Investment areas of focus for 2020

Following on from the Welcome section of this edition, we outline some common themes that will require focus within an investment strategy context and where investment advice is likely to be required.

All schemes

Without a doubt, the topic that is likely to retain most relevance throughout the year is **Responsible Investment**. Not just because new regulatory requirements were introduced into Statements of Investment Principles that will also require evidence-based material to confirm pension schemes are actually doing what they say they are doing, but also the growing awareness of investor responsibility on climate change. Due to the importance, we have introduced a regular article on Responsible Investment in each edition over the coming year.

In another regulatory theme, the **CMA objectives** that are now in force will require pension schemes to monitor and measure the success of the investment advice given. We are still awaiting The Pensions Regulator's (TPR) findings from their consultation on this subject. Regardless, pension schemes should keep their long-term objectives at the heart of their priorities and continuously reflect on whether decisions made are suitably aligned with intended outcomes.

The **future of RPI** will involve a consultation that is now expected to close six weeks after its release in March 2020 with conclusions expected to be publicised prior to the summer parliamentary recess in July 2020. We are already liaising with a range of LDI managers to obtain their views, assist clients who wish to participate in the consultation and prepare to respond to the consultation ourselves when it is released.

The **discontinuation of LIBOR** will occur at the end of 2021 and over the last two years we have been helping clients take preparatory action within their LDI portfolios. Over the next year, we will continue to work with clients to understand the impact, particularly on product benchmarks that reference LIBOR.

DB

Readers may recall that in 2019, each edition of Investment Perspectives contained at least one article which focused on the topics in the box below.

Investment governance models
Assessing the appropriateness of various approaches to Scheme governance (advisory, platforms, consolidation and fiduciary).

Stewardship/Value for money
Assessing and monitoring the qualitative and quantitative value added by investment consultant advice to clients.

Long term objectives
Setting the investment strategy should consider schemes long term objectives of self-sufficiency and risk transfer.

Risk transfer
Alternative pricing opportunities remain. Develop a clear plan for when buy-in/out will be feasible.

Cashflow driven investment (CDI)
Investing in assets that deliver relatively predictable cashflows. Structuring portfolios to meet benefit payments from income and maturity proceeds, rather than sale of assets.

Responsible Investing (RI)
Assessing the materiality of RI factors and including them when setting investment strategy, including regulatory requirements.

Brexit
Helping schemes assess funding and investment implications and some operational aspects based on the different scenarios that might yet play out.

For the DB sector, all of these themes continue to be relevant this year although some will demand more attention than others in 2020. For example, within risk transfer, 2019 was a record-breaking year for the volume of transactions. There will continue to be developments and further transactions in 2020 and we believe our experience and data gathered in managing past transactions will add value in our work in future transactions.

In terms of areas not explicitly mentioned above:

- There will be a consultation on a more prescriptive DB code of practice on scheme funding this year. The DB Funding Code consultation will be published on 3 March 2020. Outcomes and conclusions from the consultation will likely have implications for investment strategy design.
- There is work required on efficient implementation and avoiding 'leakages' within investment strategies. This flows all the way from negotiating manager fees to a level that provides appropriate value for money through to the efficient implementation and transitioning of mandates.

LGPS

The next 12 months will be a very busy time for LGPS funds. Strong asset returns in recent years made the results of the 2019 valuations largely positive for English and Welsh Funds and a similar position seems likely for Scottish valuations due this year. However, funding improvements need to be balanced with the cost of accruing benefits given the lower growth outlook for many investment markets.

To ensure a Fund's sustainability, establishing a balance between investment risk and contributions that's unique to that Fund's own needs should be high on meeting agendas in 2020. It also requires an understanding of cash flow. Some LGPS schemes are also moving into cashflow negative territory, largely due to the weight of active and new members failing to keep pace with the pensioners. Therefore, it is important to consider how the investment strategy can be structured to meet net cash requirements as well as generating the returns needed.

Finally, establishing the right type of governance model within the new LGPS pooling environment and being clear where investment advisers fit within this will be important considerations. This is not necessarily in the same vein as traditional fiduciary oversight, but there may be some elements of this approach going forward.

DC

We are now beyond the five year mark post Freedom & Choice. In that time, investment markets have been kind for both equities and government bonds. It is the vast middle ground occupied by multi-asset funds and alternative assets that have struggled to keep up. With equity markets at all-time highs and government bond yields across the world at all-time lows, there is much work to do in 2020 and beyond in assessing what is appropriate for DC members in this middle ground.

We are not the only ones thinking about this middle ground. 2019 was the year of Master Trust authorisation. Now that authorisation is largely out of the way, those that remain will have long-term investment strategy design on their agenda. Will they stick with the more vanilla approaches of passive equities and traditional fixed income? Or will they venture out into areas not traditionally seen in DC such as private markets and other forms of alternative asset classes and active management?

Authorisation also paves the way for the DC industry to think about post-retirement investment strategies. As DC becomes a member's main source of post-retirement income outside of their State Pension, there will be a number of opportunities for schemes to review and assess the marketplace. Over the coming year, we will look closely at the Investment Pathways propositions from providers which target the growing number of members taking non-advised flexible drawdown.

Conclusion

Focusing on these key areas and how investment strategy can be evolved to meet each will provide schemes with clarity beyond "20/20 vision". It will help schemes manage investment risks and comply with regulations by looking further ahead than can normally be seen.

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