SIGN OF THE TIMES

THE FINDINGS OF THE PENSION FUND PARTNERSHIP'S ANNUAL SURVEY ON OCCUPATIONAL PENSION SCHEMES IN THE UK MAKES FOR SOME INTERESTING READING. **KEVIN SIMS** REVEALS ALL.

Until recently, it was not often that news about occupational pension schemes appeared anywhere other than in specialist industry publications and the financial press. In the past few months, however, there has been an unprecedented amount of column inches and media time devoted to the topic of private and public sector pension schemes. Few people can now be unaware, even if only in passing, that changes are taking place within the industry. Just what these changes are is something The Pension Fund Partnership has been endeavouring to monitor since 1999.

Over the past four years this independent organisation has carried out an annual survey of occupational pension schemes in the UK. Last year's findings make particularly interesting reading, both as stand-alone information and compared to previous years. They confirm that change really is afoot, to varying degrees, in a number of specific areas. Yet the results also reveal that, for other aspects, there is nothing new.

REVEALING FINDINGS. Last year's research covered 269 schemes, the majority of which were defined benefit (DB) plans. This was primarily because responses were requested, where more than one scheme is operated, in respect of the scheme with the largest asset value. Even where DB schemes have been closed in favour of defined contribution (DC) arrangements for new employees, it is usually the case that the DB scheme is still the largest fund. However, when asked what other types of schemes the DB respondents operate, or are involved in, the findings are revealing (see *Table 1*).

Had this question been asked four years ago, this table would undoubtedly have been much less extensive. If nothing else, it shows the breadth of expertise which individuals responsible for overseeing their staff pension arrangements now have to call on.

Among last year's DB respondents, more than one-in-five schemes were closed to new members, while a further 3% had been closed both to new and existing members. The total percentage of closed DB schemes (25%) was up from 14% on the 2001 research figure. Of those not closed, one-fifth overall said it is likely or very likely that their scheme will be closed to at least new members in the next year, up from 13% in the 2001 survey. When examining the detailed breakdown, however, the percentage figure of DB schemes likely to be closed is actually substantially higher among respondents from the smallest schemes (less than £25m) than for the largest (more than £500m).

Aside from scheme closures, another aspect of DB schemes to have come under recent scrutiny is their Minimum Funding Requirement (MFR) positions. In last year's research, the average MFR funding position was 108.7%, down from 111.2% in 2001. Whereas research in 2001 showed a quarter of schemes had a funding level in excess of 120%, last year the equivalent figure was 16%. At the other end of the scale, almost a quarter of schemes had

TABLE 1
WHAT OTHER TYPES OF SCHEME DO YOU OPERATE OR ARE YOU INVOLVED IN?

Other Defined Benefit	17%
Defined Contribution	25%
Hybrid	2%
Group Personal Pension	11%
Stakeholder	32%
No other schemes	37%
Not answered	2%

TABLE 1
WHAT IS YOUR AVERAGE CONTRIBUTION RATE?

Year	Defined Benefit		Defined Contribution	
	Member	Company	Member	Company
2002	5.03	14.05	4.00	7.19
2001	4.88	12.17	4.03	8.21
2000	4.74	12.17	4.14	7.23

TABLE 3
AT TRUSTEE MEETINGS OVER THE PAST YEAR, WHAT HAVE BEEN THE MAJOR ITEMS OF DISCUSSION?

Investment performance	33%
Investment strategy	31%
MFR/Funding/Contribution rates	29%
Actuarial valuation	23%
Myners' Report	21%
Equitable Life (re AVCs)	21%
Investment issues (unspecified)	10%

TABLE 4
IF YOU WERE ABLE TO CHANGE ONE THING IN THE PENSIONS INDUSTRY WHAT WOULD IT BE?

Simplify/reduce legislation	34%
Simplify/remove Inland Revenue rules/limits	15%
Amend/abolish FRS 17	9%
Reduce Government interference/intrusiveness	7%
Reintroduce ACT relief	7%
Make pension scheme membership compulsory	5%

a funding position of less than 100%, compared with 12% in 2001. Overall, 9% of schemes had a funding position below 90%, although when looking just at local government pension schemes, almost one-third had an equivalent funding position of less than 90%. Comparing last year's findings with those of four years ago, the percentage of schemes with a funding position of less than 100% has almost doubled – this is change indeed.

Another aspect the research examines is contribution rates. Two points from this area are clearly revealed in the study: the marked difference between member and company contribution rates, and the substantial difference in company contribution rates between DB and DC schemes (see *Table 2*).

These findings also appear to reinforce the fact that company contributions to DB schemes are on the rise. Given the turmoil in the financial markets over the last year, it will be interesting to see how these figures turn out in next year's study.

Publication of the Myners' Report earlier in 2002 threw the spotlight on a number of issues regarding trusteeship, including trustee training and qualifications. This is an area covered by the research, with the findings last year showing that, on average, about three quarters of scheme trustees attended a trustee training course. Indeed, in well over half the schemes, all trustees have attended such a course. These results are consistent with 2001's findings.

TRUSTEE TRAINING. As to the actual amount of training received, it appears that trustees have received, on average, around two days trustee training each, although this is slightly less for the smaller schemes (two days) and slightly more for the largest schemes (2.7 days). The equivalent figure for trustees of DC schemes is 1.4 days. The individuals making up the equivalent of trustees in local government pension schemes have received, on average, 1.3 days trustee training each.

Almost one quarter of scheme trustees hold a Pensions Management Institute (PMI) or other pensions qualification, although the percentages vary considerably between 12% for the smallest schemes to 53% for schemes over £1bn. Investment qualifications are held by trustees in just 2% of the smallest schemes, but by around one-in-six trustees in the largest. Overall, two-thirds of the smallest schemes say their trustees have no PMI, pensions, investment or other relevant qualifications, this dropping

INVESTMENT

How the schemes' investments are managed forms a major part of this annual study, including detailed provider appraisals and information about review activity. Among other topics examined are cash management arrangements, portfolio constituents and multi-national arrangements.

▪ CASH MANAGEMENT

This area is particularly interesting, as specialist cash fund managers and global custodians have been raising their profile in this area recently.

The research shows that for well over two-thirds of respondents with small schemes, intentionally retained cash is managed by the investment managers appointed to oversee the other assets. While 10% overall have a direct cash management mandate with their custodian, this rises to almost one quarter of respondents with total portfolios of more than £1bn. Also, although 7% of the schemes overall employ a separate cash fund manager, again, roughly a quarter of the largest schemes adopt this route.

As a number of respondents also undertake some cash management functions in-house, particularly the local government funds, what the research reveals is that the larger schemes, as a group, are tending to use a variety of cash management responsibilities in order to maximise their returns on this asset class, whereas the smaller schemes seem less inclined or less able (because many do not use a global custodian) to utilise alternative sources.

This same is also largely true for the management of day-to-day (surplus) cash, with slightly fewer schemes (up to 17%) using separate cash fund managers and slightly more schemes (up to 38%) utilising the cash management facilities at their custodians. While more than a third of respondents also carry out some form of surplus cash management internally, it is again the investment management firms which handle the lion's share of this functionality.

Instruments used for investing the cash include deposit accounts (almost two-thirds of schemes), money market funds (about 50%) and interest-bearing current accounts (40%). Almost a quarter of the largest schemes use short-term investment funds, whereas a not dissimilar percentage of schemes of this size also invest directly into commercial paper (CP). Naturally, these >>

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to around half for the larger schemes. For the local government pension schemes the equivalent figure is 78%. However, about a quarter of all schemes do have trustees holding other types of professional qualifications, for example accountancy qualifications, although the equivalent figure for the local government pension schemes is only 13%. If schemes begin to take on board adherence to the Myners' Report principles, these findings may well change over time. However, one-third of respondents overall, particularly the smaller schemes, said they have no plans to make changes as a result of the report.

What, then, have been the main discussion points at trustee meetings? Unsurprisingly, it is investment matters that have been the dominant topic of discussion, not just over the last year, but in each annual survey. The 2002 results are shown in *Table 3*.

ON THE AGENDA. Across the years, other discussion matters move up and down the agenda. For example, FRS 17, DB versus DC options and scheme closure all feature a little more prominently in 2002's full list, whereas in previous years topics such as stakeholder pensions, pension sharing on divorce, statement of investment principles and corporate governance were slightly more to the fore. It is not that these latter issues are no longer discussed, rather that the percentage of schemes discussing them has changed over time.

The research reveals other changes too, such as a gradual increase in the incidence of using managers of managers, greater proactivity in voting, more use made of independent custodians and the like. However, some areas have not altered much. For example, as in the previous three years' studies, three quarters of respondents had not received a new business solicitation from any actuary/consultant in the previous 12 months. Of those being proactive in this field, one particular firm has been named as the most impressive company for the past four years – no mean achievement. As for ongoing service levels from actuaries/consultants, the average score for overall satisfaction last year has dropped from 0.95 to 0.88 (2 = excellent, -2 = poor). Perhaps this is why 17% of respondents say they reviewed the appointment of their actuary/consultant in the past year and 20% plan to in the next year.

One area of particular consistency in this research has been the top issue/challenge schemes feel they are facing – legislation. Complexity and intrusiveness of legislation, plus trying to keep abreast of new legislation, are still the biggest bugbears for schemes, although the percentage of respondents citing these issues has slightly diminished recently. Last year FRS 17 requirements, risk of investment underperformance and volatility in investment markets were cited by well over half the schemes. Compared with 2001, the percentage of schemes mentioning these latter two areas as major challenges has increased by 50%.

Finally, then, what would the schemes do if they could change one thing? *Table 4* reveals the top wish-list. Whether or not the government takes notice of some of these issues remains to be seen, but at least they are likely to provide fuel for further press coverage.

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<< percentage figures for the different types of cash instruments are not mutually exclusive.

▪ PORTFOLIO COMPONENTS
Some 92% of schemes include corporate bonds in their portfolios, while private equity/venture capital in the UK is held by just over a fifth of respondents overall and by more than half of the largest schemes. Private equity/venture capital outside the UK is a portfolio component for just 10% of schemes (one quarter of the largest schemes). Hedge funds appear to have increased in popularity, being held by 17% of respondents (2001: 9%) and by 30% of the larger funds.

For those schemes already investing in these various asset types, 83% say they are likely to increase their holdings of corporate bonds in the coming year. About one in six also anticipate increasing their holdings of both private equity and hedge funds, although unsurprisingly the highest percentages are recorded for the largest schemes, one-fifth of whom also expect to increase their holdings of private equity/venture capital outside the UK.

▪ MULTI-NATIONAL ARRANGEMENTS
One-fifth of respondents (37% of the largest) are part of a multi-national organisation with corporate headquarters in the UK. Interestingly, one-third overall (20% of the largest) are part of a multi-national organisation with corporate headquarters outside the UK.

Of these respondents, 15% say the degree of influence and/or control exerted on the UK scheme by the corporate headquarters is very high. Slightly less than a third say the overseas headquarters exerts some influence/control on the UK scheme, while a similar percentage say there is little such control exerted.

Just 18% say the degree of influence/control exerted by the overseas corporate headquarters on the UK scheme is none.

▪ OTHER PROBLEMS/CHALLENGES
Aside from the major issues identified by respondents, there are a couple of concerns noted by a smaller percentage of schemes. These include industrial relations implications (5%) – presumably relating to scheme closures or changes – and unanticipated cash flow requirements (also 5%), both of which were cited exclusively by defined benefit respondents.

One other concern, expressed by 4% of schemes, is the move towards flexible benefits. This will definitely be something to watch in future surveys.