Media Comments 2018

UK pensions industry faces 'fundamental shift': Consultancy predicts liability driven investment demand to be saturated by 2021, by Chris Flood, FTfm, April 14, 2018

The UK pension industry will undergo a "fundamental shift" over the next three years, curtailing new business growth for asset managers hired to provide sophisticated investment strategies to final salary retirement schemes.

A growing number of UK defined benefit (DB) pension schemes have adopted liability driven investment strategies (LDIs) over the past 20 years to reduce the risk that they may be unable to meet retirement payments that stretch for decades ahead.

Demand for LDIs will slow markedly by 2021, said Hymans Robertson, the consultancy, and the investment bank Nomura, in a joint report published today. They predicted that this shift would also significantly affect the UK government bond market.

LDIs provide protection against unforeseen changes in interest rates, inflation and life expectancy while also helping DB pension schemes to increase assets.

Insight, a division of BNY Mellon, Legal & General Investment Management and BlackRock are the three biggest players in the LDI market.

BMO of Canada, Schroders and River & Mercantile each run more than 100 mandates that are significantly smaller in combined assets than the LDI operations of each of the big three.

A survey by Hymans found that more than three-quarters of the £1.5tn total assets held by DB schemes already employed some form of LDI, suggesting that new demand could become exhausted over the next three years.

"We will reach the age of peak LDI by 2021 at the latest," said Jon Hatchett, a partner with Hymans. "Pension schemes have added about £100bn of notional hedging [via LDIs] annually over the past three years and will not materially hedge above asset levels of £1.5tn."

If new demand for LDIs was to drop to £50bn a year, then the market would not reach saturation point until 2026.

Robert Gall, head of market strategy at Insight Investment, said it would take "many years" before the hedging requirements of pension funds could be fully met.

"We expect the fundamental demand for LDI to persist for the foreseeable future," said Mr Gall.

Professor David Blake, director of the pensions institute at Cass Business School, London, said demand for LDIs would depend on changes in central banks' policies as interest rates were rising in the UK and US.

"It does depend on what central banks do. It is not obvious that pension schemes will want to put on even more hedges that protect against interest rates falling," said Mr Blake.

Hymans' analysis contradicts a more upbeat assessment published in July by KPMG, the professional services provider. It said there was "no end to growth in sight" after estimating that LDI assets stood at £908bn at the end of 2016.

Simeon Willis, KPMG's head of investment strategy, said pension schemes could still be exposed to changes in interest rates and inflation even if they believed they were fully hedged. LDIs would evolve to answer new challenges facing DB pension funds, such as cash flow requirements, predicted KPMG.

No definitive measure exists of aggregate hedging via LDI, a data gap that should be addressed to better inform debate over the health of the DB pension sector, said Hymans.

The growth of the LDI market has boosted demand for long-dated government bonds, the most useful instruments for matching pension requirements.

This demand has helped to push up bond prices and to reduce long-dated index-linked gilt yields over the past 20 years from about 3.8 per cent to -1.6 per cent.

"Pension scheme demand has been a key factor suppressing UK real (inflation adjusted) bond yields," said Mr Hatchett.

He added that any weakening in demand for LDIs among pension funds could lead to "considerable cheapening" in UK gilt prices. This may coincide with moves by the Bank of England to reverse its quantitative easing programme which has supported the bond market since the financial crisis.

Dutch pensions expert: 'Never introduce average contribution model', By Leen Preesman, IPE, 13 April 2018

The UK should not introduce the concept of average contributions for the accrual of an occupational pension, a Dutch pensions expert has warned.

Speaking at a conference at Cass Business School earlier this week, Anouk Bollen-Vandenboorn, professor of tax law for cross-border pension schemes at Maastricht University, argued that this would come at the expense of younger generations.

Younger members of Dutch pension funds paid in relatively more than their older colleagues, she said, and were often not able to reap the full benefits of their contributions at retirement as they often became self-employed during their working career.

As a consequence, support among younger workers for the Netherlands' current pension system was decreasing.

The Dutch government has decided to replace the average contribution model with a degressive one as part of pensions reform, meaning individuals' contributions reduce as they get older. No decision has been made yet over who will pay for the conversion, which could cost up to €60bn in compensation for directly affected scheme participants.

Anouk Bollen-Vandenboorn, Maastricht University

The aim of the London conference was to enable pension experts from the UK and the Netherlands to exchange good and bad experiences with their defined contribution (DC) arrangements.

DC has been introduced widely in the UK. In the Netherlands, however, no more than 15% of pension fund participants are in a DC plan.

Bollen also advised attendees to refrain from capping the tax relief for pension saving "as this would come at the expense of disposable income at retirement".

The Dutch government has limited tax-friendly pensions accrual to approximately €100,000 of a worker's salary. In Bollen's opinion, this mechanism should not be used for tax purposes.

UK pension experts, for their turn, impressed on their Dutch counterparts that freedom of choice for pension fund members should only be extended if there was a well thought-out default option . They explicitly warned against allowing workers to take out a lump sum from accrued pension rights prior to retirement.

Since the introduction of the early retirement option in the UK in 2015 for people aged 55-65, more than €19.5bn had been taken out of more than a million DC pots, according to David Blake, director of the pensions institute at Cass Business School. More than half of these had been fully emptied, he said.

David Blake, Cass Business School

Blake added that as much as €50m of pension savings had been lost to scammers , and concluded that the increased flexibility in the UK's pensions system had hardly contributed to increased pensions saving in DC plans.

Stefan Lundbergh, head of innovation at risk manager Cardano, said that even pension experts usually opted for the default pension choice.

A suggestion from a member of the audience to limit freedom of choice to apply to just part of a person's accrued pension assets was widely supported by panellists.

During the conference, Alwin Oerlemans, head of pensions strategy at the €475bn Dutch pensions provider and asset manager APG, argued that sharing mortality risk and investment risk in both the accrual and the decumulation phase were the best features in the Dutch pensions system.

David Pitt-Watson, London Business School

However, he emphasised that the Dutch system should be improved through facilitating pension savings for the more than 1m self-employed workers. Saving should also be made mandatory for this group, he said.

David Pitt-Watson, executive fellow at London Business School, said the introduction of shared longevity risk in UK pension arrangements would "generate a much better pension".

He noted that the current lack of this provision had made annuities in the UK "very expensive".

UK government exploring options for CDC [updated], By Leen Preesman, IPE, 11 April 2018

The UK's Department for Work and Pensions (DWP) is not planning to introduce secondary legislation to legally accommodate collective defined contribution (CDC) plans, an official has said.

Speaking during a conference hosted by Cass Business School on Monday, Julian Barker, defined benefits strategy team leader, indicated that the DWP would explore existing legislation for ways to provide legal backing for the introduction of CDC.

Barker was responding to a presentation by Jenny Hall, head of regulatory engagement at Royal Mail. The postal service group agreed with its union in February that it would explore switching from its current defined benefit (DB) plan to a CDC arrangement.

Barker said the DWP had not yet started drafting legislation and could not provide a timeframe for doing so, or predict the outcome.

"The subject is difficult to legislate and would require sufficient input from pension funds as well as time," he said. "However, we are working with Royal Mail to understand its concept."

"The subject is difficult to legislate and would require sufficient input from pension funds as well as time"

Julian Barker, DWP

He indicated that parliament was also short of time to deal with the matter.

Barker told IPE that there was hardly any demand from pension funds for secondary legislation for CDC.

Royal Mail's Hall said the group would not switch its pensions arrangements to CDC without proper legal backing. It wants to offer a CDC target pension combined with a DB-style lump sum at retirement for the fund's 142,000 participants.

The group's current pension plan was unaffordable, Hall said, as the employer contribution was set to increase from 17.1% to 50% this year to fund its pension promises.

As one of the advantages of CDC, Hall cited a less conservative investment strategy in the years prior to retirement with the potential of higher returns, as well as "less complexity for participants, who don't have to make investment decisions as required in pure defined contribution [DC] plans".

In 2014 the UK parliament passed primary legislation supporting the concept of defined ambition – also known as CDC – allowing pension plans to provide for arrangements in between the guarantees of DB and the non-guaranteed DC.

However, it later postponed indefinitely the full introduction of the concept.

During the conference, David Blake, director of the pensions institute of Cass Business School, had said there were no less than 11 separate definitions of CDC.

Edit: The DWP has told IPE that secondary legislation for CDC has not been permanently ruled out.

Black Box thinking in the pensions industry, by David Blake and Matthew Syed, PROFESSIONAL PENSIONS, 12 March 2018

At a glance

- The underlying problem across the industry is the lack of an objective and, crucially, timely feedback loop
- Safety in the airline industry is a cultural achievement, driven by a relentless desire to leverage feedback to improve performance

· Authentic accountability and diversity are crucial if we are to address the challenges ahead

Breaking the closed-loop thinking in pensions is possible if we can change our collective mind-set, according to David Blake and Matthew Syed

Why is it that many of us only think about pensions when a major corporation collapses? The disintegration of Carillion is a new and stark reminder. Its pension funds may need a bailout of nearly £900m and, even then, some employees may be much poorer than they expected to be in retirement.

This, together with the news about BHS in 2016, should be enough to have us all reaching for the phone to our pension trustees, checking that all is paid up and looking fine. Making sure that all will be well in our dotage. And yet we don't. And we probably won't. But what if it is already too late?

Despite the publicity surrounding Carillion, few stop to think that around 1,000 other schemes have already fallen into the Pension Protection Fund (PPF) since 2005, leaving their companies bankrupt and employees without jobs.

This is why the mounting pension deficits in the UK should be a major concern. Some FTSE companies have pension liabilities that are much larger than their equity value. International Airlines Group (owner of British Airways), for example, would have to pay an amount equivalent to its market value, in addition to the £24bn in its pension schemes, to offload its liabilities to an insurance company. Collectively, the FTSE 100 has a £680bn deficit hole.

Now, it is entirely possible that this a temporary accounting issue. Interest rates might rally and things might turn out to be fine. But what if they don't, and what if it isn't? Why do we have our heads at least partially in the sand on this vital issue? And is there anything we can do to change our mind-set in order to face this looming vortex head-on?

The underlying problem, across the UK pension industry, is the lack of an objective and, crucially, timely feedback loop. Meaningful feedback is the bedrock of learning and innovation. Take the airline industry. Last year, there were no passenger jet crashes for the major airlines anywhere in the world. This is a staggering achievement when you consider that in 1912 almost half of all US army pilots died, not in combat, but in peacetime. Flying thousands of feet in the air in a large hunk of metal is inherently risky.

Safety in the airline industry is, above all, a cultural achievement, driven by a relentless desire to leverage feedback to improve performance. Aircraft are fitted with two almost indestructible black boxes, which in the event of a crash are recovered, and lessons learned. The industry also analyses near miss events to constantly drive innovation. Even when a plane arrives safely on the destination tarmac, then, the pilots are voluntarily submitting reports highlighting issues, which are shared industry-wide. In short, timely feedback on crashes and near misses drive progress.

In healthcare, things are different. The staff are as bright and committed as in aviation, but the culture lacks a meaningful feedback loop. Instead of learning from every error and near miss, this precious information is too often lost in a culture of blame, hierarchy and fear. Senior doctors, often positioned as infallible leaders, don't like to admit to their mistakes. It is seen as a threat to ego and reputation. Junior staff struggle to admit to honest mistakes due to fear of litigation and sanction. This is tragic because most errors are caused not be negligence but subtle problems in the system which can only be addressed through openness and transparency.

The consequences of this culture can be seen in the hard data. The journal of patient safety estimates that more than 400,000 patients died as a result of avoidable medical error in the United States alone in 2013. It is the third biggest killer behind heart disease and cancer. The underlying problem is that healthcare, all too often, is a ‘closed loop' culture. Learning is lost in a system that doesn't facilitate timely feedback, either internally or across the industry as a whole. The outcome can be catastrophic.

This brings us back to the UK pensions industry, where trustees of DB schemes are also facing the difficulties of closed-loop thinking within a system which often prioritises process and advisory opinion above measurement and objective data. This is compounded by issues of hierarchy in trustee-sponsor relationships - the sponsor is often the trustee's employer. Despite being required by law to act in the best interests of scheme members, it can sometimes be very difficult in these circumstances for trustees to speak out, challenge decisions or question established models when dealing with a robust finance director who might chair the trust board and also wants to kick the pension deficit problem into the long grass of someone else's tenure.

Facing up to mistakes in previous decision-making can be difficult for many boards, communicating them even harder, but to ignore these errors is to risk missing valuable lessons which could inform adaptation and improvements going forward.

But all is not lost. Breaking the closed loop is possible if we can change our collective mind-set. The scientific revolution was inspired by a new attitude to feedback. For centuries between the time of the Ancient Greeks and Galileo in the 17th century, theories were not challenged or tested, and errors were seen as threats rather than as opportunities to learn.

After the time of Galileo, everything changed. Feedback on the defects and inconsistencies were positively sought out as ways to grow, leading to a transformation in the success of western science. Over the last few centuries, it has become arguably the most successful institution in the history of our species. A healthy attitude to failure, and an objective approach to data, has inspired learning, creativity and the solution to an array of human problems that previously seemed unimaginable.

Most pension trustees are responsible, committed and diligent individuals. Operating in a closed loop however, makes learning almost impossible. But maybe it isn't too late. What if The Pensions Regulator were to share anonymised

case studies of failed schemes? What if it were to collate and distribute the learning opportunities so that the entire industry could reap the benefit of a meaningful feedback loop? What if patterns were detected, root causes explored, creative insights shared?

New and diverse thinking is also desperately needed among trustee groups. What if each board were required to have a professional trustee? A paid individual with expertise in the pension industry, someone who would feel empowered to question models, query advice and seek to address poor decision-making in the past. If there is one clear finding from effective boards, it is that diversity in thinking is absolutely fundamental.

There are many further ideas for reform but what is clear is that the industry faces an uncertain future with urgent issues to address within the defined benefit sphere. Authentic accountability and diversity are crucial if we are to address the challenges ahead. The risk is not to confront difficult feedback, but to ignore it. This is too important an issue, however, to duck.

Professor David Blake is director of the Pensions Institute, which published Bringing Black Box Thinking to the Pensions Industry

Matthew Syed is the author of Black Box Thinking

Pension trustees urged to adopt 'black box' thinking, by Pat Sweet, Reporter, CCH Daily and Accountancy, published by Croner-i Ltd, 21 Feb 2018

Pension trustees and regulators are being urged to adopt a 'black box' approach, constantly identifying and evaluating problems with pension scheme deficits, in a bid to encourage best practice across the sector

A report from the Pensions Institute, part of Cass Business School, suggests ways in which the pensions industry might better deal with failed schemes by sharing key learnings from scheme failures.

This could be done effectively if an independent body such as The Pensions Regulator (TPR) were to publish an 'autopsy' on the failure for other schemes and their trustees to learn from, in a similar way the airline industry uses data from 'black box' flight recorders to understand crashes and near misses.

The researchers say the pensions industry is currently characterised by a lack of measurement and hence an absence of the data to make an informed judgement. In assessing errors, with the exception of quantitative information on fund deficits, there are few, if any, yardsticks that can be used to measure mistakes in DB pension schemes in the same way that mortality is used in aviation.

Professor David Blake, director of the Pensions Institute, and one of the authors of the report, said: 'It is clear from our research that too many pension schemes are making the same mistakes again and again. As an industry, trustees are not good at evaluating their failures, learning from them and sharing this knowledge.

‘If we can emulate the open-loop ‘black box thinking’ approach that the airline industry uses to such great effect, we might actually be able to address many of the issues facing DB pension schemes in the UK at the moment’.

Blake said examples include using post-mortems with lessons learned where things go wrong, and using pre-mortems as mechanisms for avoiding future mistakes, such as considering a new investment idea, a move in liability-driven investing, or a forthcoming valuation or enhanced transfer value exercise.

‘There is also an important role for the regulator to play as a clearing house for post-mortems of failed schemes and the lessons that can be learned,’ he said.

Among the problems identified are trustees focusing solely on areas where they are knowledgeable; the separation of investment and funding decisions, and the failure to challenge the sponsor’s recovery plan or dividend policy; a short-termist attitude; failing to recognise biases in others; and becoming distracted from the main focus.

The report suggests that schemes do not systematically measure mistakes, although there are individual examples of best practice. Issues raised include an absence of long-term strategy and a realistic timetable; information overload; risk not being measured; and poor spending decisions, particularly on consultants fees.

The report goes on to highlight that there is no industry-wide approach for trustees and boards to learn from their mistakes, with many boards not having a culture of seeking out and revealing mistakes. It suggests that information sharing is an effective means of addressing many of the problems facing schemes: opening up routes that trustees can acquire and share best practices themselves.

Bringing Black Box Thinking to the Pensions Industry is here.

'Black box thinking' would solve DB problems, says Pensions Institute, by Stephanie Baxter, Professional Pensions, 21 February 2018

The aviation sector's constant evaluation of mistakes to improve safety should be applied to defined benefit schemes, as too many are making the same mistakes again and again, latest research shows.

A report, published today by the Pensions Institute, explores how the so-called ‘black box thinking' approach could help address many of the issues facing DB schemes and avoid the errors of the past.

The strategy - developed by author and broadcaster Matthew Syed - is based on the use of data from black box flight recorders in aircraft to identify and understand the cause of both major accidents and near misses.

The report's authors - Pensions Institute director David Blake, and fellow Matthew Roy - argue the same thinking can be applied to pension schemes, to help manage the issues faced by the trustees and regulators of around 6,000 defined benefit (DB) schemes in the UK.

Based on interviews with pension scheme chief executives, senior trustees, senior policy advisers, actuaries and industry association leaders, the report finds "strong evidence" that "many schemes have a closed loop mind-set towards failure".

The authors argue that in assessing errors there are few yardsticks (apart from quantitative information on fund deficits) to measure mistakes in DB schemes in the same way that mortality is used in aviation. In pensions, there is a lack of measurement and hence an absence of data to make an informed judgement.

Also, the report says that strategic decision-making by boards of trustees could be markedly improved.

There are many actions that individual boards can take for themselves from the bottom-up, which include the regular appointment of new board members and advisers, the report notes. However, it says black box thinking analysis of civil aviation also finds it necessary to have a central clearing house where "actors can learn about the failings of others" - which "the DB sector lacks".

The Pensions Regulator could take up this top-down role by performing post-mortems of failed schemes and making these available to all schemes, it suggests.

Blake said in a statement that "too many pension schemes are making the same mistakes again and again, and trustees "are not good at evaluating their failures, learning from them and sharing this knowledge".

"If we can emulate the open-loop ‘black box thinking' approach that the airline industry uses to such great effect, we might actually be able to address many of the issues facing DB pension schemes in the UK at the moment.

"Examples include using post-mortems with lessons learned where things go wrong, and using pre-mortems as mechanisms for avoiding future mistakes, such as considering a new investment idea, a move in liability-driven investing, or a forthcoming valuation or enhanced transfer value exercise."

Cardano chief executive officer Kerrin Rosenberg, whose firm sponsored the report, also supported creating a "culture of shared learning" to "avoid the mistakes of the past".

"This exciting report presents a radical new approach that needs to be adopted quickly and effectively, so that we can move to a far more efficient governance system that is in a state of continuous improvement," he added.

DB pension schemes ‘make the same mistakes again and again’, by Cherry Reynard, Your Money, 21/02/2018

A report suggests that managers and trustees of defined benefit schemes are failing to learn from their mistakes.

The report from the Pensions Institute, part of Cass Business School, is proposing a new approach to managing the issues faced by the trustees and regulators of the UK's 6,000 remaining defined benefit (DB) schemes.

DB pensions have been under scrutiny as groups such as Carillion have collapsed with holes in their reserves. Pension scheme members have been concerned that their representatives did not hold the company to account.

The new approach suggested by the report aims to address some of the issues surrounding asset returns, interest rates, inflation, and life expectancy. Professor David Blake, director of the Pensions Institute, and one of the authors of the report, said too many pension schemes are 'making the same mistakes again and again'.

Kerrin Rosenberg, CEO of Cardano and sponsor of the report said: "Many trustees have been early adopters of tried and tested risk management practices that have generated good outcomes for both their members and sponsors. However, there are also a large number who haven't. Making decisions that don't deliver the hoped for outcomes is not wrong in itself, if lessons can be learnt and shared. However, making the same poor decisions many times over is the problem. If we can create a culture of shared learning, we may be able to give the pensions industry the knowledge to avoid the mistakes of the past and of their peers."

The report suggests that problems include a focus on the short-term by trustees. There has also been a failure to challenge the sponsor's recovery plan or dividend policy – this has come into focus in the case of Carillion.

Trustees may also fail to recognise biases in others, such as the career concerns of finance directors who need to show that the company is doing well on their watch, or of advisers who temper their advice to clients to avoid losing the contract.

The report said trustees and boards often don't learn from their mistakes, with many boards not having a culture of seeking out and revealing mistakes. It recommended seeking out 'new blood' board members, improving diversity, sharing best practice and using 'post-mortems' where mistakes are made.

Applying Black Box thinking to DB Pension Schemes, Actuarial Post, 21 February, 21 February 2018

A new report from the Pensions Institute, part of Cass Business School, has proposed a novel approach for managing the issues faced by the trustees and regulators of the UK's 6,000 remaining defined benefit (DB) schemes. These issues focus on the strength of the sponsor covenant in the light of huge uncertainties concerning asset returns, interest rates, inflation, and life expectancy.

The new approach seeks to emulate the constant evaluation of mistakes make by certain sectors – most notably the aviation industry – where data from "black box" flight recorders in aircraft are used to identify and understand the cause of both major accidents and near misses, and, in turn, to drive constant improvement in the safety of the sector as a whole. In 2017, through the consistent application of this "open loop" approach, there was not a single passenger jet crash for the major airlines anywhere in

the world.

The Black Box Thinking framework was developed by Matthew Syed, author and broadcaster.

Applying this approach to pension schemes, the report has sought to address three key questions:

1. What mistakes are being made by DB trustee boards today? What are the errors that emerge in strategy setting that Black Box Thinking can be applied to?

2. How do boards evaluate errors? Do boards have a culture of recognising and measuring errors and are they able to learn from their mistakes to improve future decision making?

3. Ways to improve. Based on the analysis, what can schemes do?

In assessing errors, with the exception of quantitative information on fund deficits, there are few, if any, yardsticks that can be used to measure mistakes in DB pension schemes in the same way that mortality is used in aviation. The pensions industry is currently characterised by a lack of measurement and hence an absence of the data to make an informed judgement.

Professor David Blake, Director of the Pensions Institute, and one of the authors of the report, said: "It is clear from our research that too many pension schemes are making the same mistakes again and again. As an industry, trustees are not good at evaluating their failures, learning from them and sharing this knowledge. If we can emulate the open-loop 'Black Box Thinking' approach that the airline industry uses to such great effect, we might actually be able to address many of the issues facing DB pension schemes in the UK at the moment. Examples include using post-mortems with lessons learned where things go wrong, and using pre-mortems as mechanisms for avoiding future mistakes, such as considering a new investment idea, a move in liability-driven investing, or a forthcoming valuation or enhanced transfer value exercise. There is also an important role for the regulator to play as a clearing house for post-mortems of failed schemes and the lessons that can be learned."

Kerrin Rosenberg, CEO of Cardano and sponsor of the report commented: "Many trustees have been early adopters of tried and tested risk management practices that have generated good outcomes for both their members and sponsors. However, there are also a large number who haven't. Making decisions that don't deliver the hoped for outcomes is not wrong in itself, if lessons can be learnt and shared. However, making the same poor decisions many times over is the problem. If we can create a culture of shared learning, we may be able to give the pensions industry the knowledge to avoid the mistakes of the past and of their peers.

"This exciting report presents a radical new approach that needs to be adopted quickly and effectively, so that we can move to a far more efficient governance system that is in a state of continuous improvement."

The key findings developed from a series of interviews with senior trustees and

industry experts are summarised below:

Key mistakes

In decision making, Black Box Thinking suggests mistakes occur when processes that mitigate cognitive biases are absent. Common mistakes include:

(1) Focusing on what trustees know and failing to focus on areas where trustees had little expertise or understanding.
(2) The separation of investment and funding decisions, and the failure to challenge the sponsor's recovery plan or dividend policy.
(3) A short-termist attitude, especially by sponsor-appointed trustees, e.g., in respect of investment performance and hedging strategies.
(4) Failing to recognise biases in others, such as the career concerns of finance directors who need to show that the company is doing well on their watch, or of advisers who temper their advice to clients to avoid losing the contract.
(5) Being distracted from their main focus, e.g., by being drawn into making decisions that are really outside their remit, such as resolving disputes over benefit payment or implementing adviser recommendations, when this should be an executive task handled by a project manager.

Evaluating errors

The report suggests that schemes do not systematically measure mistakes, although there are individual examples of best practice. Issues raised include:

(1) An absence of clear goals and instead a vaguely defined long-term strategy which cascades down into poor measurement of errors in decision making.
(2) Even in schemes with clearer goals, the timescale is often so flexible that the problem can be repeatedly kicked down the road.
(3) While all boards pay attention when the size of the deficit changes, there are few other commonly agreed metrics that boards can monitor that would help to detect mistakes being made.
(4) In the absence of a narrow and clearly defined set of indicators, there is the danger that trustees have so much information potentially available they have trouble identifying signals from noise.
(5) There are two issues in particular that emerge as result of a lack of benchmarks and indicators: risk not being measured and poor spending decisions, particularly on consultants fees.

The report goes on to highlight that there is no industry-wide approach for trustees and boards to learn from their mistakes, with many boards not having a culture of seeking out and revealing mistakes – consistent with a closed loop mindset. Examples raised include:

(1) No ownership of mistakes. A typical example is where an increase in the scheme deficit is blamed on unforeseeably low interest rates rather than seeing this, with the benefit of introspection and hindsight, as an error in their decision making about hedging interest rates.
(2) Executives not pointing out mistakes. The lack of ownership of mistakes is

reinforced in schemes that have a culture where the executive tries to massage the ego of the trustees, so they do not feel that they made a bad decision.

(3) Inertia and herding. Inertia is the most powerful force of all: there is a strong behavioural bias against taking action, particularly if the action is new, such as liability-driven investing. Herding, as in the rush to adopt LDI once it has become "conventional wisdom", is another powerful behavioural bias that needs to be recognised and overcome.

(4) Blaming others is classic closed loop thinking consistent with cognitive dissonance – where our minds are in a state of denial about a mistake and so we reframe the evidence and look elsewhere for scapegoats.

Examples of poor practice include:

(1) Principal-agent gamesmanship between the trustee and sponsor – with both sides holding on to information to protect their power, e.g., trustees who don't want the sponsor to see the investment strategy as they fear the sponsor will unduly try to influence it.

(2) Failing even to attempt to identify mistakes for a variety of reasons, including the skills of the boards, sponsor domination of boards, a particular board chair, poor advice, poor resourcing and low exposure to the workings of peer schemes.

(3) Boards spending too little time on strategic thinking, and instead lurching from one short term problem to another.

Ways to improve

Black Box Thinking suggests that information sharing is an effective means of addressing many of the problems facing schemes: opening up routes that trustees can acquire and share best practices themselves.

First and foremost, from the top down, there is a role for the regulator to play as a clearing house for post-mortems of failed schemes.

Then, from the bottom up, there are a number of different ways of achieving the much needed improvements:

(1) "New blood" board members and advisers appointed on a regular basis.

(2) Improving diversity – one benefit of member trustees is that they are not experts and they ask "naïve" questions in board meetings that are often actually challenging for advisers and board chairs to answer.

(3) Sympathetic advisers sharing best practice experience.

(4) Conferences and forums – these are normally organised by advisers and trustees can feel it difficult to speak openly at them: mistakes are rarely discussed. They could also be used to discuss key performance indicators that would help boards monitor their performance and make detailed comparisons of fund investment allocations.

(5) Away days with presentations from other larger schemes, but not from existing advisers.

(6) Administrative pooling arrangements and consolidation. Having pooled

support can help the sharing of experience.

Examples of good practice include:

(1) Routinely asking each board member one thing we could do better.
(2) Using post-mortems with lessons learned where things go wrong.
(3) Using pre-mortems as mechanisms for avoiding future mistakes, such as considering a new investment idea, a move in LDI, or a forthcoming valuation or enhanced transfer value exercise.

Dutch study recommends CIDC schemes over CDC schemes, by Natalie Tuck, Pensions Age, 14/02/18

Collective individual defined contribution (CIDC) schemes have the advantage over collective defined contribution (CDC) schemes, a study by the University of Utrecht has found.

The study, which was undertaken for the Pensions Institute at the Cass Business School, found that CIDC schemes have a number of important advantages over CDC schemes.

Researchers professor Hans van Meerten and Elmar Schmidt found that despite both schemes featuring collective asset pooling, CDC schemes leave little room for individual risk management. On the other hand, the study found that CIDC schemes can accommodate such individual risk management and feature less complex rules for asset allocation.

In addition, while both scheme types place the risks on pension scheme members, there being no external risk bearer, there is still greater risk sharing amongst scheme members than in individual defined contribution (IDC) arrangements which is what most private sector employees have in the UK.

As a result, the researchers believe scheme members should be duly informed of their legal position vis-à-vis their employer and pension provider. CIDC schemes feature individual pension accounts, making the identification of a scheme member's pension pot easier. This is not the same as individual ownership of the pension pot, which (typically) lies with the provider.

Furthermore, the researchers said that the UK's pension freedoms, which allow people to take their pot as a lump sum, is contrary to the idea of collective risk sharing in CDC and CIDC schemes.

The paper supports a recent submission by Pensions Institute director professor David Blake to the UK's Work and Pensions Select Committee which argued that CDC schemes might be the only form of collective pension scheme that is feasible in the short term.

Blake said the University of Utrecht paper comes at a crucial time in the ongoing debate around pensions.

"In the Netherlands as in the UK, a discussion questioning the sustainability and complexity of DB schemes and their pension promise is taking place and it is useful for us to learn from their experience.

"CIDC schemes do have an advantage – they maintain individual accounts and are better able to deal with sudden cash withdrawals than CDC schemes, yet are still able to exploit economies of scale to the full which lowers costs through, for example, automatic enrolment and the pooling of investment and longevity risks."

Therefore, Blake recommends the government examines the feasibility of establishing CIDC – for both the accumulation and decumulation phases.

"Such schemes would be compatible not only with the defined ambition agenda, they would also be compatible with the new pension flexibilities following the 2014 Budget, while, at the same time, exploiting economies of scale to the full and allowing a high degree of risk pooling," he said.

Collective individual DC schemes best route for savers, finds report, by James Phillips, Professional Pensions, 14 February 2018

David Blake: CIDC schemes do have an advantage

Collective individual defined contribution (CIDC) schemes should be sought as the next form of pension provision, a university paper has recommended.

Although collective defined contribution (CDC) has been touted as the potential middle ground between, and replacement of, expensive defined benefit (DB) provision and inadequate defined contribution (DC) schemes, it does not allow for much individual risk management, the University of Utrecht said.

In the paper, written for the Pensions Institute, professors Hans van Meerten and Elmar Schmidt said the more individual nature of CIDC, where pots are segregated within a pooled investment vehicle, allows for better identification of savers' individual pots.

The paper, titled *The Legal Differences between CIDC and CDC,* drew on experience of CDC in the Netherlands and found that, although it allows for risk-sharing, CDC cannot be tailored to take into account the risk of individuals' needs.

For example, it cannot identify individual pots, and also poses intergenerational issues where older workers are subsidised by younger workers' contributions as premiums are defined and fixed.

In contrast, CIDC, the report said, allows for clear definition of pots, individualisation of risk management, and actuarially fair benefits, while also pooling risk and investments, allowing for economies of scale.

The report said: "The more individual nature of CIDC schemes not only makes the identification of a scheme member's pension easier, it also allows for more individualised risk management and appears to afford more scope for personal freedom of choice."

However, lump sum payments under Freedom and Choice would have to be banned, the report said, as otherwise this "would mean not only an end to risk-sharing in the pay-out phase, but it seems to be contrary to the idea of a CIDC scheme (and indeed a CDC scheme)" making the ‘C' redundant.

Commenting on the report, Cass Business School professor David Blake said CIDC schemes had a clear advantage.

"In the Netherlands, as in the UK, a discussion questioning the sustainability and complexity of DB schemes and their pension promises is taking place, and it is useful for us to learn from their experience," he said.

"CIDC schemes do have an advantage - they maintain individual accounts and are better able to deal with sudden cash withdrawals than CDC schemes, yet are still able to exploit economies of scale to the full which lowers costs through, for example, automatic enrolment and the pooling of investment and longevity risks."

The report comes as Royal Mail reached an agreement with its workers and unions to seek to establish a CDC scheme as soon as legislation permits. The company is understood to be lobbying the government to make the necessary changes in law, which may not require full primary legislation.

PP has explored the viability of introducing CDC in the binary UK pensions system.

UK academic advocates for ‘collective individual’ DC schemes, By Gail Moss, IPE, *12 January 2018*

A leading UK pensions academic has argued for lawmakers to consider introducing “collective individual” defined contribution (CIDC) schemes.

Professor David Blake , director of the Pensions Institute at Cass Business School, is one of a number of experts to have submitted evidence to the UK’s Work and Pensions Select Committee’s inquiry into collective defined contribution (CDC) pension schemes , also known as defined ambition plans.

The select committee, formed by members of the lower house of the UK parliament and chaired by Frank Field, launched its inquiry last November to assess the merits or otherwise of introducing CDC schemes.

Such structures are currently not allowed in the UK, but have been debated in recent years. CDC was put forward by a mediator as a potential solution to a dispute between Royal Mail and workers' union CWU late last year.

However, CIDC schemes would be better suited to the immediate needs of the UK's system, according to Blake.

Professor David Blake, Cass Business School

In his submission to the Committee, he said said: "CIDC schemes maintain individual accounts, they are better able to deal with sudden cash withdrawals than CDC schemes, yet are still able to exploit economies of scale to the full which lowers costs, such as through automatic enrolment and the pooling of investment and longevity risks."

According to Blake, CIDC schemes include three key features that are specific to each individual member and make them easy to understand:

- The CIDC scheme maintains individual accounts for all members in the accumulation phase, so it is easy to value each individual's pension pot;
- The contribution rate is set to be actuarially fair to each member, implying a direct relationship between the contributions that an individual pays into the scheme, and the pension they eventually receive. This contrasts with CDC schemes, in which contributions are averaged on a collective basis to meet a target average salary pension;
- Each individual has their own de-risking investment strategy in the lead up to retirement.

Professor Blake recommended that the government examine the feasibility of establishing CIDC schemes, for both the accumulation and decumulation phases.

He said: "Such schemes would be compatible not only with the defined ambition agenda, they would also be compatible with the new pension flexibilities following

the 2014 Budget, while at the same time exploiting economies of scale to the full, and allowing a high degree of risk pooling."

The deadline for written submissions to the inquiry has been extended to 31 January, after which there will be a call for oral evidence.

The committee is expected to publish its report in the spring.

CIDC schemes 'better' than CDC schemes, pension academic claims, by Natalie Tuck, Money Age/ Pensions Age, 10 January 2018

Collective individual defined contribution schemes are the best pension scheme model, and "better" than collective defined contribution schemes, a top pension academic has said.

The Cass Business School's Pensions Institute director David Blake has said that CIDC schemes may be the only form of collective pension scheme that is feasible in the short term. He added that CIDC schemes might now be possible because of the freedom and choice pension reforms, introduced in 2015.

Blake made the comments in response to the Work and Pensions Committee's inquiry into CDC schemes, which is accepting written submissions until 31 January 2018.

"CIDC schemes maintain individual accounts, they are better able to deal with sudden cash withdrawals than CDC schemes, yet are still able to exploit economies of scale to the full which lowers costs, e.g., through automatic enrolment and the pooling of investment and longevity risks," Blake said.

The academic highlighted three key features of CIDC schemes that are specific to each individual member and which make the scheme easy to understand. The first is that CIDC schemes maintain individual accounts for all members in the accumulation phase, so it is easy to value each individual's pension pot.

Secondly, the contribution rate is set to be actuarially fair to each member, implying that there is a direct relationship between the contributions that an individual pays into the scheme and the pension they eventually receive. This contrasts with CDC schemes in which contributions are averaged on a collective basis to meet a target average salary pension.

And finally, each individual has their own de-risking investment strategy in the lead up to retirement.

Therefore, Blake, in his submission, recommended that the government examines the feasibility of establishing CIDC schemes for both the accumulation and decumulation phases.

"Such schemes would be compatible not only with the defined ambition agenda, they would also be compatible with the new pension flexibilities following the 2014 Budget, while, at the same time, exploiting economies of scale to the full and allowing a high degree of risk pooling," he said.

The Work and Pensions Committee announced its plans to launch an inquiry into CDC schemes in November 2017. The Committee's inquiry is considering the merits of CDCs, the role that they could play in the pensions landscape, the potential benefits to savers and the wider economy and the legislative and regulatory framework that would be required to successfully implement these schemes.

Also known as defined ambition schemes, CDCs differ from defined benefit schemes as they do not promise a retirement income, but have a target or "ambition" amount that it will pay out to members based on long term, mixed risk investment plans. These schemes have view to pay out an adequate level of index-linked pension for life, but also have the ability to redefine the benefits offered if circumstances, like volatile economic conditions occur.

The Pension Schemes Act 2015 outlines "shared risk/defined ambition" or CDC as a distinct category. Despite this, however, regulations under the Act to implement these schemes have not been introduced. This was delayed by further announcements in October 2015 that plans for CDCs would be paused indefinitely in order to allow for auto-enrolment and pension freedoms to be implemented.

Those in favour of CDC schemes have argued that they provide greater assurance of retirement income and more efficient pooling of costs and risks among members than traditional DC schemes.

CIDC schemes offer best scheme model, says academic, By Pensions Expert / *January 10, 2018*

Collective individual defined contribution schemes may be the only viable form of collective pension scheme in the short run, according to David Blake, director at the Pensions Institute, Cass Business School.

In a submission to the Work and Pensions Committee inquiry on collective defined contribution pension schemes, Blake outlined three key features of CIDC schemes.

CIDC schemes keep individual accounts for all members in the accumulation phase, making it easier to value each saver's pension pot, according to the academic.

The contribution rate, would be set to be actuarially fair to each member. Blake said a third advantage of CIDC would be the unique derisking investment strategy afforded to every individual in the run up to retirement.

"Such schemes would be compatible not only with the defined ambition agenda, they would also be compatible with the new pension flexibilities following the 2014 Budget, while, at the same time, exploiting economies of scale to the full and allowing a high degree of risk pooling," he said.

CIDC schemes divide industry, By Alex Warnakulasuriya /Pensions Expert, *January 11, 2018*

Collective individual defined contribution schemes may be the only viable form of collective pension scheme in the short run, according to David Blake, director at the Pensions Institute, Cass Business School.

In a somewhat unexpected move, the Work and Pensions Committee launched an inquiry into collective defined contribution pension schemes in November 2017.

In his submission to the inquiry, Blake outlined three key features of CIDC schemes.

CIDC schemes keep individual accounts for all members in the accumulation phase, making it easier to value each saver's pension pot, according to the academic.

The contribution rate would be set to be actuarially fair to each member.

A third advantage of CIDC, according to Blake, would be the unique derisking investment strategy afforded to every individual in the run-up to retirement.

CIDC facilitates freedom of choice

Under a CDC arrangement, employer and employee contribution rates are set in the same manner as conventional DC schemes. However, assets are pooled, and members are without individual pension pots. Schemes outline a notional target, or ambition, for pension payments, but these are not guaranteed.

In contrast, a CIDC arrangement would draw boundaries between member benefits with their separate pots.

The WPC continues its work on pension freedoms, alongside its CDC investigation. According to Blake, conventional CDC schemes are incompatible with freedom and choice, but CIDC could offer the solution.

The CDC model is "designed to have the members sharing, but it's not designed to have any flexibility whatsoever", Blake said. This comes down to the absence of an identifiable pension pot for each member, he added.

CDC schemes have also raised concerns over intergenerational fairness. "There is a danger of redistribution… the earlier cohort take out money that should really be more appropriately given to the later cohort. It can turn into a Ponzi-type scheme," Blake said.

Advantages of CIDC include low transaction costs and economies of scale achieved through pooled risk, according to Blake.

Arrangement could put schemes up against insurers

The regime under which a CIDC scheme would operate would hold importance, according to Paul Sweeting, professor of actuarial science at the University of Kent.

“If it was an insurance regime then you’d be quite limited on the investments that you’d be able to hold for those retirement payments,” he said.

“If you were in a pensions regime, then you might be able to argue that you could take more investment risk, but you’d be setting yourselves up as direct competitors to insurance companies with perhaps an unfair advantage in terms of the level of capital you’d need to hold,” he added.

Sweeting disagreed with Blake’s view that CDC schemes and pension freedoms are incompatible.

“It’s not necessarily inconsistent with freedom of choice, because you can always work out some sort of transfer value to give to people so they can take it somewhere else and take the level of investment risk they wanted to take, but it’s not designed with freedom of choice in mind,” he said.

The difficulty of linking members to income

In his submission to the select committee, Blake highlighted the ability to set contribution rates for each member with CIDC, creating a direct link between payments into the scheme and the benefits received.

Phil Farrell, partner at consultancy Quantum Advisory, queried the ability to set individual contribution rates in a CIDC arrangement.

“How do you calculate a contribution rate that is deemed to be appropriate to the individual, because it’s inextricably linked to the ambition income level for that person. It might not be what they’re after, it might not be what they require,” he said.

Pension freedoms have been a popular way of giving savers control over their retirement planning. The identifiable nature of savings afforded by CIDC goes some way to meet this demand, but has left Farrell unconvinced.

Although individual pots might address some of the concern of people wanting to know where they are putting their money away, “ultimately, all the kind of factors around that which are going to generate... this adequate income, are going to be out of their hands”, Farrell said