THE CHALLENGES PROFESSIONAL TRUSTEES FACE TODAY

The Planning Puzzle

CHARLES STANLEY

Fiduciary Management

Contents

Introduction

Bob Campion, Senior Portfolio Manager, Charles Stanley Fiduciary Management

Professional trustees play a critical role in the world of defined benefit (DB) pension schemes. Their position on the board as a trusted and expert voice in deciding the best route for the scheme – from the collection of contributions, to the investment of assets, to the payments of benefits – has become more entrenched as the landscape for DB schemes gets more complex.

Last year, Charles Stanley Fiduciary Management ran its first deep-dive research study into the opinions and behaviours of professional DB trustees. It revealed a fascinating state of the market in the throes of the Covid pandemic. A lack of knowledge and confidence seemed to be preventing trustees from taking the investment risks they so keenly wanted to take. Huge swathes of trustees hadn't set a long-term funding target. Concerningly, onerous regulatory requirements were prompting an exodus of skilled pension trustees from the market altogether.

In the year since, the world has changed. In August 2021, the UK was grappling with the final waves of the Covid pandemic, but the economy was showing signs of recovery. 12 months later, the worst of the pandemic is behind us but the negative long-term economic fall-out is starting to reveal itself.

Closer to home, The Pensions Regulator confirmed its new DB funding code would kick-in in September 2023; trustees had a deadline to work to. In November 2021, Clara-Pensions became the first DB superfund to be successfully assessed by the regulator, making superfunds a feasible option for endgame for the first time.

For trustees, our research shows that funding targets have changed dramatically over the past year, with buyout growing in popularity – but the number of professional trustees yet to set a long-term funding target at all has made no improvement at all. Concerningly, there's a disconnect between risk appetite, asset class appetite, and investment behaviour; much of this is led by those with no set funding target.

Now, as we approach the winter months, we are seeing a period of unprecedented turbulence in the DB pensions market, prompted by dramatic tax announcements from the Chancellor. It is more important than ever that trustees have the expertise, support, and long-term vision to sail through a choppy sea.

About the Research

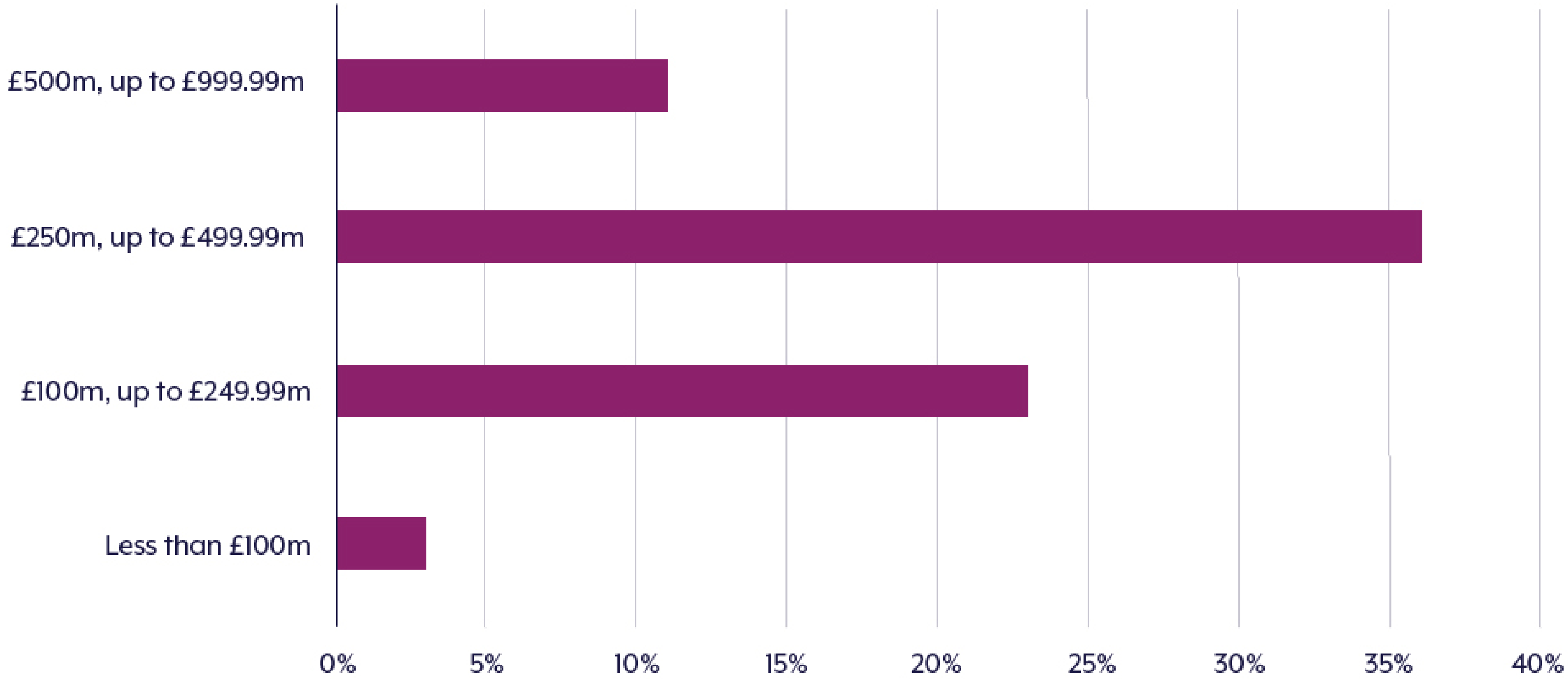
- 70 professional trustees of DB pension schemes took part in the survey
- Participants represented a wide range of DB pension schemes – most work on 3, 4, or 5 schemes each
- The average scheme size of the trustees surveyed is £370m; the total AuM each trustee presides over is £863m
- Between them, the trustees manage schemes with a total AuM of more than £60bn

Methodology

Research was carried out by Censuswide among 70 professional trustees of UK DB pension schemes. It was completed in July 2022 and considered a broad cross spectrum of professional trustees

What is the scheme size that you oversee?

If you manage multiple DB schemes, then please answer as a typical or average for your schemes.



Mean: £ - Millions 362.85

Research at a glance

76%

Three quarters (76%) of professional pension trustees of DB Pension Schemes are yet to set a long-term funding target.

39%

Two fifths (39%) of professional pension trustees say their long-term funding target is going or likely to be self-sufficiency. This is up from 51% last year.

24%

24% say regulatory uncertainty will have the greatest impact on their investment appetite in the next 12 months – more than say the economic uncertainty will do so.

37%

37% of those whose long-term funding target is going (or likely) to be superfund consolidation said they are pursuing consolidation conversations with a TPR-assessed superfund provider already.

73%

73% of trustees believe they'll achieve their funding target in 10 years. This rises to 88% of those who have already set a funding target.

40%

40% of trustees said they have become more inclined towards hedging scheme liabilities in the last 12 months; 41% are less inclined.

69%

69% of professional DB trustees say their appetite for credit risk has increased over the last 12 months. This is up from 47% last year.

47%

Trustees without a set funding target are driving the increase in UK equity exposure (47% without a target vs 29% with), and currency exposure (45% vs 24%).

73%

73% of professional DB trustees say their appetite for inflation risk has increased over the last 12 months.

34%

34% say their long-term funding target will be buy-out via an insurer – an increase from 19% last year.

30%

Nearly one in three (30%) say concerns around greenwashing is a key factor in hindering the growth of ESG investing.

80%

80% of professional DB pension trustees plan to step down from their role within 3 years.

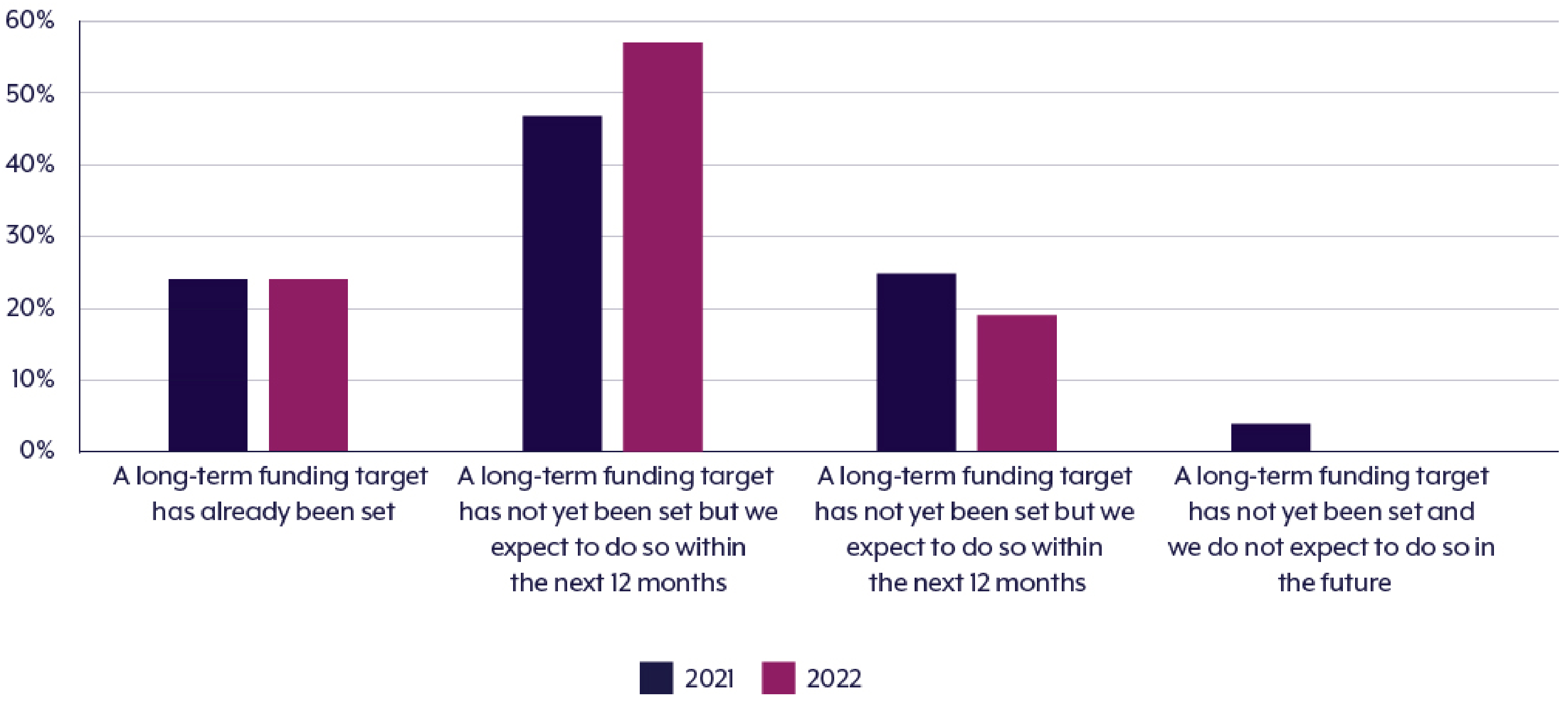
1. Eyes on the Prize: Trustees and their funding targets

Trustees have made little headway in setting a long-term funding target

Professional trustees of DB pension schemes are increasingly eyeing up buyout as their long-term funding target. But there is a disconnect between expectation and long-term planning. Three quarters (76%) of professional trustees are yet to set a long-term funding target at all, making no progress from last year.

24% of trustees say that they have already set a long-term funding target. This is dramatically at odds with the DWP's impact assessment of the DB funding code, which assumes 80% of DB schemes already have a set funding objective.

What is your schemes position regarding the regulatory requirement to set a long-term funding target?



76%

Three quarters (76%) of professional pension trustees of DB Pension Schemes are yet to set a long-term funding target. Made up of:

12

57%

say that while a long-term funding target has not yet been set, they expect to do so within the next **12 months**

This is an increase from **47%** last year

24

19%

say that while a long-term funding target has not yet been set, they expect to do so within the next **12-24 months**

24%

say that a long-term funding code has already been set

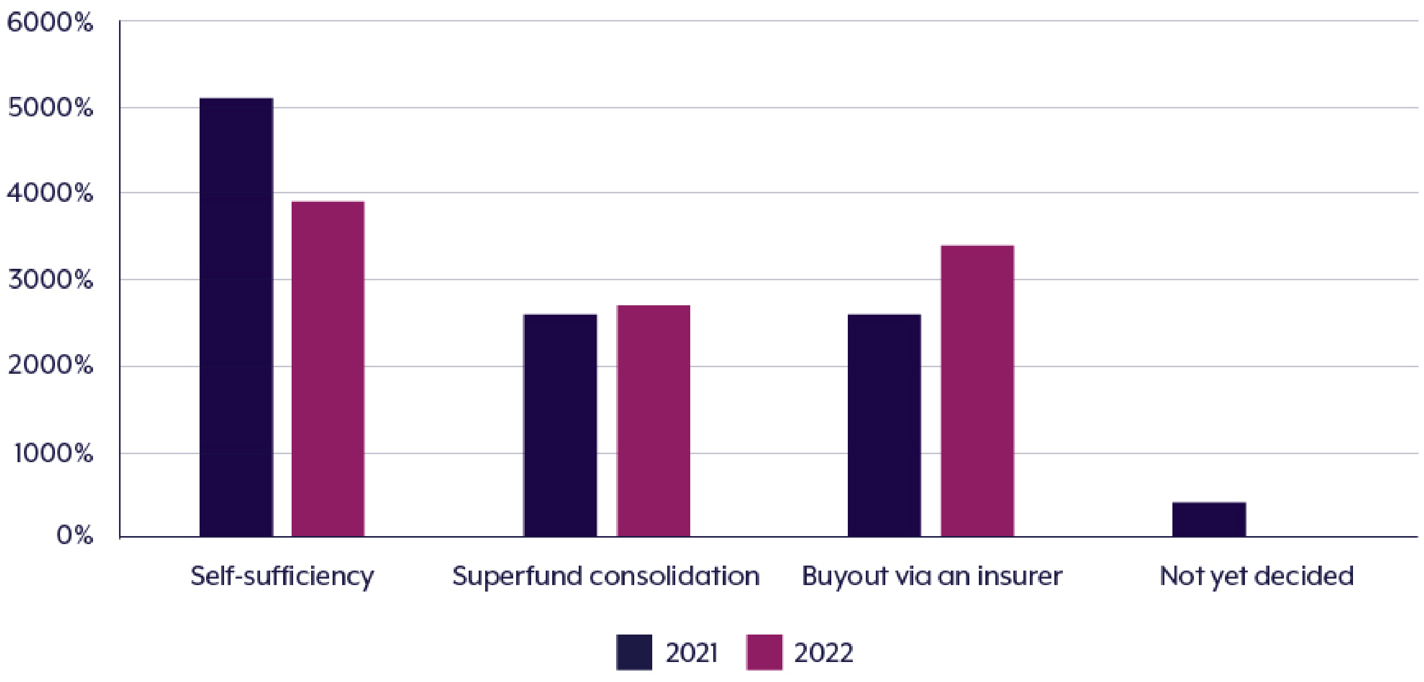
Funding targets have changed dramatically over the past year

Buyout has become a more popular avenue for professional DB trustees, with last year's research finding 19% of trustees' long-term funding target being buy-out via an insurer – this year it has risen to 34%.

Two fifths (39%) of professional pension trustees say their long-term funding target is going or likely to be self-sufficiency – this has dramatically fallen in popularity from last year.

Finally, 27% say their long-term funding target is going to be superfund consolidation – this is about stable to last year (26%). It's perhaps surprising to see no change here, despite Clara-Pensions being TPR-assessed between the two tranches of research.

What is your long-term funding target going (or likely) to be?



Charles Stanley Opinion

Bob Campion, Senior Portfolio Manager
Charles Stanley Fiduciary Management

After a record year for buyout deals in 2021, and then a massive drop in buyout prices due to rising gilt yields in 2022, it's no wonder that some trustees have already moved their goalposts towards buyout. I'm sure more are planning to do so. Buyout is now a cheaper, more viable, route to endgame than it has been for years, and the gradual emergence of superfunds will keep the pressure on insurers to keep their prices affordable.

For any pension fund that anticipates buying out within a reasonable timeframe, we would encourage the trustee to consider adopting buyout as the formal target for their investment strategy.

What are superfunds?

Superfunds, or capital-backed consolidators, are vehicles for DB pension schemes to secure their members' benefits while removing themselves from the sponsoring employer. The idea is that by consolidating small schemes into larger schemes, employers and members will benefit from higher efficiencies, lower running costs, and better outcomes.

In November 2021, Clara-Pensions became the first superfund to complete The Pensions Regulator's (TRP) assessment process to become a viable consolidation vehicle. Other providers, including the Pension SuperFund (PSF), are working with the regulator to ensure the options entering the market and robust and well-governed.

Findings from the research:

37% of those whose long-term funding target is going (or likely) to be superfund consolidation said they are pursuing consolidation conversations with a TPR-assessed superfund provider already. Over half (53%) said they are hoping to pursue consolidation conversations with a TPR-assessed superfund provider soon, while 11% said they are pursuing consolidation, but awaiting more schemes to be assessed by The Pensions Regulator.

41%
said they don't understand the governance structure

35%
said superfunds are too early in their journey for consolidation to be a long-term funding target

33%
said it's not financially suitable for their scheme

33%
said not enough superfunds have been assessed by TPR

27%
had already decided on a different long-term funding target

25%
revealed they don't know what a superfund is

22%
said superfund consolidation isn't best for their members

73% of trustees believe they'll achieve their funding target in 10 years. This rises to 88% of those who have already set a funding target, and is true of 70% aiming for self-sufficiency, 71% aiming for buy-out, and 79% aiming for consolidation.

Half of trustees (50%) believe they will realistically achieve their funding targets between 5 and 10 years, while a quarter (26%) believe they'll realistically achieve their funding targets between 10 and 15 years. A fifth (20%) believe they'll realistically achieve their funding targets between 5 and 10 years.

Every single trustee with a set funding target is confident they'll achieve that objective

Confidence is high among professional pension trustees, with 71% saying they're confident their scheme will achieve its long-term funding target objective.

Over a quarter (27%), however are indifferent to whether they are confident or unconfident about reaching their long-term funding objective.

73% of those who believe they'll reach their target within 10 years (from Q4) are confident, compared to 68% who said they'd take more than 10 years. In good news, 100% of those with a set funding target are confident they'll achieve their objectives; this falls to 62% of those yet to set a target.

2. Risky Business: A lack of planning is prompting poor risk analysis and investment technique

Across the board, appetite for risk has increased over the last year, despite a volatile economic environment

Much of the ‘significant increase’ in risk appetite is driven by those with a set funding target. This is especially true for inflation risk and interest rate risk, which more than 40% of trustees with a set target have significantly increased their appetite for.

Only equity risk and credit risk have seen any reduction in risk appetite, and this is only for relatively small numbers of trustees.

Thinking about your investment approach, how, if at all, has your appetite for risk changed over the last 12 months?

	All	Funding target set (net)	Funding target not set (net)
Inflation risk			
Increased significantly	34%	47%	30%
Increased somewhat	39%	24%	43%
Neither increased nor decreased	24%	24%	25%
Reduced somewhat	3%	6%	2%
Reduced significantly	0%	0%	0%
Interest rate risk			
Increased significantly	39%	41%	38%
Increased somewhat	39%	24%	43%
Neither increased nor decreased	20%	35%	15%
Reduced somewhat	1%	0%	2%
Reduced significantly	1%	0%	2%

Thinking about your investment approach, how, if at all, has your appetite for risk changed over the last 12 months?			
	All	Funding target set (net)	Funding target not set (net)
Equity risk			
Increased significantly	36%	35%	36%
Increased somewhat	39%	47%	36%
Neither increased nor decreased	14%	6%	17%
Reduced somewhat	11%	12%	11%
Reduced significantly	0%	0%	0%
Credit risk			
Increased significantly	29%	35%	26%
Increased somewhat	44%	35%	47%
Neither increased nor decreased	19%	24%	17%
Reduced somewhat	7%	0%	8%
Reduced significantly	1%	0%	2%
Overall appetite for investment risk			
Increased significantly	26%	18%	28%
Increased somewhat	43%	59%	38%
Neither increased nor decreased	27%	24%	28%
Reduced somewhat	4%	0%	6%
Reduced significantly	0%	0%	0%

Hedging appetite divides opinion

40% of trustees said they have become more inclined towards hedging scheme liabilities over the last year. This rises for those who have a set funding target (53%), and those aiming for superfund consolidation (58%).

About the same number (41%) of trustees said they are less inclined towards hedging scheme liabilities. The remaining 19% said their attitude has not changed.

This polarisation is surprising when so many trustees report an increased appetite for interest rate and inflation risks; it begs the question whether trustees adequately understand the interaction between hedging constraints and risk assessment.

But when it comes to asset allocation, a lack of set funding target is prompting risky investment decisions

Have you adjusted your scheme's exposure to the following asset classes in the last 12 months?				
	Increased exposure	Reduced exposure	No charge	N/A
UK equities	43%	13%	41%	3%
Global equities	41%	11%	46%	1%
Property	47%	14%	39%	0%
Currencies	40%	10%	49%	1%
Fixed income	44%	7%	49%	0%
Commodities	33%	14%	53%	0%
Hedge funds	50%	13%	36%	1%
Infrastructure	50%	13%	37%	0%
Illiquid assets	46%	16%	36%	3%
ESG/sustainable investment assets	34%	16%	49%	1%

There are a range of interesting discrepancies between those trustees with set funding targets (and those without). Namely:

Those without a set funding target are driving the increase in UK equity exposure (47% vs 29%), and currency exposure (45% vs 24%)

Those with a set funding target are leading appetite for fixed income (65% vs 38%) and hedge funds (65% vs 45%)

These findings suggest that trustees without a plan are at risk of making investment decisions which aren't in the best interests of the schemes funding objectives.

Have you adjusted your scheme's exposure to the following asset classes in the last 12 months?					
	Funding target set (Net)	Funding target not set (Net)		Funding target set (Net)	Funding target not set (Net)
UK equities			**Commodities**		
Increased exposure	29%	47%	Increased exposure	29%	34%
No change	53%	38%	No change	59%	51%
Reduced exposure	18%	11%	Reduced exposure	12%	15%
Global equities			**Hedge funds**		
Increased exposure	47%	40%	Increased exposure	65%	45%
No change	41%	47%	No change	29%	38%
Reduced exposure	12%	11%	Reduced exposure	6%	15%
Property			**Infrastructure**		
Increased exposure	53%	45%	Increased exposure	59%	47%
No change	29%	42%	No change	35%	38%
Reduced exposure	18%	13%	Reduced exposure	6%	15%
Currencies			**Illiquid assets**		
Increased exposure	24%	45%	Increased exposure	59%	42%
No change	71%	42%	No change	24%	40%
Reduced exposure	6%	11%	Reduced exposure	18%	15%
Fixed income			**ESG/sustainable investment assets**		
Increased exposure	65%	38%	Increased exposure	29%	36%
No change	29%	55%	No change	59%	45%
Reduced exposure	12%	8%	Reduced exposure	12%	17%

Charles Stanley Opinion

Preksha Shah, Associate Portfolio Manager,
Charles Stanley Fiduciary Management

All investing, be it retail, professional, or institutional, should be done with an outcome in mind. The fact that so many trustees are making notable investment decisions in an extremely volatile market without a set funding target is worrying enough. Delving into those decisions, and seeing the contrast with risk and hedging appetite, is cause for real concern.

Trustees need to lean on expert help to ensure they fully understand their schemes funding goals, what that means for their risk profile, and which investment options are best suited to those outcomes.

3. The Regulatory Rollercoaster: Regulatory uncertainty more impactful than economic uncertainty for professional trustees' investment appetite

Looking to the next 12 months, investment appetite will be hit by a range of macro and micro factors.

24% of professional trustees say regulatory uncertainty will have the greatest impact on investment appetite in the next 12 months. This came above all economic factors.

23% said the reversal of Quantitative Easing (QE) will have the greatest impact on investment appetite in the next 12 months. The same number (23%) also respectively said the lack of/unclear long-term scheme strategy, cash flow challenges, and the Russia/Ukraine war would have the greatest impact on investment appetite in the next 12 months.

21% said recent market volatility/equity sell-off has the greatest impact, and 20% said the COVID-19 pandemic. 19% said concerns over the strength of the employer's covenant.

The Pension Regulator's DB Funding Code is set to be operational by September 2023, and will put pressure on schemes to improve their funding positions quickly.

In that context, it is perhaps surprising that most trustees expect their appetite for investing across different asset classes to continue to increase, including long-term and illiquid investments like property and infrastructure.

	It will increase (Net)	It will increase significantly	It will increase somewhat	It won't change	It will fall (Net)	It will fall somewhat	It will fall significantly
ESG/sustainabale investing	**77%**	31%	46%	19%	**4%**	4%	0%
Property	**77%**	34%	43%	17%	**6%**	4%	1%
Currencies	**73%**	36%	37%	23%	**4%**	3%	1%
Equities	**74%**	40%	34%	21%	**4%**	4%	0%
Fixed income	**69%**	30%	39%	27%	**4%**	4%	0%
Commodities	**77%**	30%	47%	16%	**7%**	7%	0%
Infrastructure	**73%**	27%	46%	21%	**6%**	4%	1%
Infrastructure	**74%**	37%	37%	20%	**6%**	4%	1%
Illiquid assets	**74%**	44%	30%	20%	**6%**	3%	3%

The same themes persist when we look at this through the lens of set funding targets though, and by what trustees' intended targets are likely to be.

Despite most trustees not having set a funding target, we can see clear diversions in appetite depending on what the likely target is going to be. Those pursuing superfund consolidation are expecting to take on more long-term investments like property and 'illiquid assets', whereas trustees pursuing self-sufficiency are leading the charge on ESG/sustainable investing.

	All trustees	Funding target set?		Likely target?		
		Funding target not set (Net)	Funding target set (Net)	Self-Sufficiency	Buy-out via an insurer	Superfund consolidation
ESG/sustainable investing						
It will increase (Net)	77%	82%	75%	85%	71%	74%
It will fall (Net)	4%	0%	6%	11%	0%	0%
Property						
It will increase (Net)	77%	82%	75%	74%	67%	95%
It will fall (Net)	6%	0%	8%	11%	4%	0%
Currencies						
It will increase (Net)	73%	59%	77%	81%	58%	79%
It will fall (Net)	4%	6%	4%	4%	4%	5%
Equities						
It will increase (Net)	74%	65%	77%	74%	67%	84%
It will fall (Net)	4%	6%	4%	7%	4%	0%
Fixed income						
It will increase (Net)	69%	76%	66%	59%	75%	74%
It will fall (Net)	4%	0%	6%	11%	0%	0%
Commodities						
It will increase (Net)	77%	82%	75%	81%	71%	79%
It will fall (Net)	7%	12%	6%	7%	13%	0%

	All trustees	Funding target set?		Likely target?		
		Funding target not set (Net)	Funding target set (Net)	Self-Sufficiency	Buy-out via an insurer	Superfund consolidation
Hedge funds						
It will increase (Net)	73%	71%	74%	74%	71%	74%
It will fall (Net)	6%	6%	6%	11%	4%	0%
Infrastructure						
It will increase (Net)	74%	82%	72%	78%	71%	74%
It will fall (Net)	6%	0%	8%	7%	4%	5%
Illiquid assets						
It will increase (Net)	74%	82%	72%	70%	71%	84%
It will fall (Net)	6%	0%	8%	11%	4%	0%

The 2030 time bomb

In 2030, RPI and CPIH will be aligned. A decision taken by the Treasury rather than the DWP or TPR, this regulatory shift will no doubt have an impact on scheme funding decisions.

39% of professional DB pension trustees say they will increase their exposure to index-linked assets to mitigate the risk of RPI and CPIH shifting to become aligned. 23%, however, said they will reduce their exposure to index-linked assets to mitigate the risks of this shift

This discrepancy is largely led by the nearness of the funding target – of those aiming to achieve their funding objective within 10 years, 35% will increase their exposure compared to 47% who will be 10 years+. Contrastingly, 27% will reduce their exposure vs 11% of those 10 years+.

39% say they will bring forward their endgame planning to pre-2030 to mitigate RPI and CPIH alignment risk 37% said they will push for a higher contribution from employers to mitigate any investment losses. A mere 4% are taking no measures to mitigate risk because of the RPI/ CPIH shift.

4. The Great Trustee Exodus: Two in five professional trustees plan to step down from their role within a year

80% of professional DB pension trustees plan to step down from their role within 3 years – this is an increase from 62% last year. Crucially, 40% of professional DB pension trustees plan to step down from their role in 7-11 months, while 40% plan to step down from their role in 1-3 years. The final 10% plan to step down from their role in 4-5 years.

This means that the average professional DB pension trustee expects to stand down in about 20 months.

Should this exodus intention bear true, pension schemes will find themselves with a sudden gap in professional oversight. It's vital that the industry puts the work in now to find out what's driving the move, and also try to attract and retain the required new influx of talent.

Once again, regulatory burden is a consistent theme here

Looking into the reasons behind why professional DB pension trustees plan to step down from their role, 28% said the regulations are too burdensome.

Year-on-year comparisons

	2021	2022
The regulations are too burdensome	56%	28%
I don't feel I have the knowledge to perform the role	44%	22%
The reporting requirements are too onerous	41%	20%
I have health concerns	29%	30%
It's taking up too much of my time	24%	23%
I'm retiring from all work	18%	35%
It's the end of my tenure	12%	27%
I've struggled doing the role remotely	6%	28%
There are no key motivations in my decision to step down as my position as a trustee in the next 3 years	0%	0%

Charles Stanley Opinion

Bob Campion, Senior Portfolio Manager, Charles Stanley Fiduciary Management

The volatility of recent months has shone a spotlight on how vital expertise and experience are in the management of pension funds. Professional Trustees hold a critical position on the board as trusted and expert voices in deciding the best route for the scheme – from the collection of contributions, to the asset allocation, to the payments of benefits – which has only become more entrenched as the landscape for DB schemes gets more complex.

"However, with a notable rise in the number of DB pension scheme trustees looking to step down from their tenure, pension schemes could swiftly find themselves in a sudden shortfall of professional oversight. It's vital that the industry puts the work in now to find out what's driving the move, and also try to attract and retain the required new influx of talent. The good news is that many professional trustee firms already have plans underway to recruit new professional trustees to the industry as it continues to evolve and navigate the changing economic landscape.

About Charles Stanley Fiduciary Management

Charles Stanley has been acting as a Fiduciary Manager to UK defined benefit pension schemes ranging in size from as small as £3m up to over £200m for more than a decade.

Our Fiduciary Management service is designed to be a comprehensive investment solution. We support schemes of any size, providing hands on assistance to the trustees and their advisers throughout the pension scheme's journey. Charles Stanley Fiduciary Management works alongside trustees to plan their investment strategy at the outset, and then takes complete responsibility for implementing it, providing comprehensive yet clear reporting along the way.

Our dedicated fiduciary portfolio managers provide trustees with tailored training, advice and ongoing support as often as needed. We have a team of over 160 investment professionals underpinning the Fiduciary Management service, ensuring we design and implement a sophisticated, long-term investment strategy. The substantial scale of our organisation allows our clients to access best-in-class funds, research, and investment ideas that will enable them to reach their intended goal.

For more information on our Fiduciary Management service and how we can help your Pension Scheme please visit www.charles-stanley.co.uk/fiduciary-management or call 020 7149 6922 to speak with our Fiduciary Management team.

Report contributors

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Bob is responsible for leading Charles Stanley's Fiduciary Management service.

Bob has worked with DB trustees and their advisers for almost 20 years. He is a CFA Charterholder, has a degree in Philosophy from the University of Warwick and is a Council and ExCo member of the Society of Pensions Professionals.

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Rebekah joined Charles Stanley Fiduciary Management in April 2022 as Consultant Relations Director, focussing on business development alongside Bob Campion. Rebekah joins from SEI, where she was also Consultant Relations Director. Prior to that, Rebekah spent 10 years on the Consultant Relations Team at BlackRock. Rebekah has a Business Economics degree from London Metropolitan University, and holds the Investment Management Certificate.

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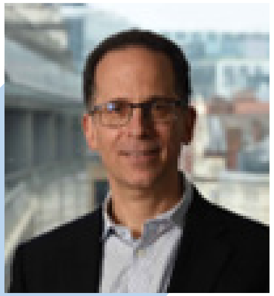

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Jeremy joined Charles Stanley in 2022 from Kempen Capital Management, where he was a portfolio manager for their UK pension schemes. Before Kempen, Jeremy led the development of a new savings solution for UK insurance brand, Vitality, and held senior investment consultant roles at Willis Towers Watson and Mercer, advising institutional clients on investment strategy, risk management and funding objectives. Jeremy has also worked as a scheme actuary. He is a Fellow of the Institute and Faculty of Actuaries and a CFA Charterholder.

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For more information on our Fiduciary Service and how we can help your Pension Scheme please visit www.charles-stanley.co.uk/fiduciary-management or call 020 3918 9343 to speak with our Fiduciary Management team.

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