



**Plus ça change, plus c'est la même chose**

**Pensions World, February 2006 (PW Sub-Editor: "I'd like to teach the world to sing")**

15 years ago, I was young, idealistic and tactful. The little problems that were then encountered in day-to-day work would soon be solved, and the world would be a better place. Or so I thought. That was before I realised quite what UK pensions and investment were about, with all the 'solutions' being marketed by managers and consultants alike. I'm still not sure I really know what UK pensions and investment are about now, but at least I now suspect that I'm not alone. And whilst I really wish I could be more positive that things are getting better, this seems unlikely in the short term at least, and many 'solutions' are not as "new" as some might have us believe.

Further, in spite of all the well-meaning legislation and attempted protection through paper trails, there are many basic things which still drive me up the wall about UK pensions and investment, and I simply don't know which magic buttons to press to change them. So here, dear readers, are a few of them. Anyone who can solve most of them quickly and easily is probably in line to be parachuted without election, via the House of Lords, into Government and the DWP, winning the Nobel prize for economics in the process.

## **Make better use of actuarial valuations**

Actuarial valuations are wonderful things. They cover all your actuarial compliance needs, and they go on for pages ... and pages (in some cases). Yet their writers and users still don't make nearly as much use of the underlying calculations as they could. Few sets of Trustees (or consultants?) seem to realise how much further useful information can be got out of valuation systems at minimal extra cost. For example, you can look at the current age-by-age profile of the liabilities, and see how this is likely to evolve over the next few years (and hence the feasibility or otherwise of maintaining a static investment strategy). You can also see where there are significant accumulations (either individually, or by groups or employment sites). At every stage, this improves Trustees' (and employers') awareness of the interaction between the liability profile, the contributions and costs, and the investment strategy, and makes for better planning. Yet surprisingly few seem to do this.

## **Asset-Liability Studies – do consultants explain their limitations?**

Talk of interaction and analysis leads me on to asset-liability studies - otherwise known as a licence to print money for the advisers in some (many?) instances. The reason for this acerbic observation is simply that most end-users stand little chance of being able to separate out the intrinsic impact of a particular model and its underlying assumptions from genuine scheme-specific effects, and even less chance of knowing which are the key drivers behind the results. Also, even if reports do now focus more on protecting against risks of extreme events (as opposed to focusing on strategies which are better most of the time), this is an area where model- and assumption-sensitivity is greatest. Subjecting reports on these studies to (brief) second opinions can be beneficial for Trustees, yet surprisingly few seem to do this.



## Fees – are professionals killing the goose that lays the golden eggs?

That gets me on to fees in general. Isn't the general idea that we are meant to keep money inside the pension funds for their beneficiaries, rather than lining our own pockets to excess? The key phrase there is "to excess". It is difficult to avoid the conclusion that a non-negligible proportion of advisers are willing to charge more than is reasonable, but they are able to do it because of inherent inefficiencies in the system (or in some cases, advisers may have to do it because of the pressures placed on them by their parent employers). "Nobody ever got fired for hiring IBM" used to be the mantra. Maybe that is still true for those who want the "illusion of comfort". Trustees and employers need to be able to demonstrate they have appointed appropriate lawyers, actuaries, consultants and so on, but when fat-cattery seems on the rise all over the place, "charging because you can" does little to endear us professionals to the underlying pension scheme members.

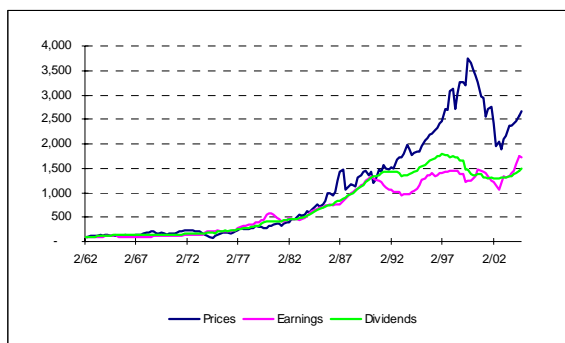
## Asset Transfers for smaller schemes – a plea for uniformity

This is a minor, but surprisingly frequent bugbear. Administration of transfers of assets between investment managers just seems to get ever more tortuous, particularly for small- and medium-sized schemes with the majority of their assets in pooled funds. It would be wonderful to think that for any given product type, you could have consistency across managers for pricing time, dealing time (preferably the same as pricing time), publication of pricing time, and settlement date, but there's a plethora of approaches out there. So, investment consultants face difficulties minimising clients' out of market exposure, while not inadvertently creating double-exposure, and in some cases trying to implement (disproportionately expensive) derivative strategies to bridge the gaps. All this takes time (and fees) which could be better used elsewhere, if a consistency principle was applied.

## A Bond Bubble?

Finally, something else rather bewildering - stampede mentality seems on the rise again, but in a different area. As a baby actuary, I marvelled at the relentless rise of equities, and the way many schemes' asset allocations were becoming more and more biased. I still recall investment managers being shown Figure 1 in the late 1990s and them arguing that there was no reason to be unduly defensive about equities having become too expensive. (The chart shows levels of historic earnings and dividends, and the actual market prices – things got really out of kilter as the 1990s progressed! Use of a log scale would reduce the distortion from compounding, but there was still a material gap emerging.)

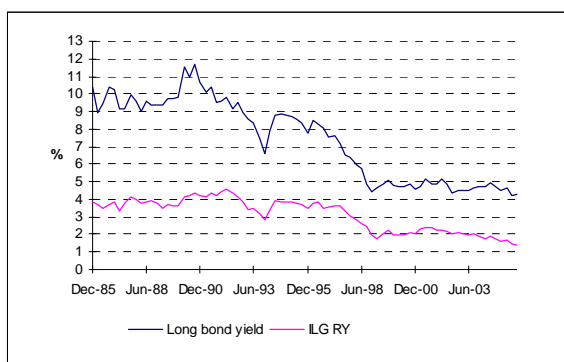
**Figure 1: UK Equities Prices v Earnings v Dividends**





Now, inspired by supposedly “new” liability led investment, the charge is on into (bond) markets which are too small to cope (and made even smaller by significant chunks of relevant assets being held to redemption by investors). Investing to match liabilities is not new (although aiming for marking-to-market is), but the belief in the associated risk minimisation is leading people towards locking in real yields of 1% p.a. (or less) in long-dated index linked gilts, and a vicious circle risking driving yields down further. Figure 2 shows the history of long-dated conventional and index-linked gilt yields – even allowing for falls in expectations of inflation, real yields are in uncharted territory.

**Figure 2: Gilt yields**



And that’s before the cynic in me starts to wonder whether excessive (rather than modest) diversification away from ‘vanilla’ equities and conventional bond products into new, higher-manager-fee, higher-monitoring-cost products is in fact simply going to enable the continuation of a manager- and consultant-feeding gravy train.

So, readers, is it time to change these things? Can we change? Will the world be a happier place? Don’t laugh too much - I only ask.

Simon Jagger  
Director & Actuary