

## Media Comments 2010

**Londres envisage d'avancer l'entrée en vigueur de la retraite à 66 ans, NICOLAS MADELAINE, Les Echos, 25/06/10**

*L'horizon du passage de 65 ans à 66 ans pourrait être avancé de dix ans, et donc intervenir dès 2016. Le gouvernement regarde déjà vers le seuil de 70 ans d'ici au milieu du siècle.*

Dans la foulée de son budget d'austérité présenté mardi, le gouvernement britannique a annoncé hier qu'il lançait une étude sur la nécessité de faire passer l'âge légal de la retraite de 65 ans à 66 ans avant l'horizon prévu de 2026. Et, alors que les travaillistes avaient fixé 2046 comme butoir pour les 68 ans, l'administration Cameron considérera également l'option d'un âge légal de 70 ans d'ici au milieu du siècle. Elle a annoncé qu'elle envisageait aussi de supprimer l'âge de la retraite « par défaut » à 65 ans. Il correspond à l'âge à partir duquel un salarié peut être remercié par son entreprise qu'il le veuille ou non.

Le lancement de cette étude signifie que le gouvernement veut certainement mettre à exécution la plate-forme de campagne des conservateurs qui prévoyait un passage à 66 ans dès 2016 pour les hommes et quelques années plus tard pour les femmes. L'âge de la retraite est actuellement de 65 ans pour les hommes et de 60 ans et quelques mois pour les femmes. Pour ces dernières, il est pour l'instant prévu un âge légal de 65 ans en 2020.

### **« Stupéfiante » espérance de vie**

Iain Duncan Smith, ministre des Retraites, a nié hier que le gouvernement voulait faire travailler les Britanniques « jusqu'à ce qu'ils s'écroulent ». Il a invoqué la « stupéfiante » espérance de vie : 89 ans pour les hommes et 90 ans pour les femmes, des chiffres qui anticipent une poursuite de la progression par rapport au niveau actuel.

En Grande-Bretagne, où on estime qu'environ 60 % des revenus des retraités proviennent du système étatique de retraites et 40 % des systèmes privés, le sujet d'inquiétude numéro un est le montant des retraites. « A partir des années 1980, le gouvernement a abaissé le niveau de la retraite d'Etat », explique Carl Emmerson, directeur adjoint de l'Institute for Fiscal Studies. Aujourd'hui, pour simplifier, un retraité touche environ 98 livres par semaine de retraite d'Etat de base et peut au maximum doubler ce montant en fonction de sa retraite d'Etat indexée sur ses revenus, explique cet expert. Toute personne ayant travaillé trente ans, et atteignant l'âge légal de la retraite, qu'elle continue à travailler ou non, bénéficie de ce traitement (si elle n'a travaillé que vingt ans, elle en touchera les deux tiers).

### **Revalorisation des pensions**

Jusqu'à récemment, presque tous les salariés du privé bénéficiaient de retraites complémentaires relativement généreuses offertes par leur entreprise. Mais les employeurs ont pu rogner sur leurs engagements. Au lieu de garantir des annuités, ils ne se sont notamment engagés qu'à mettre de côté un certain montant par an dans un

fonds. Pour **David Blake**, expert à la Cass Business School, « *la Grande-Bretagne est particulièrement mal préparée au passage à la retraite de ses baby-boomers, moins prêts à une diminution de leur niveau de vie que les générations précédentes.* »

Pour revaloriser les pensions étatiques, le gouvernement a annoncé l'indexation des retraites de base sur le plus avantageux de ces trois critères : l'évolution des prix, des revenus ou un minimum de 2,5 %. Il veut également que l'inscription à un système privé soit automatique au lieu d'être optionnelle. Le coût de la nouvelle indexation coûtera très cher. D'où le passage de 65 ans à 66 ans, et peut-être aussi de nouvelles contributions demandées aux actifs.

**PP Investment Conference 2010: UK government should issue longevity bonds to mitigate risk, Professional Pensions, 2 Jun 2010, By Sebastian Cheek**

The UK government should issue longevity bonds to help pension schemes and insurance companies address longevity risk, the Cass Business School says.

Cass Business School professor of pensions and economics, and director of the Pensions Institute David Blake said the government should set up a working party to carry out a cost benefits analysis to issue longevity bonds.

He said this would provide a benchmark for the pensions industry.

The bonds would pay a declining coupon to a cohort of the population, for example, 65-year-old males, payable until the age of 75.

The bonds would have a terminal payment to cover risk past 105 years. Blake added: "No one wants to pick up tail risk".

He said with £1trn in defined benefit liabilities, the largest plans were going to consider and need this. With £450bn in defined contribution assets, a longevity bond fund would reduce income volatility at retirement.

Blake said the issuance would be small compared with the overall size of government bonds.

He added the call had received support from the Confederation of British Industry, the International Monetary Fund, the Organisation for Economic Co-operation and Development and the World Economic Forum.

**Pension policy will wreck savings plans: Retired people risk outliving their resources and also bear the responsibility of managing their financial assets, *The Times*, May 27, 2010**

Sir, The new Government has confirmed manifesto promises to remove the requirement that individuals use their pension fund to buy an annuity at retirement. Such a policy would be popular, easy to implement and generate much-needed tax revenues. However, we have grave concerns that this will have serious consequences for the security of pensioners' retirement incomes and the public finances.

Without an annuity, retired people risk outliving their resources and also bear the responsibility of managing their financial assets. If things go wrong, they will surely turn to the taxpayer for help. The Conservatives propose a minimum annuity purchase, so pensioners never become eligible for means-tested benefits. We suspect that estimating such a minimum will be difficult, since benefits are calculated according to individual circumstances and these circumstances, together with the level of state support, are likely to change considerably over the next 30 years.

The proposal could lead to significant changes in the nation's savings decisions and tax payments. It could also encourage members of occupational pension plans — including those in the public sector — to access their entire fund as a lump sum rather than receive it as income. This would turn the current steady decline in defined-benefit pension plans into a rout, as pension fund sponsors — and that would include the Government — had to find cash immediately, instead of gradually over a long period into the future.

We suggest that the seriousness of the unintended consequences of their pension policy is fully recognised and that the policy proposal is re-examined.

Professor David Blake  
Director, Pensions Institute, Cass Business School

Dr Edmund Cannon  
University of Bristol

Professor Ian Tonks  
University of Exeter

### **ANALYSIS-Who wants to pay forever? Hedging longevity risk**

- \* Pension industry sees longevity risk concentrated on them
- \* Says nascent swaps market needs longevity bond to support
- \* Government, capital markets hesitate to buy in

By Sarah Hills

LONDON, April 7 (Reuters) - The ageing of Europe may open opportunities to sell savings products, but it also spells a real threat to parts of the financial services industry. Pensions experts call it the "toxic tail".

Like the subprime crisis faced by banks in 2008, the risk of people living for up to 20 years after retirement seems to have crept up on an industry based on using historical data to calculate people's chances of an early death.

Now, pension funds and insurers say the mounting burden of protracted pensions payments is increasingly concentrated on a small group of providers: them.



Global pension private-sector liabilities are of the order of \$25 trillion, according to OECD data in a January Pensions Institute report, which cited estimates that every additional year of life expectancy at age 65 adds around 3 percent to the present value of some UK pension liabilities.

Several factors -- the market crash brought on by subprime lending, new solvency rules for insurers due in 2012 and the stampede of baby-boomers to retirement age -- are adding urgency to providers' efforts to spread their exposure.

The UK has seen a flurry of over-the-counter longevity swaps deals, the biggest of which so far involved German car maker BMW <BMWG.DE> in February offloading 3 billion pounds of risk from its UK pension scheme to Deutsche Bank's <DBKGn.DE> insurance subsidiary Abbey Life.

Abbey Life insured the longevity risk on the BMW pension scheme, taking responsibility for the payments and transferring a proportion of that risk to a panel of reinsurers.

Building on these deals, pension providers are working to construct capital markets instruments to slice and dice longevity risk into tradeable portions.

But the pensions industry says such markets should be underpinned by a roster of government bonds that are structured to help maintain payments to people who are tending to outlive even current expectations -- for example, those aged over 90.

If that seems like a small group, the evidence is it's the population segment most likely to grow. There are around 450,000 centenarians in the world today and experts estimate there could be a million across the world by 2030. For more details on how centenarians are the fastest growing demographic in the developed world, click [here](#).

There's also mounting uncertainty about how many people will have died by age 90, and the Pensions Institute cites mortality projections which show some men at that age will live beyond 110 -- a long "tail risk" which may boost liabilities significantly.

"Longevity risk is a size that it should also go out to the capital markets," said John Fitzpatrick, a partner at Pension Corporation, which buys out liabilities and sponsors some pension funds. He is also a director of a fledgling venture to make such a market happen.

So far, neither capital markets nor the British government have been enthusiastic about the plan, although investment banks are behind the latest efforts to build a tradeable longevity swaps market.

Proponents of a longevity bond say they are receiving a more receptive response from the Conservatives, the party challenging Labour for government in elections due this spring, but the party declined comment.

WHO WILL BUY?

In a longevity swap like the BMW deal, the automaker reduced its exposure to its longer-lived pensioners by passing this liability to Abbey Life for 3 billion pounds (\$4.6 billion). Typically, that premium is based on agreed mortality risks in the portfolio.

Abbey Life transferred a proportion of the risk to a consortium of reinsurers. The idea is that this risk is then passed onto investors such as Insurance-Linked Securities (ILS) investors, hedge funds and sovereign wealth funds.

They are attracted by the new asset class as an investment which would trade out of synch with traditional assets such as equities, bonds and real estate.

At the fundamental level, longevity risk is a good thing to own if you believe for any reason that more people will die sooner than currently forecast, if you have a portfolio that would lose money should such a catastrophe happen, or if you anticipate returns on the asset.

"Investors ... who own the risk of hurricanes, typhoons, earthquakes and lethal epidemics are ideally suited to take on longevity risk," said Fitzpatrick.

"There is no known correlation between the wind blowing and the earth shaking and how long UK pensioners live -- longevity offers a good diversifying risk for their portfolios," he said.

Capital markets players have already been involved in longevity transactions to a small degree: of the eight publicly announced swaps, the longevity risk was passed through to investors through reinsurers and investment banks.

But these have been bespoke deals. A key to developing such a market would be standardised indices. The Life and Longevity Markets Association (LLMA), of which Fitzpatrick is a director, was set up in February by a consortium of banks, insurers and pension experts to do just this.

## HOT POTATO

Pricing the risk is complex. For a longevity transaction to happen, the investor, pension fund and investment bank have to agree on a forward projection of the cash flows related to either a population index or to a specific pension block.

And markets' resistance at current prices is palpable.

"Pension funds are marketing liabilities at unreasonable levels," said Andrea Cavalleri, head of Life at Securis Investments Partners, a fund dedicated to transferring insurance-linked risk to the capital markets.

"We often disagree with the mortality improvement assumptions provided by the pension funds in what can be outdated models," he said, underlining the basic problem -- people are living longer than previously expected.

"In reality, the capital markets should not be picking up the bill for unreasonable assumptions that the pension funds have on their books," he added, referring to liabilities the pension providers already hold.

Enter the government?

The many arguments in favour of a sovereign bond linked to longevity rest on one fundamental expectation: if pension providers can't pay, or become insolvent, governments will have to.

Longevity bonds could make the process neater, and more politically palatable, than the collapse of a pension provider.

"We will develop collateral mechanisms so investors can trade the risk themselves," said Fitzpatrick of the LLMA.

"But it would be helpful if the government did issue a longevity-linked bond, because such a system would reduce the amount of longevity risk that the government is likely to have in the future."

For a factbox on how a government bond would work, click [here](#).

## UNINTENDED CONSEQUENCES

A paradox in all this is that waves of pension reforms have been designed to shift the risk of providing for old age away from the state or corporates and onto the individual, and people have been encouraged to turn to capital markets to provide.

In principle, pension providers' liabilities have been reduced by moves away from the guarantees in Defined Benefit pension schemes towards less-secure Defined Contribution models, which are more like the U.S. 401(k) plans.

But in practice insurers say that even with the reforms, because people are living longer than expected, the risk of funding new schemes is becoming concentrated with them, especially in Britain.

"Insurance companies are beginning to play a big role in aggregating longevity risk in the economy," said the Pensions Institute paper, co-authored by Blake and Tom Boardman, director of retirement strategy and innovation at Prudential UK <PRU.L>.

When they retire, Defined Contribution plan members usually use capital accumulated in the schemes to buy an annuity -- commonly sold by insurers -- to provide their future income.

So sellers of annuities are the ones now exposed to the risk that holders will typically live longer than expected in pricing the product. This "aggregate longevity risk" cannot be hedged, Boardman says.

"The situation is particularly acute for insurance companies operating in the European Union," said the paper. The insurance industry's equivalent of Basel II for banks, Solvency II, is due to be introduced in 2012 and currently proposes that insurers be required to hold significant extra capital to back their annuity liabilities if longevity risk cannot be hedged.

As a result, affordable annuities are becoming harder to find.

"If the private sector is unable to hedge aggregate longevity risk, it increases the likelihood that insurance companies stop selling annuities or increase annuity prices, which would reduce pensioner income in retirement," said Boardman.

## LONGEVITY FLOATERS

The pensions industry wants the government to issue bonds whose coupon payments, made to pension plans and annuity providers, depend on survivorship: if more people survive at each age than was expected, the government pays higher coupons.

If, on the other hand, survivorship is lower than expected, the bond pays out lower coupons. Pension plans and annuity providers would see their payments also fall.

Boardman argues that the private sector can hedge risks at an individual level, but the government needs to provide the hedge against the trend. The industry says the bond could be similar to inflation-linked gilts first issued for pension funds in 1981.

"The government helped the development of the inflation swap market by issuing an index-linked bond because it gave a pure price for inflation risk to the market," said the Pension Corporation's Fitzpatrick.

"Likewise, it would be helpful for investors to be able to see a pure price for longevity. A large traded market in longevity would develop as you have today around inflation swaps."

The government has so far been averse to the implication that by issuing a longevity bond, it would be assuming the risk of the old getting older that no-one foresaw when pension reforms were implemented.

But the pensions industry points that the government is already exposed to longevity risk: private-sector pension liabilities and public sector funded pension plans both exceed 1 trillion pounds each, according to Boardman's paper.

"Nobody wants to take on the tail risk," said Blake. "The government bonds are necessary because the investors who have recently become interested in taking the other side of the longevity swaps market have no appetite for hedging long-duration tail longevity risk."

Securis Investments Partners' Cavalleri thinks it's simpler than that.

Unless the starting assumptions are appropriate, the need for pension and annuity players to hedge is misleading, he said.

"It is about getting rid of unwanted and unattractive risks. Frankly, we don't see who would want to be on the receiving side of that -- at least on current terms."

(Editing by Sara Ledwith and Nigel Stephenson) ((sarah.hills@thomsonreuters.com))

### **FACTBOX - How longevity bonds may work**

(This complements a story on longevity risk and capital markets. Click [here](#) for the article)

Apr 7 (Reuters) - Pension insurers have been lobbying the British government to issue bonds linked to the longevity of the population, to help pension schemes and insurers manage the financial pressure of increased life expectancy.

Similar to the introduction of inflation-linked gilts first issued for pension funds in 1981, the government could issue a series of longevity-linked floating-rate bonds, creating a hedge against the financial risks posed by increase life expectancy.

Here's how the bonds would be structured:

- \* The bond pays coupons that reduce over time in line with the actual mortality experience of a particular age group in the population, such as 65-year-old males from the national population: so the coupons payable at age 75, for example, will depend on the proportion of 65-year-old males who survive to age 75.
- \* The bond pays coupons only and has no principal repayment.
- \* Coupon payments are triggered when the longevity risk is high: so, for example, the first coupon might not be paid until the cohort reaches age 75. The coupon payments continue until the maturity date of the bond which might, for example, be 40 years after the issue date, when the cohort of males reaches age 105.
- \* The final coupon incorporates a terminal payment equal to the discounted value of the sum of the post-105 survivor rates to account for those who survive beyond age 105. The terminal payment is calculated on the maturity date of the bond and will depend on the numbers of the cohort still alive at that time and projections of their remaining survivorship. It is intended to avoid the payment of trivial sums at very high ages.
- \* If population survivorship is higher at each age than was expected, the bond pays out higher coupons. This is what pension plans and annuity providers need to help match the higher than expected pensions and annuity payments they need to make.
- \* If, on the other hand, survivorship is lower at each age than was expected, the bond pays out lower coupons. But the pension plans and annuity providers are not likely to mind this, since their pensions and annuity payments are also likely to be lower.

Support for the idea:

\* The Pensions Institute has cited a number of organisations that support the concept of governments issuing longevity bonds.

\* The UK Pensions Commission and the IMF agree the government should consider their use to absorb tail risk for those over 90, while the OECD and the World Economic Forum argue that governments could improve the market for annuities by issuing longevity indexed bonds and producing a longevity index.

\* The UK Confederation of British Industry said the government should drive development of a market in longevity bonds.

Who benefits?

\* Proponents say the government gains by having both a more secure defined contribution (DC) pension savings market and a more efficient annuity market, resulting in less means-tested benefits and a higher tax take.

It earns a market-determined longevity risk premium, further reducing the expected cost of the long-term national debt.

\* Defined Benefit (DB) schemes have the opportunity to reduce longevity risks and can hedge longevity risk exposure prior to buy out.

\* Insurers can potentially establish a mark-to-market longevity risk term structure, and hence hold the optimal level of economic capital or at least hold capital closer to the economic level, in line with current proposals for Solvency II regulation, due to take effect in 2012.

\* Capital markets would get help to kick-start market participation through the establishment of reliable longevity indices and key price points on the longevity risk term structure.

They can build on this longevity risk term structure with liquid longevity derivatives.

\* Investors get access to a new (longevity-linked) asset class whose returns are uncorrelated with traditional asset classes, such as bonds, equities and real estate

\* Pension plan members would have a means of hedging the longevity risk associated with purchasing an annuity at retirement.

(Source: Pensions Institute discussion paper - Sharing Longevity Risk: Why Governments Should Issue Longevity Bonds) (Reporting by Sarah Hills; Editing by Sara Ledwith)

**Jury out on top fund persistence, By Steve Johnson, *Financial Times*, FTfm, March 29 2010**

Investment companies should reward their star fund managers more lucratively and sack poor performing managers more quickly, according to research by Cass Business School's Pensions Institute.

The Institute concluded that past performance is no guide to future returns in the fund industry because successful, skilled fund managers jump ship and the highest returning funds attract sizeable inflows that render them less nimble.

In contrast, poor performing funds that suffer significant outflows and fire their fund manager tend to improve their performance.

“Losing fund managers seem to be incapable of extricating themselves from losing positions without external prompting, so the investment management company needs to replace them much more quickly,” said Prof David Blake, director of the Institute and co-author of the report\*.

However, a separate study by Aviva found that for multi-asset unit-linked life and pension funds, buying the previous year's winners was a successful strategy.

Over the past 20 years, Aviva found that top quartile funds returned, on average, 8.3 per cent in the following year, while previously bottom quartile funds made just 7.1 per cent.

Its analysis of the £200bn (€222bn, \$297bn), 1,675-fund strong sector found funds were significantly more likely to be in the same quartile in consecutive years than if performance was purely random.

“I was taken aback to see not only was there persistence [of performance], but that it was statistically significant,” said Jason Josefs, manager of Aviva's £16bn multi-asset book, who compiled the research. “You should think about buying the best performing funds.”

However, the Cass study suggests that persistence of performance does not exist for mutual funds, even though some managers are more skilled than others.

Based on a sample of almost 4,000 US equity funds between 1992 and 2007, the research found if the manager of a “winner” fund (top decile in the previous year) departed, performance deteriorated, on average, by 1.21 percentage points the following year. If the fund also experienced above-average inflows, the deterioration rose to 2.29 percentage points.

A “winning” fund that both lost its manager and had strong inflows undershot a winning fund that saw neither of these effects by 3.60 percentage points.

“A successful fund is going to get an awful lot of flows coming in. If you try and scale-up the investments you dilute performance,” said Prof Blake.

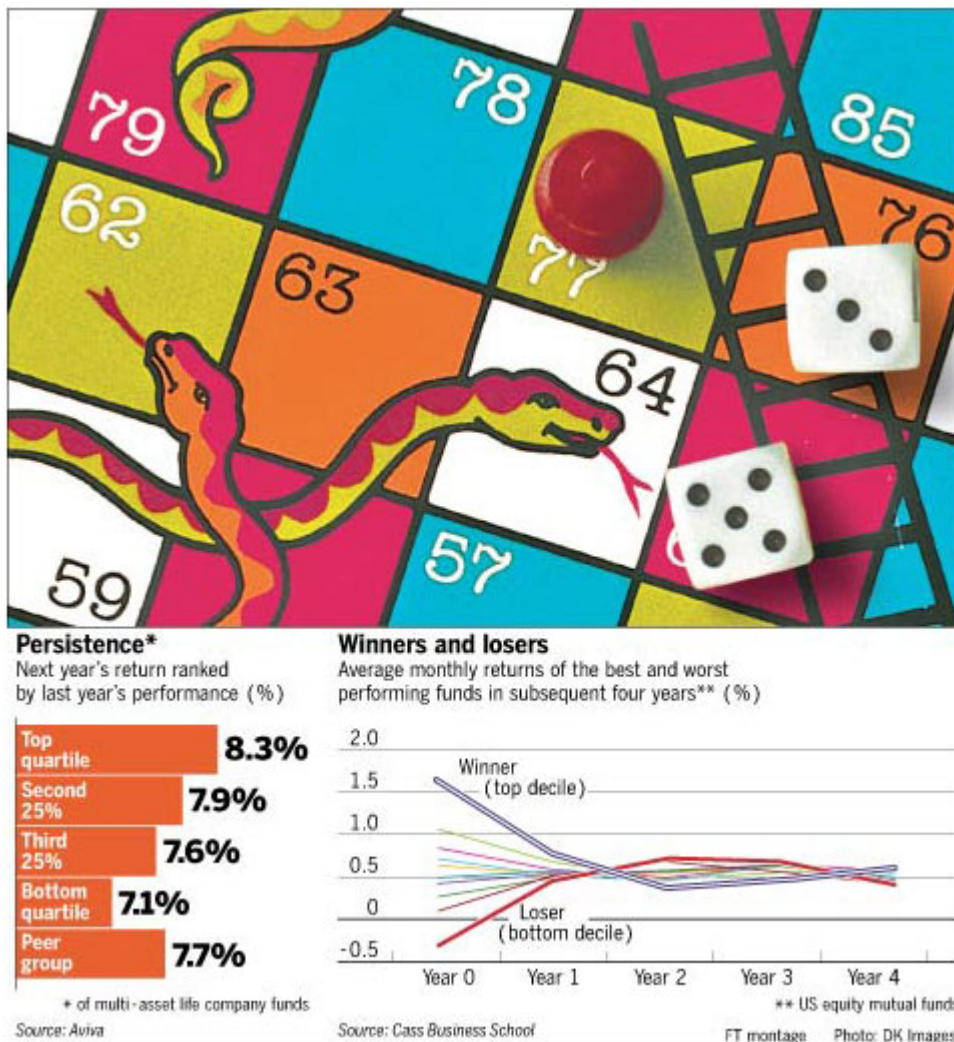
The effect is so strong that top decile funds in one year will typically be the very worst performing ones two years later.

The deterioration occurs even when the star manager of a large fund house leaves, the analysis found, suggesting even the industry heavyweights do not have large enough talent pools to compensate.

In contrast “loser”, or bottom decile, funds that sack managers and suffer strong outflows improve their performance by 3.00 percentage points the following year.

Prof Blake believed Aviva’s findings reflected a degree of momentum in performance from one year to the next, as well as the fact that life funds are less susceptible to damaging “hot money” flows than mutual funds.

\* Why does Mutual Fund Performance not Persist? The Impact and Interaction of Fund Flows and Manager Changes by Wolfgang Bessler, David Blake, Peter Lückoff and Ian Tonks



Bring the ‘golden cohort’ to the fore, *Financial Times*, March 22 2010

From Prof J.H.C. Leach.

Sir, Although there has been much concern over the impact on [pension schemes](#) – especially the state scheme – of what appears to be the UK's unexpected, and therefore unpredicted, increasing life span, I have yet to see in your pages any discussion of one highly relevant matter, well known to actuaries: I refer to the “golden cohort”. This body of persons is that which was born in, or around, the middle 1930s.

Of course, one can rightly refer to the decline in smoking, the abolition of childhood diseases, the NHS, and the overall rise in the standard of living. But there is another, non-recurring factor: food rationing. Those in the UK who were born in the 1930s, and are now in their late 70s, were faced with rationing from 1940 to its end in 1954. No chance then to glut oneself on dairy foods, or other deleterious foodstuffs: they were simply not available. And the fact appears to be that the said “cohort” is contributing markedly to what would have been otherwise an unexpected current rise in longevity.

This raises the question: when the golden cohort itself passes on (which it appears to be in no hurry to do), will actuaries’ predictions of longevity revert towards their earlier assumptions? Or not?

The matter is of no little importance to pensions providers – as evidenced by the letter from David Blake ([“Why government should issue longevity bonds”](#), March 18).

J.H.C. Leach, London N6, UK

### **Government should buy protection, *Financial Times*, March 22 2010**

*From Mr Daniel Ah-Sun.*

Sir, I fear that [David Blake](#) (Letters, March 18) has overlooked the key risk that increased longevity poses to the country: namely, it is the state that faces that risk at least equally with, and most probably to a greater extent than, private sector pension schemes and insurance companies. Be it through state pensions, care for the elderly, housing requirements or other state spending, it is the government that should wish to buy protection against increased longevity, not sell it.

While I agree that a liquid and tradeable market in longevity bonds is desirable and will surely be formed over the coming years, the idea that the government should be a seller and not a buyer in such a market seems to me to be entirely wrong-headed. Any engagement by the government in this issue, sadly ignored and pushed under the carpet for the last decade, would be a step in the right direction. However, when it comes to having capital to put behind any such sale, the current government may not have enough credibility in the markets to be able to back such a bond in any case. No bad thing.

Daniel Ah-Sun, London SW1, UK

### **State should sell annuities direct to our pensioners, *Financial Times*, March 24 2010**

*From Mr Paul Dare.*

Sir, Prof [David Blake](#) (Letters, March 18) is confident that the UK could issue longevity bonds at prices that would benefit the taxpayer and that this would, if done, be carried out profitably.

However, it would be much safer and efficient for taxpayers if the government sold annuities directly to UK pensioners, rather than relying on the market to construct good annuities with the help of longevity bonds. This would cut out so many middlemen and avoid the risk of overly benefiting others if longevity bonds were issued, such as non-UK citizens needing good pensions and the investment bankers and so on who would become involved.

Everything needing to be known about these prospective UK annuitants is known already by the state. Their bank accounts (where they already receive their state pensions), addresses, National Insurance numbers, ages and much more besides are on record. Further, the annuity products offered need not be sophisticated. The products could be kept simple. The selling process could be simple too, like the current one for deferring the state pension in exchange for a bigger pension later.

If it later transpired that the annuities sold were overpriced, the taxpayer would benefit as Prof Blake indicates. If, however, the annuities sold were underpriced, then taxpayers would have benefited through the opportunity they had to buy the cheap annuities.

Paul Dare, London SW13, UK

### **Why government should issue longevity bonds, *Financial Times*, March 18 2010**

*From Prof David Blake.*

Sir, Your editorial "[Sovereign equity: governments need new instruments for raising finance](#)" (March 15) failed to mention longevity bonds as a source of new government finance. Not only would the government earn a longevity risk premium from issuing longevity bonds, the bonds would help private sector pension schemes and annuity providers hedge the aggregate longevity risk they face, a risk that cannot be hedged using existing financial instruments.

This issue will become increasingly acute over the next couple of years as the baby-boomers begin to retire, crystallising the longevity risk exposure of pension schemes and annuity providers. There is a risk that Solvency II will require insurers to hold significant additional amounts of capital to cover longevity risk as it will be deemed to be "unhedgeable". This could result in annuity rates falling by up to 10 per cent, with a consequential increase in means-tested benefits and a reduction in taxation from pension incomes.

In short, there are three main reasons the government should issue longevity bonds: it has an interest in ensuring an efficient annuity market; it has an interest in ensuring an efficient capital market for longevity risk transfers; it is best placed to engage in

intergenerational risk sharing and the longevity risk premium earned from issuing the bonds will be more than sufficient to compensate for the additional risk it would be assuming.

David Blake,  
Director, Pensions Institute,  
Cass Business School,  
London EC1, UK

**How firms 'avoid' pension costs, by Fran Abrams, File on 4, BBC Radio 4, Tuesday, 9 March 2010**

Once, Steve Hall could have looked forward to a prosperous retirement thanks to his company's pension scheme. But now he is facing financial uncertainty.

"The worst case scenario is I could lose probably 30 to 40% of my pension - it's not just me as it must be 200 to 300 people that have an interest in the pension scheme that are going to have their futures affected," he told BBC File on 4.

Eight months ago the Worcester-based company he worked for, which was owned by former Tory cabinet minister Stephen Dorrell MP and made work wear, went into so-called pre-pack administration.

The assets were sold to a new business trading under a new name but without the pension liability of the old business.

Instead of drawing his planned pension, Steve Hall and others in the scheme will have to rely on the government's Pension Protection Fund (PPF), which was set up to ensure pensioners were not left high and dry when their former employers went bust.

The PPF is funded by levies on company pension schemes.

*Pension cap*

Most employees will receive 90% of what they are owed. But as a high earner Mr Hall said he would get less because payments are capped.

"All the pensioners are still in limbo as to what their pensions will be in the future, it just seems totally wrong," he said.

Mr Dorrell took his and his wife's pension out of the scheme before the company closed, in an attempt to reduce its liabilities.

He now has shares in the new company plus a director's salary in addition to his Westminster pension.

"My wife and I would have been better off if we had stayed in the fund and ended up in the PPF," said Mr Dorrell, who added that his family had lost the £500,000 it invested during 2007 to try and save the business.

He told File on 4 that administration had been a bitter pill to swallow for both his employees and himself but it had saved 400 jobs.

There is no suggestion that the pre-pack deal was illegal - the Pensions Regulator approved the scheme's admission to PPF.

But it has left a bad aftertaste for employees such as Steve Hall.

"Pre-pack is so easily arranged you can in a single day effectively remove a company's assets and leave the creditors and indeed the pension scheme out on a limb," he says.

"Immoral is perhaps too-strong a word but that's how I feel, it cannot be right that you can so easily rid yourself of liabilities."

### *Fund burdens*

David Blake, director of the Cass Business School in London, also believes pre-pack administrations are being used to dump costly pension fund liabilities.

Under pre-pack administration the company's assets are sold immediately after it has entered administration and often the previous directors or management buy the assets from the administrator to set up a new company.

**“It's obviously legal, because it has been accepted by the regulator, but whether it's moral or fair on everyone else is a different matter”**

It has the advantage of enabling any profitable parts of a business to be salvaged quickly but Mr Blake believes it can also be used to exploit the PPF.

David Blake, director of the Cass Business School in London

"The pension liabilities and assets [of a company] go into the Pensions Protection Fund and then that company restarts under a different name and then finds itself doing business a few weeks later with its pensions liabilities off the books," he told File on 4.

"It's obviously legal, because it has been accepted by the regulator, but whether it's moral or fair on everyone else is a different matter."

The Pensions Regulator brief includes ensuring that companies do not place unfair burdens on the fund.

David Norgrove, its chair, defended the regulator's record.

"There are cases where companies set out deliberately to avoid their pension liabilities and we do have powers to prevent those, and I think we have been pretty successful at that," he said.

Mr Norgrove added that pre-pack deals were "particularly difficult cases and it is our role to act as a creditor with the PPF to make sure that the company really is

inevitably going into insolvency and that the pension scheme is treated fairly in the restructuring".

### *Taxpayer bailout?*

More than 30,000 people rely on PPF, but six times this number are waiting for their scheme to be accepted into the fund, which has a £1.2bn deficit.

David Norgrove said he was confident that the PPF could "continue to meet the claims on it".

He said fears that the fund might become insolvent were "greatly exaggerated".

However David Blake said the taxpayer could have to bail out the PPF.

"The fund will have a reducing fund of good schemes to charge levies to and an increasing pool of weak scheme it can't charge a fair levy on," he said.

"These trends will lead to increasing deficits in the Pension Protection Fund."

*File on 4 is broadcast on BBC Radio 4 on Tuesday, 9 March 2010, at 2000 GMT, repeated Sunday, 14 March, at 1700 GMT. You can listen via the BBC [iPlayer](#) or download the [podcast](#).*

### **David Blake, director of the Pensions Institute at City University's Cass Business School, assesses contract-based DC pensions investment as 2012's reforms approach. Jenny Keefe reports for *Employee Benefits Magazine*, February 2010**

Contract-based defined contribution (DC) pension schemes are the pensions equivalent of Ugg boots - they are loved and loathed in equal measure. In the UK, DC schemes are managed in two ways. They are either trust-based, where the employer provides a trust to represent employees' interests, or contract-based, where employees deal directly with the pensions provider and make their own investment decisions.

Contract-based schemes are cheap and easy to run, but many believe they have a downside because there are no trustees to protect members' interests. David Blake, director of the Pensions Institute at City University's Cass Business School, says: "The most important issue with contract-based DC pensions relates to governance. Trust-based schemes have a trustee board, which does all the due diligence work on key aspects of scheme design.

"Trustees pick appropriate minimum contribution rates and decide the range of retirement income options. They make asset allocation decisions, deciding how much will be in equities and how much in cash, and they choose the specialist investment advisers to carry it all out. Contract-based schemes do not have a board of trustees to provide such good governance.

"There is just the general impression that the default investment funds are not well designed to achieve their required purpose: a good-value retirement income for money that has been invested for so long."

### *Trustees not investment advisers*

Of course, trustees, many of whom are employees, are not investment advisers. This raises the question of whether it would be better for staff to save on administration fees and just give the cash to an insurance company to manage through a contract based scheme. "If significant contributions from both employer and employee are going to be invested over 40 years, then it pays to get an appropriate, dynamic investment policy in place," says Blake.

He concedes that "trustees do not have the skills to do this", and says it is worth appointing a good investment consultant.

When choosing between trust- and contract-based schemes, much depends on an organisation's size, says Blake. "Small employers with low governance budgets will find it easier to hand the contributions over to an insurance company, especially if employees are not sufficiently interested to become trustees. It is this situation the National Employment Savings Trust (Nest) [formerly known as personal accounts] is intended to deal with.

"Larger employers with a workforce more interested in pensions might go down the trust-based route. The future, however, could be Nest for small employers and trust-based DC schemes for larger employers." Nest is due to be introduced in 2012 as part of the government's pension reforms, which will also see the introduction of auto-enrolment, and compulsory employer and staff contributions.

### *Feeling the economic pinch*

Like other investments, contract-based schemes are still feeling the economic pinch. "Very few investment assets have done well in the recession," says Blake. "Equities led the way with falls of more than 25%. Yet, where the default fund in a contract-based scheme was an insurance company's managed fund, which, typically, has a significant holding in bonds, this might have fallen less than funds with heavier equity weightings. But where the managed fund had a large holding in bank bonds, these would have performed badly, too."

Some employers have encountered criticism that they have used the absence of trustees to cut their contribution rates to contract-based schemes. But Blake has not seen any evidence of this. "It is more likely that employer contributions were not that high in the first place," he says. "Employers do not currently have to contribute to stakeholder pension schemes."

Governance is not the only issue bothering Blake. "There is also the general impression that, with contract DC schemes, everything is commission-driven on the part of providers," he says.

### *New FSA rules*

But new rules proposed by the Financial Services Authority (FSA) could knock such practices into shape. The FSA's Retail Distribution Review, published in December last year, could mean consultants and advisers will no longer be able to cash in on

commission from sales of group personal pensions (GPP), stakeholder pensions or group self-invested personal pensions (Sipps). The new rules will come into effect by the end of 2012.

"The FSA is proposing to end commission and replace it with fees for advice," says Blake. "It is likely the greater transparency this will bring will result in fee income being lower than total commission over the life of a typical scheme. Given that contract-based schemes come under the auspices of the FSA, this is likely to lead to advisers being much less willing to market the schemes."

Which brings us to Nest. Under the new system, employers will be obliged to enrol staff into a company scheme or open a Nest, to which they both must contribute. Significantly, the new schemes will be trust-based, run by not-for-profit trustee body, the Nest Corporation. "The Personal Accounts Delivery Authority is, in a sense, the predecessor to the trustee board," says Blake. "It is putting a lot of effort into good governance planning, for example design of the default fund, which 90% of members are expected to adopt."

#### *Need to increase take-up*

"The government has learned some lessons from the poor take-up of stakeholder schemes. The most important of these is the need for auto-enrolment to increase take-up. If auto-enrolment fails because employers encourage employees to drop out, then the only remaining solution is mandatory participation. Even then, the 8% combined minimum contribution into Nest is not going to generate that big a pension in retirement above the state pension, especially when means testing could leave a number of people with little additional net benefit from their additional pension savings."

So the introduction of Nest could mean contract-based plans are on the way out. "The new accounts will be trust-based, so auto-enrolment into these will do little to improve the share of contract-based schemes in the future," says Blake.

He adds the new pension contribution limits for high earners could result in fewer contract-based schemes because staff on high incomes are less likely to be in this type of plan. "The importance of DC plans will continue to increase as [employers] move away from defined benefit provision. But contract-based DC schemes are likely to decline relative to trust-based DC plans."

#### *Blake's top tips for contract-based DC pension investment*

- Look long term. Remember that a pension scheme can last for more than 70 years: 40 years of contributing and 30 years of providing income.
- Bolster governance. Review the scheme's governance arrangements. Is it possible to introduce the equivalent of a trustee board to oversee investment performance and other issues?
- Add up contributions. Regularly review both employer and employee contributions to ensure workers are amassing enough to fund their retirement. Consider future investment returns and changes in members' life expectancy.

- Ditch dud defaults. Make sure the default investment fund offers decent returns without excessive risk.
- Keep a balance. Ensure the default fund shifts to lower-risk asset investments as employees come up to the age at which they want to retire.
- Earn extra income. Make sure workers have access to a range of annuities, including joint-life annuities for those with a partner and impaired-life annuities for people with a health condition. Encourage employees to shop around before buying an annuity.

**Admin woes will distract from NEST investment strategy, *Professional Pensions*, By Emma Dunkley, 29 Jan 2010**

The “administrative nightmare” of auto-enrolment into National Employment Savings Trust will divert necessary attention from the scheme’s investment strategy, the Pensions Institute warns.

Director professor David Blake said keeping track of contributions for migrant and casual workers will be a major challenge for NEST Corporation and it could face problems managing cash flows.

He said: "Think of the problem of dealing with seasonal farm workers living in tents and moving every few weeks to another job. Think what would happen if there was a slight mistyping of their name or National Insurance number when this happened."

He added: "Tim Jones will be concerned to ensure that the money collected is properly allocated to each member's account. He will be far less concerned with investment strategy and stock market movements - the biggest problem will be losing track of cash flows."

A number of people previously recommended collecting contributions for NEST through the National Insurance system, however Blake said the government knew it could not cope with this degree of transactional frequency.

He added: "That's why the government went for a private sector solution."

Blake said PADA also wanted the default fund in auto-enrolment to be fairly low risk in the early years, in order to avoid any reputation damage if there are big falls in the value of members' accounts.

A PADA spokesman said: "PADA is very much focused on achieving excellence for both the administration and the investment strategy."

**Genuine active managers can add value, By Marcus Whitehead, *FTfm*, January 10, 2010**

Within the investment management industry there is the eternal question – does [active management add value](#)? To better inform the debate, I have reviewed the latest academic research in this area from both sides of the Atlantic and come to some

interesting conclusions: passive is rational, closet indexing is not and unconstrained active may just be where the skill is.

The investment market rings with the Financial Services Authority's risk warning that past performance is not a guide to the future. Despite this there is a strong perception that in making decisions to hire and fire investment managers many pension schemes are strongly influenced by past performance – good or bad, and that this can lead to manager changes that add little to performance and in fact can be outright detrimental.

Research on decisions by more than 2,000 UK pension schemes over a 20-year period by [Blake, Timmermann, Tonks and Wermers](http://www.pensions-institute.org/workingpapers/wp0914.pdf) (<http://www.pensions-institute.org/workingpapers/wp0914.pdf>) in 2009 suggests managers were typically fired having significantly underperformed a UK equity benchmark, managers were appointed having recently outperformed the benchmark and that both the fired and hired investment managers produced returns broadly in line with the benchmark index after the change – that is they both performed in line with an index tracker.

A study by [Goyal and Wahal](#) in 2008 looked into similar hiring and firing decisions by US plan sponsors. It showed US equity managers were typically fired for poor performance and hired after significant outperformance. As in the UK, the outperforming manager, once appointed, typically produced returns broadly in line with the index. The fired manager proceeded to outperform the benchmark in the period after their removal.

This leaves us to conclude that pension schemes have failed to consistently add value when changing investment managers. But can active equity managers add value for pension schemes in the first place?

Research into more than 700 pooled funds available to UK pension schemes over a 25-year period by Clare, Cuthbertson and Nitzsche in 2009 found there was little evidence the managers studied could outperform their benchmark index. They also studied “performance persistence”, – whether a manager outperforming in one period tended to outperform in the following period – again they found little evidence of persistence.

A further piece of research comes from the US by Busse, Goyal and Wahal, in 2008 where more than 4,000 US institutional equity funds were analysed over a 16-year period. They found no evidence of manager outperformance on average and also no evidence of performance persistence.

Therefore it seems rational for many UK pension schemes to select a passive manager, as the average equity manager has not exhibited skill and schemes have struggled to identify outperforming managers, despite being strongly influenced by past performance.

However, the academics seemed to bemoan the lack of depth in the data they had available, as they were working off little more than quarterly investment performance data. To dig deeper, we have to look to retail investment funds and in the US, in particular, where these funds must disclose full portfolio holdings on a quarterly basis.

Research into US equity retail funds by [Cremers and Petajisto](#) in 2009 used data on more than 2,500 funds over a 24-year period. They analysed the concept of “active share”, which is the proportion of a manager’s portfolio that does not overlap with the benchmark index. They define a closet indexer as a manager with an active share of less than 60 per cent. They found that managers with a high active share, the concentrated stock pickers, significantly outperformed the closet indexers. They also investigated past performance alongside a manager’s active share, and found outperforming managers with a high active share showed strong performance persistence.

So have we found the Holy Grail – pick top performing managers with a high active share? As ever, there are lies, damn lies and statistics and one piece of research is not an irrefutable proof. However, for investors committed to active management, the message is clear that closet indexers should be avoided and the focus should be on genuine active managers.

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