

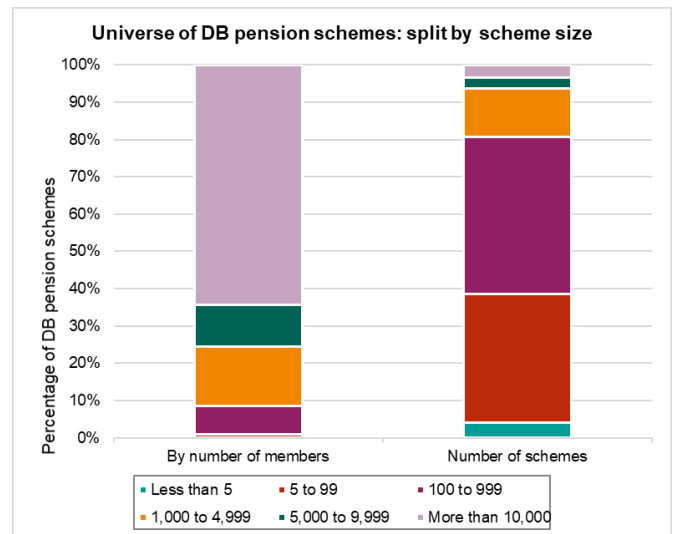


Investment Bulletin

In the final part of our series on defined benefit pension scheme investment risk management, we discuss how smaller pension schemes deal with the issues outlined in the previous articles.

Background

In our previous 2 editions of Investment Bulletin, we discussed the way that pension schemes have to consider risks; highlighting the need to consider risks holistically (integrated risk management or IRM) and / or the need to consider environmental, social and governance (ESG) risks. Smaller schemes generally find it harder to allow for IRM and ESG because they are run on smaller budgets, making allocating people and resource to these objectives harder. Further, they tend to have smaller holdings in their investment, reducing the impact of their active engagement on such issues. Whilst there are more members in larger pension schemes (see left bar of chart), 80% of the schemes in the UK have fewer than 1,000 members (see right bar) and hence are likely to face such challenges in considering IRM and ESG.



Source: The Pensions Regulator, The DB Landscape 2018

Approaches to IRM and ESG for smaller schemes.

Although IRM might seem daunting for smaller schemes, trustees are encouraged to be proportionate, accounting for both the trustees' and employer's circumstances. [Research from The Pensions Regulator](#) (TPR) shows that, generally speaking, small schemes lag behind on governance standards. To address these issues, TPR is stepping up its proactive involvement with smaller schemes and provides a [quick guide](#) on getting started with IRM and a [checklist for applying it](#).

The fact that ESG risk factors include an inherent element of subjectivity, brings significant challenges for smaller schemes to successfully allow for them. They are also less likely to have access to an internal investment manager, research and ESG ratings which facilitate ESG decisions. Smaller schemes may be able to determine an appropriate and proportionate approach to ESG and might be able to consolidate their efforts on ESG and IRM – for example, the most material ESG risk to a pension scheme might reside in the sponsor covenant. Or smaller schemes could passively invest in an ESG-based index. While smaller schemes may not have the influence of larger ones this does not mean that as a collective, smaller schemes cannot have an influence on the overall investment environment by using their voting rights.

Conclusion

The changing approach to risk management brings challenge to all schemes regardless of their size. Although the challenges might seem a more daunting task for smaller schemes, proportionate actions can be taken. Indeed, successful IRM and ESG risk management is likely to improve the way in which decisions are made – and may not result in drastic changes to the way that a scheme is run.

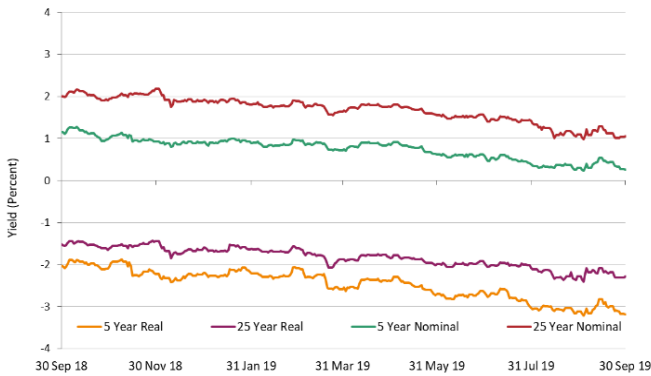


This month in brief

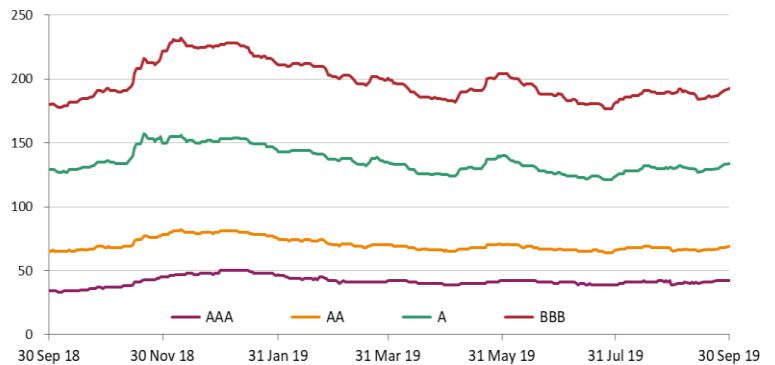
Continued political and Brexit-related uncertainty impacted asset returns, in what has been a volatile month for FTSE 350 pension schemes, with deficit levels fluctuating between £49bn to £74bn. Meanwhile, the Bank of England (BoE) warned that interest rates may be cut against a background of political uncertainty, which could have consequences for any pension schemes running interest rate risks. Trustees should consider the risks they may be running, given the uncertain political climate and potential interest rate cut.

The International Monetary Fund also warned that persistently low interest rates may be encouraging investors to take dangerous risks to maintain financial returns. As such, they highlighted concern that current performance may be unsustainable, and the risks taken may put longer term growth at risk. The ongoing search for returns was highlighted when global corporate bond issuance set a new weekly record during September – with companies around the world taking advantage of low borrowing costs.

Real and nominal yields ended the month at the same level.



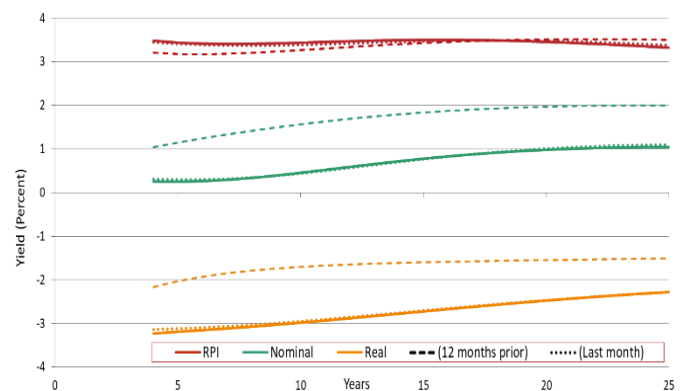
Credit spreads of lower rated bonds rose slightly over the month.



All equity markets rose slightly over the month.



Real and nominal yields are in line with last month.



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