A fresh look at the pension scheme model

If we could start over and create a scheme model from scratch, what should it look like? Sion Cole, partner and head of European distribution, Aon Hewitt, has some firm ideas.

Imagine we had a clean slate and could start from scratch when it comes to the pension scheme model. How would we set up the running of a pension scheme?

**What would the ideal scheme structure look like?**

It might make sense that the starting point for a pension scheme would be to empower a group of investment professionals (the ‘group’) with different backgrounds, tasked solely with the improvement and stabilisation of funding levels. This group of individuals should represent both the views of the sponsor company and the scheme members, enabling decisions to take into account both perspectives while focusing on member needs. This will also help the careful balance between contributions and risk/return targets that can often be a point of contention with the current framework.

Secondly, it is important that scheme knowledge would not transfer out when one of these investment professionals leaves or the sponsoring company changes (through takeover or merger, for example). Retaining knowledge of the scheme, its history and understanding of the decisions made is important to enable the scheme to evolve and improve the portfolio as conditions/needs change.

It is also key that the scheme’s benchmark should be designed around its specific liabilities. The risk and return targets around this benchmark should then reflect the collective views of the group, from both the sponsor and member perspective.

**Expertise, systems and risk management are key**

In an ideal world, the scheme’s investment professionals would also have access to a range of comprehensive systems to model and monitor a wide range of potential investment strategies. This also requires them to have expertise across the whole investment universe and understanding to distinguish between the different options available, and what would work best for their specific scheme.

**Access to a wide support network**

While those involved in the daily running of the scheme should have a robust understanding in these areas, we understand that the investment universe is incredibly vast and no single person can have sufficient expertise across all areas. Therefore, access to professional researchers in areas such as equities, fixed income, hedge funds, property, private equity and infrastructure is important to give more in-depth analysis. These specialists should have the knowledge to be able to look through all the potential products and investment solutions available, assess these and then choose what they believe are the best in class. This will help ensure that only the very best the market has to offer is considered for inclusion in the scheme’s portfolio, thereby increasing the chances of success, i.e., meeting the end-goals of the scheme in the set timeframe.

Furthermore, macroeconomic outlooks from dedicated market economists with decades of experience in understanding the complexities surrounding the workings of the world’s markets should also be fed into the decision-making process. This, combined with the professional research expertise, will help ensure that as new products develop, these are researched and managers identified in order to exploit opportunities as they arise.

**A nimble yet risk-focused framework**

With regard to the day-to-day running of the scheme, agility alongside robust risk management is key. Tools that provide daily details on funding levels, asset holdings, risk management and general portfolio oversight will help ensure the scheme’s portfolio is being carefully monitored and managed. Daily monitoring of funding level and any appropriate triggers will also allow the scheme to take effective action within a very short space of time and switch between asset classes, strategies and managers where necessary to capture opportunity as they present themselves.

Systems and tools are also important to ensure that all possible risk/return trajectories are considered; including undertaking shock testing, scenario analysis and complementary manager analysis in order to assess the wide range of risks contained at an individual stock level, asset class level and overall portfolio level.

**Achieving more: fees and reporting**

Within this idealistic pension scheme environment, the group of scheme professionals would be able to combine with other schemes to collectively drive down the fees of underlying managers and improve the terms under which they invest. Schemes would no longer be treated as a single investor but would work together, all being treated as collective investors with a common outlook and aim; achieving economies of scale and value for money.

Clear, concise and easy to understand reporting would also be easily available in the ideal world we are describing. It would be focused on the key metrics, as outlined by the scheme, and be tailored to the individual stakeholders within the group.

**Time for change?**

Legislation has evolved. The investable universe has expanded and become increasingly complex. Schemes are closing, which means a finite timeframe to reach the end-goal. However, we would probably all acknowledge that the pension scheme model has not evolved to the same extent or pace.

So, if we had our time again, and could start from scratch, would you set up a pension scheme as we have just described?

If so, and you agree with what we have just proposed...then it is time to explore fiduciary management as that is what we have just described.}

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