now have.

The expansion, backed by business finance from the Welsh Government, has seen us relocate our Cardiff headquarters to larger premises on the same site in St Mellons and will enable us to increase the number of employees in the capital city by a further 40 to more than 100 within the next three years.

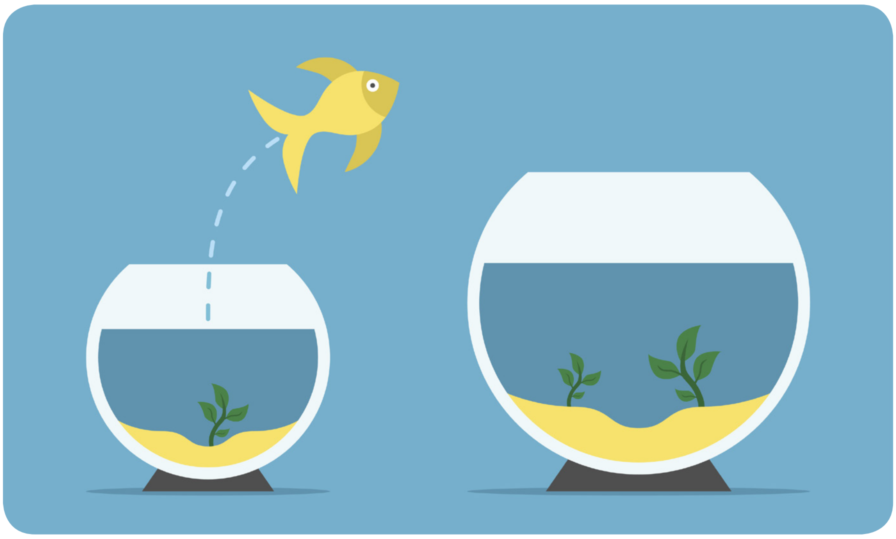
The news has been welcomed by Economy Secretary Ken Skates who said: "Quantum Advisory is an indigenous business working in one of our key economic sectors and I am pleased Welsh Government support helped secure this expansion for Wales.

The investment supports the Financial and Professional Services sector strategy and will create high value sustainable jobs associated with actuarial science which is a growth market."

For those of you who don't know us that well, we provide pension and employee benefits services to employers, scheme trustees and members. Advising on over £3.5 billion of pension fund assets we have delivered a pension administration service to clients from outset as well as investment, actuarial and pensions consultancy services to clients both in the UK and internationally.

The employee benefits and pensions consultancy market is dominated by a small number of large corporate entities and we are proud of the fact that we are the only consultancy firm headquartered in Wales specialising in providing tailor made services and solutions.

Since setting up the company with a single office in Cardiff, we now boast regional offices in Amersham, Birmingham, Bristol and London and last year saw an increase in our turnover of over 10%. ●



DB

IRM

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There is something peculiarly appealing about things that come in threes; whether it is three musketeers, an Englishman, an Irishman and a Welshman walking into a bar or three strikes and you're out. Orators and politicians have used the rule of three to great effect and it appears that the Pensions Regulator ("tPR") is no exception, with the publication of its guidance on Integrated Risk Management ("IRM") for trustees, employers and the advisers of trust-based Defined Benefit ("DB") pension schemes. But, nearly 18 months after the formal introduction of IRM, have pension schemes truly adopted an integrated approach?

What is IRM?

IRM can be viewed as a tool to assist trustees in identifying and managing those factors that affect the prospects of meeting the scheme's objective; with most schemes having the single overriding objective to pay pensioner benefits as and when they fall due. Whilst the IRM framework identifies employer covenant, investment and funding as the three primary risks facing DB pension schemes, it is the interaction of these three pillars that is of primary concern. IRM calls on trustees not only to consider those risks facing their pension scheme, but to formulate contingency plans if they come to fruition. It quickly becomes apparent that the framework calls for a greater understanding of risk and its potential consequences.

So, what's the problem?

Sound easy? No, I didn't think so either. In an ideal world, we would grade the strength of the sponsor covenant on a triennial basis, in line with the Actuarial Valuation process, identify the pertinent investment and funding risks and plan accordingly. However, we do not live in an ideal world and this approach misses a fundamental concept; risk (both rewarded and unrewarded) is not static. This point is well illustrated when we consider the recent decision by the UK public to exit the European Union ("EU"). Suddenly, UK companies face the very real possibility of losing EU trade deals, which will surely feed into the grading of the sponsor covenant and, therefore, the level of investment and funding risk that can be underwritten. It would appear that the days of isolated decision making have been thrown onto the ash heaps of history, paving the way for a more integrated and dynamic approach.

Sounds good, but how practical is it?

With the recognition that the risks facing pension schemes are ever changing, comes the realisation that a much greater level of involvement is required from trustees, sponsoring employers and advisers. However, with many trustees juggling a full-time job with their trustee role, a lack of company representation on trustee boards and the often lack of cohesion between investment advisers and scheme actuaries this can be a daunting thought.

IRM can be viewed as a tool to assist trustees in identifying and managing those factors that affect the prospects of meeting the scheme's objective

It is these difficulties that often lead to the partial adoption of IRM. All too often, trustees, sponsoring employers and advisers identify the pertinent risks at the time of the scheme Actuarial Valuation and undertake a cursory review of said risks on an ad hoc basis. Whilst such endeavours start with the best of intentions, it is important to remember what the road to hell is paved with!

So, what is the solution?

The answer to this question involves a synchronised change in perceptions and the formulation of strong governance frameworks.

The relationship between trustees and sponsoring employers can often be contentious and adversarial. This needn't be the case. Trustees want nothing more than to fully fund the scheme, whilst sponsoring employers wish to lock down risk and refrain from paying large deficit contributions. The objectives of the two parties are the same, not mutually exclusive. The relationship between the trustees and sponsoring employer can often be enhanced by ensuring company representation on the trustee board. After all, one of the best ways to foster good relations is to be completely transparent and inclusive.

A higher standard is also required from scheme advisers. Trustees should ensure that the scheme actuary and investment adviser are operating in harmony. Long-gone are the days where the liabilities were the sole remit of the scheme actuary and assets the sole remit of the investment adviser. Remember, whilst most schemes have the primary objective to achieve a 100% funding level, and thus be able to pay benefits as and when they fall due, the path the funding level takes is highly important (all too often trustees have seen the funding level of their scheme collapse moments before undertaking an Actuarial Valuation, with the sponsoring employer being called upon to underwrite the deficit). A collaborative approach between the scheme's actuary and investment adviser can facilitate the efficient management of scheme assets and liabilities and thus smooth the funding level progression.

With regard to governance frameworks, there are at least three key areas that need to be considered:

1. **The roles and responsibilities of all parties should be clearly identified**, with a streamlined decision making process being implemented; a point well made in tPR's March 2017 guidance on investment for DB pension schemes. Whilst the various involved parties will have specific roles and responsibilities, it is important not to lose sight of the fact that the sum of the parts is greater than the whole. A collaborative approach should be sought by everyone involved, not least because the risks facing pension schemes span multiple areas.

2. **A degree of delegation has the potential to improve success**. Whilst the trustees are ultimately responsible for the pension scheme, the delegation of certain responsibilities to investment advisers or fiduciary managers can be an effective means of freeing trustee time to focus on those areas that add the most value. Integral to the success of such an approach is the establishment of a clear framework in which the investment adviser or fiduciary manager should operate. Remember, delegation does not mean a loss of control!

3. **Monitoring and reporting is more than a box ticking exercise**. Remember, the risks facing pension schemes are dynamic and it is crucial that we respond to such risks in a timely manner. Monitoring systems should be established, with streamlined channels for feeding the information to the relevant parties.

One thing is clear, the implementation of a strong, collaborative governance framework affords trustees and the sponsoring employer the ability to be responsive, whilst not demanding unpalatable amounts of time.

Conclusion

The introduction of tPR's IRM guidance c18 months ago reinforced what the majority of trustees, sponsoring employers and advisers knew, that the greatest chance of success comes from an integrated and collaborative approach. Unfortunately, for too many trustees, sponsoring employers and advisers, this utopia has existed solely in the realms of theory. Hopefully, this article goes some way in assisting in bridging the gap between theory and reality … after all, everything that has been said is the truth, the whole truth and nothing but the truth. ●

DB DC

Automatic re-enrolment

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Although the concept of automatic enrolment staging dates has been around since 2012, for some smaller employers, their automatic enrolment staging date was only three years ago. As such, they will now be going through the automatic re-enrolment process. Employers should not find this difficult, because it is largely a repeat of the original process. Where the majority of the employees are already in a pension scheme, there will not be much for the employer to do.

While postponement cannot be used, the re-enrolment date can be three months either side of the three-year anniversary. However, it would be sensible to check the communications sent to members at the original staging date, to make sure the re-enrolment date is consistent.

A re-declaration of compliance is needed within five months of the three-year anniversary of the original staging date. The process is the same as that following the original staging date. The declaration needs to be completed even if no employees were originally enrolled.

An easement which you may wish to consider is that there is no need to enrol anyone who has opted out in the 12 months before the re-enrolment date nor employees who are working their notice period.

Employers should also note that legislation allows them not to enrol those with Lifetime Allowance protection. Some forms of protection are lost if contributions start up again following re-enrolment. High earners who have opted out or reduced their contribution rate because of the tapered Annual Allowance will need to pay attention, as they may need to take action. Of course, the employer would need to know that an employee has some form of protection and the onus is on the employee to tell their employer.

Remember that in most cases, the employer should not provide the opt-out form; it should come directly from the pension provider.

Of more interest is what will happen when minimum contribution rates start to increase from April 2018. Might we see a different story then, with a higher opt out rate? For many schemes, the minimum employee rate is currently 1%, which is a relatively small amount that most people would not miss from their pay. When the rate increases to 3% from April 2018, someone with an annual salary of £24,000 could see their monthly contribution increase by £30 to £40, depending on the definition of pensionable pay. While this might not be enough to make an employee opt out, particularly when they realise that the employer rate is increasing at the same time, the increase in the employee rate to 5% from April 2019 could well lead to a higher level of opt-outs.

The new Lifetime ISA might appear more attractive to some people, once it becomes more widely known. However, a pension scheme is generally still considered the best way to save for retirement and automatic enrolment tries to make sure people take advantage of that. ●

Pensions Monitor

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Regulated Apportionment Arrangements

Hoover has just become the 27th company to use a regulated apportionment arrangement (RAA) as part of their restructuring process as The Pensions Regulator (TPR) and Pension Protection Fund (PPF) approved the proposal on 30th April 2017. The Hoover (1987) Pension Scheme will now pass into the PPF (unlike the British Steel Pension Scheme which, although awaiting official sign off as at the time of writing, is offering an alternative scheme to just entering the PPF).

A RAA is an arrangement which allows a financially troubled employer to separate itself from its liabilities in respect of a defined benefit pension scheme. These types of restructurings are difficult to achieve as employers are only able to proceed if they are facing insolvency within the next 12 months. For further details on the Hoover case see page 8.

Pensions dashboard

For regular readers of Quantum News, you'll know that the government wants a working pensions dashboard to be launched by 2019. Whilst Phase One has been completed (the prototype was unveiled this April), there are going to be many challenges ahead if the timescales are to be met.

It surprises someone of my age, but the average number of jobs in a working life now stands at 11, which will only increase as the traditional way of working disappears. If you factor in corporate activity, it will make it difficult for many employees to keep tabs on all their pension provision.

You would have thought that the production of a pensions dashboard should be relatively simple, given that the Netherlands, various Nordic countries and Australia already have such systems. However, those countries have smaller populations than the UK and a much less fragmented market. The UK has something like 46,000 schemes to contend with.

The Association of British Insurers is overseeing the project on behalf of the government and is working with major master trusts, insurance companies, third-party administrators and employee benefit consultancies to complete the task.

Work undertaken so far has raised a few issues, least not the multitude of IT systems and data standards, the latter being addressed in the next phase as the ABI push the industry to adopt a common standard. This seems easy in principal but there is no incentive (or regulation currently) for schemes to submit this data for the dashboard's use which makes it more difficult, particularly as the older schemes may not have a complete set of digital data.

Success can only be measured in terms of ease of use and coverage. There have been comments that a 90% coverage should be the target to aim for. Members should be able to use the dashboard to easily assist them flesh out a retirement plan – this can only come about with the use of the right set of tools which provide unbiased information for the end user. This will restrict the companies that have been pivotal in its construction from using it as a sales outlet for its services.

To make it a great success, once the above obstacles have been overcome, it will require encouragement from the government (which has been slow thus far) and regulatory oversight and the foresight to keep the model updated to reflect the future needs.

Consolidating scheme rules and deeds

You will be aware that the Pension Regulator's (TPR) guidance recommends that it should be good practice for schemes to consolidate all changes to a scheme's rules at least every five years. You will also be aware, perhaps from personal experience, that schemes are not following this guidance despite it being in existence for more than a decade.

It has long been normal practice to make any changes through separate amending deeds and (hopefully) store them in one easy to find place.

The industry has raised concerns with this stance as it is difficult to keep track of changes which could result in inaccurate information or paying/buying out the wrong benefits and has suggested that some form of regulation should be imposed upon schemes to ensure that they conform.

This will mean extra costs at a time when money may be tight for sponsoring employers.

This is never going to be an easy decision, given that all schemes would naturally choose to consolidate if the exercise was free. A half-way house could be to create an electronic working copy of the deed and rules that consolidates all the amendments online via a member portal for all to see, with any changes being made each time there are changes.

This isn't a new concept although there are few legal advisers who are currently offering this facility. We do work with one or two though and would be delighted to broker a meeting between interested parties to see if this is attractive for schemes.

The "triple lock"

Following their deal with the Democratic Unionist Party, the Tories have agreed to retain the triple lock on the state pension. The protection, which guarantees annual increases in line with the higher of the Consumer Prices Index, average earnings and 2.5%.

The deal was part of a number that ensured the support of the DUP on votes on the Queen's Speech, the Budget, finance bills, national security policy and Brexit.

Whilst many in the industry had called on the government to drop the triple lock, stating that it is financially unsustainable, with both inflation and average earnings expected to increase over the next few years, maintaining the triple lock is not expected to cost the government any money in the short term. The Office for National Statistics estimated that the Consumer Prices Index was 2.9% in May 2017, its highest level in four years, above the 2.5% "floor".

Charity Work

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We have always taken part in ad-hoc charity days, keen to support and raise money for various charities. After meeting with a representative, a relationship was formed with the children's charity Tŷ Hafan to support them by taking part in their 'Pay for a Day' scheme.

It costs over £4 million a year to keep Tŷ Hafan running, equating to almost £11,000 a day, and the charity relies heavily on donations. Their 'Pay for a Day' initiative invites organisations to raise £11,000, paying for one whole day of care.

Tŷ Hafan provides comfort care to life-limited children and young people throughout Wales, as well as providing emotional and practical support to their parents, siblings and extended family. The work they do is focussed on quality of life, rather than end of life, helping families to create precious memories. They not only offer support at the hospice but wherever it is needed, in the homes of the families or in hospital, doing this completely free of charge.

In order to fulfil our pay for a day goal we introduced monthly dress-down days, held bake sales, sporting sweepstakes, and also held a raffle to win an extra day's leave, which proved very popular and raised £220! We also organised two external quizzes and raffles, raising over £400 on each occasion. However, our most ambitious fundraising event was certainly the 'Race to the Stones Challenge' where a group of 20 walked 51km in a day. This was, as you can imagine, very challenging, even for the most avid walkers amongst us! Thankfully our hard work was rewarded by generous support from family, friends, colleagues and clients and we managed to raise just over £7,740 for this one event.

We started our fundraising mission in March 2016, originally aiming to achieve the £11,000 within 18 months but happily we raised the full amount in just under 12 months. As a thank you from Tŷ Hafan a group of us were invited to the hospice and awarded an inscribed bronze apple to place on their special commemorative Gift Tree which honours all donors.

We are very proud to have reached our target and have not stopped there, continuing with our efforts to raise money for this worthwhile charity. Our next largescale event will be a black-tie dinner celebrating Quantum's continued success, with all proceeds from the evening's raffle and auction going to Tŷ Hafan. The dinner will be taking place on Saturday 3rd March 2018 at the Celtic Manor Resort Hotel, further details to be released in the coming months.

For further details on our charity work, please visit https://quantumadvisory.co.uk/about-us/charity-work. If you would like further information about Tŷ Hafan please visit www.tyhafan.org.

supporting tŷ hafan

DB DC

Transfer value take-up increases seven-fold in two years

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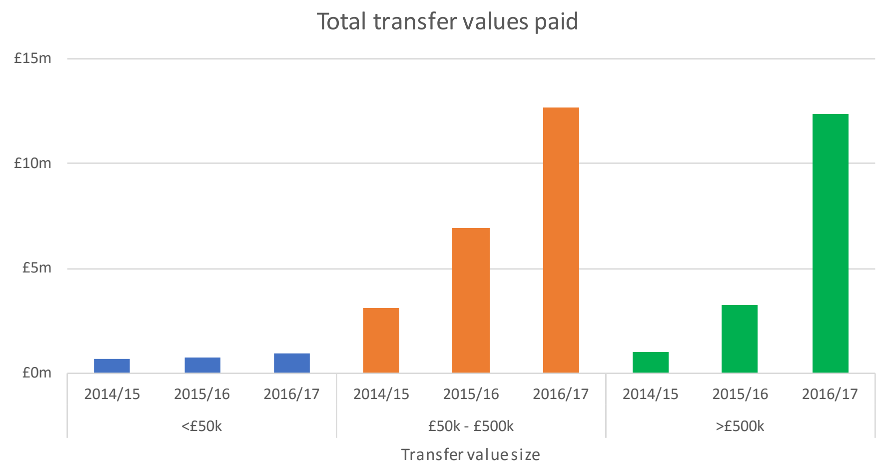
In April 2015 the Chancellor dropped a bombshell on the world of Defined Contribution (DC) pensions, allowing members to take their pension pot as cash instead of buying an annuity. This made DC pensions much more flexible than Defined Benefit (DB) pensions, meaning DB members must transfer out of their existing scheme if they want to access their pension flexibly. After a slow start, we are now seeing a significant increase in DB transfer value activity.



During the 2014/15 tax year (just before the new flexibilities were introduced) Quantum paid a total of £5m of Cash Equivalent Transfer Values (CETVs) from the schemes we administer. This increased to £11m in the 2015/16 tax year, then £26m in the tax year 2016/17. These figures are for individual transfers only and exclude bulk exercises.

The increase in transfer value payments has been driven by members with CETVs higher than £50,000, and the largest increase is for CETVs over £500,000. There are likely to be two drivers for this:

1. Members with a fairly large pension might feel that they have enough retirement income to live on, and can therefore afford to access some of their pension flexibly.

2. Members with very large transfer values might also want to leave some of their pension fund invested as inheritance for their family.

Interestingly, we haven't seen a noticeable increase in members with small pensions deciding they would rather have the cash up front via the CETV route. This suggests that members do see a lifetime income as important, at least at a low level.

We also haven't seen a decline in members commuting pension at retirement for tax-free cash. This seems inevitable in the longer term though, as some members who were considering taking tax-free cash look instead to access their whole pension flexibly via a transfer value.

Market movements

Part of the reason for the increase in the number of CETVs must surely lie in the recent increase in CETV values due to lower gilt yields on which CETVs are based. The CETV for an average 55-year-old has increased by 20% since the pension freedoms were introduced in April 2015, and by over 50% since 2010. This makes the CETV appear much more attractive, and may make it easier for a financial adviser to recommend transferring.

What should trustees be doing?

• Speak to your Scheme actuary. Trustees generally set their transfer value basis below the level of scheme funding, and this gives a funding gain when a member transfers out. However, the gain is often largest at young ages and might be small or non-existent as members get close to retirement. Over 80% of transfer values paid in 2016/17 were to members aged between 55 and 65, so trustees should consider reviewing their transfer value basis to make sure transfer values in this age band are set appropriately.

• Speak to your investment consultant. Most pension schemes do not hold enough cash to pay CETVs of the size we are now seeing quite regularly. That means trustees need to think about where they should disinvest assets from and what the costs of disinvesting are.

• Speak to your administrator. There is a wide range of transfer value policies across pension schemes. Some schemes actively offer transfer values to members at retirement, while at the other end of the spectrum some schemes don't allow a member to take a transfer value after their statutory right expires one year before Normal Retirement Age. The more flexible and proactive schemes are likely to end up with greater member satisfaction and benefit most from an increase in transfer value activity.

• Consider allowing partial transfer values. The ultimate flexibility for members is to transfer some of their benefits to a DC scheme but retain some as a lifetime pension. We are seeing more requests from members for this flexibility, but whether trustees should offer it will vary according to scheme circumstances. A recent ruling by the Financial Ombudsman means it is good practice to state whether partial transfers are allowed when quoting CETVs. •

DB DC

Live fast, die younger?

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It is well publicised that life expectancy in the UK has increased significantly over the past few decades and for many years the majority of actuaries have taken it as read that this trend will continue well into the future. However, in recent years mortality improvements have slowed considerably and, since 2015, have actually started to worsen. Why is this? Does this mean we are all going to die younger? What does this mean for pension schemes?

Mortality experience – England and Wales

When the mortality statistics for 2015 were published in early 2016, they showed an increase in the numbers of deaths since the previous year for the first time in many years. Many commentators put this increase down to short term events, such as an influenza outbreak in the early part of the year.

The 2016 statistics are now available and these show that the number of deaths in the UK has again increased. Does this indicate there are longer term influences that are affecting mortality rates?

Higher health spending throughout the noughties by successive Labour governments is cited as a major reason for the significant improvements seen in mortality over this decade. In more recent times, the much-publicised financial distress of the NHS is widely perceived to be the major contributor behind the worsening mortality in the UK.

However, we cannot solely blame this increase in mortality on the NHS funding crisis. There is also evidence that mortality rates are worsening further afield. For example, in the USA, overall mortality increased from 2014 to 2015 – the first such increase in 20 years. The main causes of this increase have been attributed to the significant rise in deaths from unintentional injuries and liver disease, largely put down to increasing drug and alcohol consumption. Similarly to the UK, the USA has also seen significant increases in deaths from Alzheimer's.

While, on a broader level, cancer remains the UK's largest killer a more detailed analysis of the latest ONS data shows that dementia and Alzheimer's is now the leading cause of death in the UK. Much of this increase has been put down to increased knowledge of the disease, affecting both diagnosis and death reporting, however with people living longer and increasing evidence of a link between diabetes and Alzheimer's, this trend could be set to continue.

The 2016 statistics are now available and these show that the number of deaths in the UK has again increased.

Impact on pension schemes

The Continuous Mortality Investigation (CMI) Bureau mortality improvement tables are commonly used by actuaries for calculating pension scheme liabilities. The CMI's 2016 tables show lower life expectancies than the 2015 tables, which themselves showed a reduction in life expectancy when compared to both the 2013 and 2014 tables. Therefore, all other factors being equal, schemes adopting the 2016 improvement tables for their mortality assumptions will see a fall in their liabilities.

When the 2015 tables were released, the Pensions Regulator commented that they were comfortable with the 2015 tables being used for funding valuations, however, they did not believe there was evidence to suggest that lower increases will continue. With the trend now continuing for another year, it will be interesting to hear their views on the 2016 tables.

It is too early to say definitively if this trend is set to continue into the future. However, having seen two years of worsening improvements maybe it is time to change the widely held view that we will all continue to live longer. A key assumption for valuing liabilities, mortality is sure to be a major consideration for future funding negotiations in many schemes and, if we are at the beginning of an era of prolonged lower mortality improvements, may serve to improve funding levels! ●

DB

Does Hoover's deal with the Pensions Regulator and the Pension Protection Fund suck?

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Over the past 12 months three pension stories, BHS, Tata Steel and Hoover have been making headlines. Each story is different but ultimately has a similar outcome.

In this article, we have looked at the less publicised Hoover story and given our thoughts as to whether the outcome will have an everlasting impact on pensions in the UK.

So, what is so special about this story? Well, in June this year, a deal was struck between the Pensions Regulator (tPR) and Hoover to transfer Hoover's defined benefit pension scheme into the Pension Protection Fund (PPF). The deal was unusual as Hoover was solvent.

The PPF – a reminder of why it was created

In 2002, Allied Steel and Wire became insolvent and at the same time its defined benefit scheme had a huge deficit. With no employer to support the scheme, thousands of workers, ex-workers and pensioners either lost some all or of their pension.

The PPF was consequently put in place to stop this situation ever happening again and it is ultimately a safety net for members of underfunded defined benefit schemes whose sponsoring employer has become insolvent.

So tPR making deals to allow solvent employers to offload their pension obligations to the PPF is unusual, so we know the situation at Hoover must have been critical.

What was the Hoover deal?

The Hoover 1987 Pension Scheme (the Scheme) had a deficit of over £300m. Hoover, the Scheme's sponsoring employer, was struggling and could no longer support the Scheme and if they could not remove themselves from their obligations, they stated they would become insolvent and the remaining 500 or so workers in the UK will lose their jobs.

Following discussions with all parties and after careful consideration, tPR stepped in and agreed to a regulated apportionment arrangement with Hoover. This meant that the PPF would take on the Scheme's liabilities in return for Hoover giving the PPF a £60m payment and a 33% share in the Hoover business. This would allow Hoover to continue and safeguard the jobs of the 500 or so Hoover workers in the UK. The £60m payment was a better outcome for the PPF compared to Hoover becoming insolvent and the 33% stake in the Hoover business was put in place as an anti-embarrassment clause for the PPF in case the Hoover business has a huge turnaround in fortune.

The underlying factors as to why some employers can no longer support their defined benefit pension schemes have not happened overnight.

What about the members?

So, what did this mean for the 5,000 plus pensioners and 2,000 members who have yet to retire from the Scheme? PPF compensation that's what. For those above the Scheme's normal retirement age, they are protected, but will see their future annual increases reduced. For those below the Scheme's normal retirement age, they will receive an immediate 10% reduction to their Scheme benefits in addition to reduce annual increases.

Is this fair?

Many would argue no, but it appears that whatever scenario you look at with this case, Scheme members would get PPF compensation whatever the outcome.

How did this happen?

The underlying factors as to why some employers can no longer support their defined benefit pension schemes have not happened overnight. It can be argued that when financial conditions were healthier, employers did not contribute enough money into these schemes and since the credit crunch in 2007/08 we have remained in a low interest rate environment which isn't good for defined benefit pension schemes. The fact that people are living longer and therefore pension schemes are costlier to run than first anticipated is also a reason, along with the increase in guarantees the government has added on to pension benefits over the last 20 years or so.

Whatever, the reasons, we are seeing situations like this happen more frequently. As with the similar case at Tata Steel, the reduction in the members' pension benefits appears to be subsidising the continuation of the employer.

Unfortunately, we expect to see more of these types of cases in the future, which is obviously not good news for defined benefit scheme members. However, when you put in perspective that there are around 6,000 defined benefit schemes in the UK, many of which are well run and backed by strong employers, in my opinion the actual numbers will be relatively small. ●

DB

Green Paper – is it a GOer?

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On 20 February 2017, the Department for Work and Pensions (DWP) published a Green Paper exploring the key challenges facing many private sector Defined Benefit (DB) schemes. It also sets out several proposed solutions to address these challenges to improve the "security and sustainability" of the industry. The Paper focusses on four key areas:

Funding and Investment

Although the DWP recognises that the current valuation measures are largely adequate, it has proposed some potentially problematic changes. For example, reducing the valuation timescale from 15 to nine months might seem sensible, but is likely to cause difficulties, particularly where there are active members and updated salary information is required from the Company before the valuation process can commence (it can often take nine months to get the data!). More regular valuations for high-risk schemes adds to costs, and it is highly likely that the high-risk schemes are those where affordability is already an issue.

Mandating the use of professional trustees, whilst seemingly sensible, also adds another layer of cost to running schemes, particularly small schemes.

Regarding investment, I find it strange that the DWP questions the "overly-cautious" investment strategies of pension schemes, having sat through several conference calls with the Pensions Regulator (tPR), where trustees have been admonished for having strategies that are too aggressive.

Employer contributions and affordability

Again, some of the suggestions within this area seem to conflict with tPR's stance. Longer recovery plans and back-end loading have always been frowned upon. Allowing a reduction in benefits under certain circumstances is probably a good thing if it isn't abused – the difficulty here is trying to decide which circumstances should be accepted and who ultimately makes that decision, the trustees or tPR.

Member protection

The Paper outlines the belief that, overall, regulatory protections are "working broadly as intended". However, there is a case to extend the power wielded by the Pensions Regulator in particular regarding scheme funding powers as well as imposing a formal duty to cooperate and engage with tPR. The Paper also queries whether certain corporate transactions should require regulatory clearance and whether trustees of "severely underfunded" schemes should be consulted before dividends are paid.

The Paper outlines the belief that, overall, regulatory protections are "working broadly as intended"

Anything that strengthens member protection should be welcomed, but it must not come at the expense of hindering the sponsoring employer's development.

Consolidation of schemes

Apparently, the DWP believes a large proportion of small DB schemes have high administrative costs proportional to their size and suggests the aggregation of small schemes to reduce administrative costs, create investment opportunities and improve governance.

Personally, I'm not convinced by these arguments, having seen some DB master trusts levying costs higher than Quantum's standard charge for small schemes. If the DWP wants to reduce costs, less red tape would be a good start!

We all want a good "balance between member protection, sustainability and affordability of these important pensions" as the Paper puts it, but some of the suggestions are either conflicting or unworkable. ●

DB

Predicting the new normal - a certain uncertainty?

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Recent events have shown us that forecasting the future involves a significant degree of uncertainty. Over the past 12 months or so, the decision of the UK public to leave the EU, the election of Donald Trump as president of the United States, and the UK election resulting in a hung Parliament, are all examples of times where the vast majority of financial markets, statistical models, economic and political experts, and bookmakers, have not been able to predict the correct outcomes.

When modelling investments for Defined Benefit pension schemes, adopting a holistic approach, that models assets and liabilities in tandem, provides a more robust framework for decision making. Pension schemes are among the largest institutional investors therefore having a robust modelling technique in place is imperative. Necessary input parameters such as future expected inflation, interest rates, GDP and asset class returns need to allow for uncertainty; there are numerous techniques that can be implemented to achieve this.

"Technological progress has merely provided us with more efficient means for going backwards." *- Aldous Huxley*

The most common technique "the survey method" is the simplest. Relying on expert opinions, this method utilises professionals who are immersed in the financial markets. Assessing the fundamentals of markets regularly gives a unique human feel that stochastic programming can potentially overlook. However, this method has the disadvantage of subjectivity and "herding", where people are more likely to sit on the fence or follow the opinions of others than have a contrarian opinion.

"The future influences the present, just as much as the past"

- Friedrich Nietzsche

A second method is to use historical data as a proxy for future events. This eliminates subjectivity and personal bias, and provides a sound basis, but relies on a very heavy assumption that the future will be reflective of the past.

Since the 2007/08 financial crisis, the global economy is said to be heading towards the "new normal", which is expected to be very different to economic environments witnessed before. In Developed Markets, interest rates are at record lows - negative in some cases, inflation is muted, dampened by low energy prices and equity markets are at record highs bolstered by loose Monetary Policy. This environment is unlike any experienced before, resulting in data derived from the past becoming less representative of the future.

"Facts are stubborn, but statistics are more pliable" *– Mark Twain*

Econometric and stochastic models use statistical techniques to try and capture uncertainty. Using this as a foundation, these models use complex algorithms to predict a range of future economic variables. By analysing historical data, these models can look for relationships between variables and use random simulations to build up a large number of plausible future economic scenarios. This technique allows a user to quantify a very subjective area of finance, and assess the probability of different events occurring.

A common measure is Value at Risk ("VaR") which in the pension industry can be used to measure downside risk. For example, a "1 year 5% VaR estimate of £10m" implies that over a year, a pension scheme deficit has a 95% probability of not increasing by more than £10m. Despite these advantageous characteristics, the effectiveness of the model to predict future variables is limited by the choice of statistical distributions and correlations derived from past data. Furthermore, these inputs are assumed to be static and therefore do not allow for any change in correlation during market stress, which may result in underestimations of downside risk measures such as VaR.

"In this world, nothing can be said to be certain, except death and taxes" *- Benjamin Franklin*

Results from modelling assets and liabilities will be highly sensitive to the inputs of the model, hence the choice of method to derive these inputs is critical.

Quantum uses a combined approach when considering future economic forecasts. We are able to use a combination of statistical methods, past data and a qualitative overlay to help us paint a picture of various future economic environments. A scheme's assets and liabilities can then be modelled against these environments, allowing for the construction of an investment strategy which best suits a scheme's objectives.

Do changes to pension tax relief remain on the horizon?

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After weeks of manifesto promises, reactions and a surprise General Election result; predictions of likely changes to pensions have been varied and wide-ranging, as well as a high-profile subject for financial and political commentators alike.

In the past few weeks, finer details about pensions have been superseded by political wrangling, but now with a new Government formed and with economic circumstances still delicate, it's likely that changes to pension tax relief may be forced back onto the agenda.

The current system of giving tax relief at people's marginal income rate costs the Treasury £35bn a year, according to the Pensions Policy Institute, which also estimates a single flat rate at 20 per cent would save the Treasury around £13bn a year while a single flat rate set at 30 per cent would be cost neutral, with the latter making pension saving more beneficial for the less well off.

In my belief, a single flat rate of pensions tax relief would make pensions far simpler for savers to understand and easier for the pensions industry to administer, ultimately saving costs.

A single flat rate could also remove the requirement for the Annual Allowance which compounds the move towards a simpler system, as undeniably in recent years the entire pensions landscape has become more and more complex for people to understand and the pensions industry to administer.

However, losers in a proposed single flat rate tax relief system would include higher tax rate-payers not currently impacted by the Annual Allowance.

Overall, it remains to be seen if the new Government with such a limited majority will introduce such a far-reaching policy with many winners and losers. However, the economic benefits of moving towards a different tax relief system can be seen, so in my opinion, pension savers should be prepared for such changes soon.

Quantum chronicles

Past Events

- Cardiff Trustee Training Part 1 on 9th February 2017
- Wales and South West Pensions for Breakfast @ The Celtic Manor on 28th February 2017
- Cardiff Trustee Training Part 2 on 2nd March 2017
- Wales HR Awards @ SSE Swalec Stadium on 23rd March 2017
- Cardiff Trustee Training Part 3 on 20th April 2017
- Pensions and Investment luncheon @ The Celtic Manor on 14th June 2017
- Wales and South West Pensions for Breakfast @ The Celtic Manor on 20th June 2017
- Cardiff Business Awards nominated finalist 23rd June 2017
- London pensions and investment seminar @ Merchant Taylors' on 13th July 2017

Upcoming Events

- LDI Conference and T20 in conjunction with Insight Investment @ SSE Swalec Stadium on 3rd August 2017
- Wales and Southern pensions conferences in conjunction with Blake Morgan on 21st September 2017 (Cardiff) and 11th October 2017 (Southampton)
- Wales and South West Pensions for Breakfast @ The Celtic Manor on 8th November 2017
- Evening seminar in conjunction with Darwin Gray on 23rd November 2017
- Quantum Advisory Tŷ Hafan Dinner @ The Celtic Manor on 3rd March 2018

New arrivals

Neema Begum
Paul Black
Stefano Carnevale
Katie Vincent
Francesca Allen
Emily Baker
James Fiddow
Daniel Read
Rhys Davies
Jayna Gandhi

For further information on any of our events, please visit www.quantumadvisory.co.uk/events/

Who we are

Established in 2000, Quantum Advisory is an independent financial services consultancy that provides solution based pensions and employee benefit services to employers, scheme trustees and members.

We design, maintain and review pension schemes and related employee benefits so that they operate efficiently and effectively and are valued by employees. This means that you can get on with doing the things that you do best, therefore saving you time and money.

Products and services

We offer a range of services to companies and pension trustees, all designed to focus on your specific needs, including:

- Actuarial services
- Administration of defined contribution and defined benefit pension schemes
- Banking, accounting and pensioner payroll
- Company advice
- Employee benefits consultancy
- Governance
- Investment consultancy
- Pension and employee benefit communications
- Risk benefits advice
- Pension scheme wind up
- Secretarial services to trustees
- Trustee training

Getting in contact

We have offices in Amersham, Birmingham, Bristol, Cardiff and London. Give us a call to see how we can help with your pension and employee benefit challenges.

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