Pensions Review

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Contents

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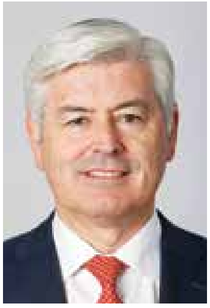
The need for professional advice has never been greater



Des McGarry
Managing Director

In an era of ever increasing regulation and legislative complexity, combined with historically low interest rates, the need for professional advice to ensure the best outcome from pension savings has never been greater. Equally there continues to be a need for simplification and reform to ensure that not only the current but also future generations make adequate provision for their retirement.

While in the future defined benefit (DB) schemes may only be preserve of the public sector, private sector DB schemes are still very significant in value terms representing €72 billion or 62% of the total Irish pension scheme assets. In theory, those who have benefits in the remaining DB schemes might expect a reasonable retirement income. However, managing these schemes in a long run-off phase is now an increasing challenge in an era of very low bond yields as trustees and sponsors seek to manage liabilities and balance risk and reward. In this regard there is an urgent need to reform the statutory funding standard and review the regulatory requirement to "de-risk" to Eurozone government bonds in order to avoid to unintended adverse outcomes.

If the past (and still for some the present) is DB, the future for most of us is certainly defined contribution (DC). This means that all the risk and reward lies with the member. This in turn means that advice on the appropriate structure and investment strategy becomes critical.

In terms of structure, Invesco supports the proposed government policy of reform and simplification. The Invesco Master Trust was established in June 2016. This can help deliver better outcomes for members through economies of scale and is an ideal vehicle for the stated, but yet to be launched, auto-enrolment systems.

While auto-enrolment will help address pension coverage, pension adequacy also needs to be tackled. Any minimum pension requirement needs to be meaningful. We continue to call for other measures to encourage pension provision, including early access to funds, restoring PRSI and USC relief on employee contributions and indexing of the Standard Fund Threshold (SFT). The extension of ARF options to transfers from DB schemes prior to retirement is to be welcomed but members need to think carefully and seek professional advice before making a decision on their options.

With negative short term interest rates and government bond yields at only around 1% p.a., it is not possible to achieve a reasonable rate of investment return without taking some level of risk. Traditionally this has meant investing in equities, property or more recently in absolute return funds. Investing in infrastructure is another alternative which we believe is worth considering and could be seen as an ideal investment for long term investors in both DB and DC schemes. It would also help to increase the exposure to Irish assets in pension funds which has fallen from around 50% of total pension scheme assets in 1999 (prior to the introduction of the Euro) to around 10% today.

Developing an appropriate investment strategy should be built around the needs of scheme members and recognise their different risk appetites and potential benefit outcomes. At Invesco we continue to work with trustees and members to develop and offer innovative investment choices and default strategies. Our objective is always to achieve the best outcome for all stakeholders. This should also be the guiding principle of government pension policy.

Des McGarry

Can you risk it?

Finian O'Driscoll
Director

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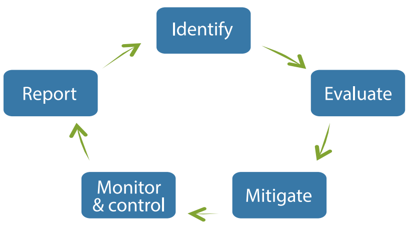
Finian O'Driscoll looks at manging risks for pension schemes.

Following the financial crash in 2008, risk management has become a major function in banks and insurance companies. So it is no surprise that risk management is one of the key requirements in the Pensions Authority's Financial Management Guidelines for trustees of defined benefit pension schemes.

Pension schemes need to take some level of risk in order to generate sufficient returns so that the benefits provided can be funded at an affordable cost. A risk management framework will help the trustees to determine the appropriate level of risk the scheme should take.

The Pensions Authority in their Guidelines expect that trustees should undertake an annual risk assessment which identifies the biggest risks, how likely they are to occur and what impact they would have on the scheme should they occur. Trustees should then examine what the scheme should be doing to limit the risks.

So what does this involve? A risk management framework will involve the following tasks:



Identification of risks

The first task is to identify scheme risks which will typically be grouped into the following categories:

- Scheme management
- Funding and solvency
- Investment
- Legislative
- Sponsor covenant

A risk register should be drawn up where the various risks under the above headings are evaluated.

Evaluation of risks

Risks should be evaluated by the likelihood of their occurrence and potential impact. Non-financial risks will require qualitative measure of risk. Financial risks may allow for some quantitative measurement of risk, this can be done by doing a scenario / sensitivity analysis. Techniques such as "VaR" (value at risk) are sometimes used, with any modelling proportionate to the nature and scale of risk.

Mitigation of risks

It is important to remember that the aim is not to eliminate all risks. Rather the aim is to understand the risks involved and decide what level of mitigation is appropriate.

Mitigation can mean:

- Removing the risk altogether (e.g. fully hedging the interest rate or inflation risk)
- Reducing the likelihood or the impact of the risk to an acceptable level
- Transferring some or all of the risk to other parties
- Accepting or exploiting the risk

Decisions should be noted in the risk register and responsibility should be assigned for the management and monitoring of each risk.

Monitoring and control of risks

The risk register needs to be reviewed for effectiveness of the risk mitigation processes previously agreed. This will include:

- Reviewing the performance of individuals and entities involved in the operation of the scheme
- Examining areas where mitigation did not work as planned
- Examining areas where agreed mitigation was not fully implemented

Consideration should be given to any new risks that have been identified and the relevance of risks previously included should be examined.

It is suggested that there should be a high level review annually with a more formal review every three years (unless there is a significant change in the circumstances of the scheme). Periodically an external review of the risk management framework could be undertaken.

Reporting risk management

The trustees should get reports in relation to the following delegated functions:

- Legislative compliance
- Service levels
- Risk incidents / issues
- Emerging risks

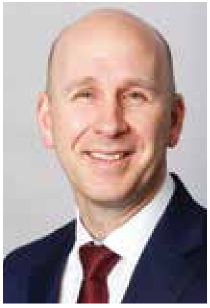
The trustees should consider communicating details of the risk management framework to members. Options in this regard include:

- Disclosure of risk appetite statement
- Inclusion of a risk analysis in triennial valuation reports
- A report to members on the regular reviews of the scheme's risk register in the Trustees' Annual Report

While not yet a regulatory requirement, the trustees may be asked to report on the scheme's risk management framework to the Pensions Authority.

The Chinese symbol for risk is a combination of danger and opportunity. Strategically managing risk by following a risk management framework should help trustees and scheme sponsors balance this danger and opportunity and help in good decision making for all stakeholders.

Investment Evolution



Gerry Winters
Director

Gerry Winters looks at the evolution of default investment strategies.

Changes to legislation allowing members to opt for different benefits at retirement have thrown into question the suitability of default investment funds which have been designed on the assumption that members would purchase an annuity at the point of retirement. Members now have the option of an annuity or an approved retirement fund (ARF) and a different level/calculation of tax free cash.

Another critical design assumption associated with default investment funds is being challenged – the underlying risk profile of the member during what is commonly referred to as the accumulation period. All default funds assumed that age and proximity to or from retirement age were the key factors when deciding on the underlying asset allocation. But there is much more to be taken into account when designing an appropriate investment strategy.

Trustees' role and responsibilities

It is the regulator's view that trustees must offer an appropriate default investment strategy. But just what is an appropriate default strategy?

Clearly, such an appropriate strategy should be built around the needs of the scheme members and recognise the different risk appetite and benefit outcomes of its members.

Evolution

The definition of an appropriate default strategy has changed greatly over the years. In the 1980s trustees' tended to use balanced funds as the default. The problem was that these left members with a continuing exposure to equities right up to retirement. For the most part the funds performed well and members had little cause for complaint. However, anyone who retired in the weeks and months following Black Monday in October 1987 will have good reason to argue that the balanced fund was not an appropriate investment strategy for their needs.

Lessons were learned and there was a move towards consensus-style funds in the 1990s. These funds relied on the "wisdom of the crowd" to a certain extent. The approach was to track the main investment managers in Ireland and match the investments they made in equities, property, bonds and cash. The aim was to deliver performance that was consistently in line with the average of all managed funds in the market.

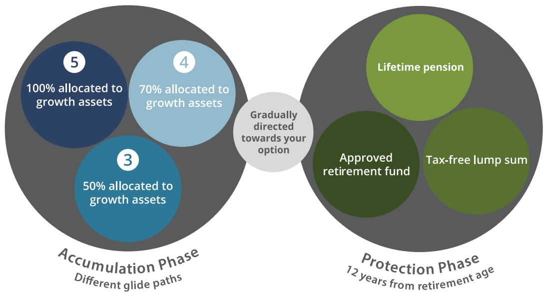
The issue again was that these funds were driven by the needs of the investment industry and had continuing exposure to equities up to retirement. There were certain built-in protections as exposures to different asset classes were automatically adjusted in line with market performance and sentiment. However, as we have learned time and again in investment markets, the crowd is not necessarily infallible and a further evolutionary step was required.

This step saw the move towards lifestyle strategies in the early 2000s. These strategies saw equity exposure reducing sharply to zero with assets moving into cash and bonds over the five years in the run-up to retirement. This was certainly an appropriate strategy at a time when cash and bonds were delivering respectable returns for comparatively low risk. However, in today's historically low yield market a further step along the evolutionary path is required.

Developing an appropriate default strategy

We believe that there are two component parts to a lifestyle strategy; the risk profile of the member and the expected benefit outcome at retirement of the member.

In developing an appropriate strategy trustees need to understand the likely benefits their members will take when they reach retirement age. For example, how many members are likely to have sufficient assets for the pension tax-free lump sum only, how many will elect a lump sum and annuity and how many are likely to elect the flexible retirement route which includes the ARF option?



This knowledge will allow the trustees to build funds for the protection phase which is most closely aligned with members' expected outcomes.

The trustees will then be able to offer different risk profiled options to members during the accumulation phase which will allow them to select a default fund more aligned to their personal appetite for risk. Linking both the expected member's benefit outcome and the member's risk profile provides a genuine, personalised lifestyle strategy which passes the "appropriate" test.

To find out more about the development of appropriate default investment strategies contact ***Gerry Winters***

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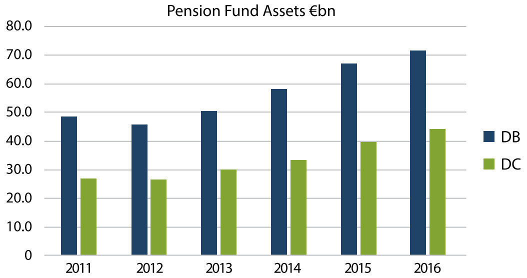
DB Schemes – they haven't gone away you know…

Frank Downey
Director & Consulting Actuary

The future for defined benefit schemes is considered by Frank Downey.

Despite the fall in number, the assets held for defined benefit (DB) schemes are still very significant, with a total value of around €72bn in 2016. In fact the share of total pension scheme assets represented by DB schemes has only changed marginally from 64.3% in 2011 to 62% in 2016[1].



The total number of funded DB schemes in 2016 was 666 (excluding schemes in wind up), which represents a reduction of around one third from the number in 2011 and almost 50% from the number in 2006[2]. In addition most funded DB schemes are closed to new members and around 28% are closed to future accrual of benefits.

The total membership of funded DB schemes is currently over 650,000 which is made up as follows:

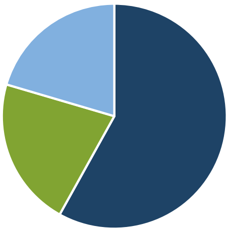
	Number	Average Liability
Pensioners	100,585	€336,000
Actives	121,995	€102,000
Deferreds*	430,518	€28,000

** includes active members no longer accruing benefits*

This shows that very many individuals, especially pensioners, have a significant benefit from and interest in a funded DB scheme.

The number of active members accruing benefits in funded DB schemes has fallen from around 239,000 in 2006 to approximately 100,000 today, which is broadly in line with the percentage decline in the number of schemes. By contrast the number of active members accruing benefits in unfunded public sector schemes has risen from around 258,000 in 2006 to 339,000 in 2016.

Funded DB schemes are increasingly maturing. Currently over 58% of liabilities (as measured under the statutory funding standard) are in respect of pensioners with the balance almost evenly split between active and deferred members.



So what is the future for the remaining DB schemes as we move towards a long run off phase? Trustees and scheme sponsors will generally be seeking to preserve as much as possible the current benefit promises and achieve the best outcome for all stakeholders.

At the end of 2015, 70% of funded DB schemes satisfied the statutory funding standard[3], although larger and more mature schemes were more likely to be in deficit. Of the 203 schemes in deficit, all but nine schemes had a funding proposal in place, most of which would have been "on track" at the end of 2015. So that's all good? Well not quite.

The funding standard itself is not a true measure of the long term cost of a pension scheme. It values pensions in payment on an annuity buy out basis (which might typically involve a "premium" of 20%), whereas liabilities for active deferred members are valued by reference to a now relatively weak standard transfer value basis. This means that as schemes continue to mature, satisfying the funding standard will become an increasing challenge.

The additional funding standard reserve requirement for liabilities not matched by bonds and the obligation to do a funding check at the end of each scheme year highlights other issues with the funding standard. The problem with the latter was well illustrated in 2016. Due to a further fall in bond yields, many schemes would have fallen into deficit or had their funding proposal go off track in 2016 if their year-end date is, say, 31 March, 30 June or 30 September. A positive fourth quarter meant that the position was more favourable at the end of 2016 which helped schemes with a 31 December year-end date. However it hardly makes sense to have to make significant changes just because of an unfavourable result at a particular year-end date.

A fundamental overhaul of the funding standard regime is required and it should be replaced by a scheme specific funding requirement based on the true long term cost of the scheme. In the short term, the funding standard reserve requirement should be removed and more flexibility on annual funding checks should be introduced. These changes may help avoid unnecessary benefit reductions and wind ups. The objective of pension policy should be to help achieve the best outcome for all members and stakeholders. This objective is not served by the current funding standard.

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1 *IAPF Investment Surveys*
2 *Pensions Authority Annual Reports*
3 *Pensions Authority – Defined Benefit Schemes Review of 2015 Statistics*

Time to make auto-enrolment a reality

Brian Sexton
Client Services Director

Brian Sexton calls for action instead of further reports and investigations into auto-enrolment systems.

Not long after he took office the Minister for Social Protection, Leo Varadkar, addressed the Pensions Authority's Pensions Reform Consultation Forum where he declared his support for universal supplementary pensions.

"A majority of our citizens will rely solely on the State pension in retirement", Minister Varadkar said. "For some, it will be enough to maintain their standard of living into old age. But for many, it will not. That's why I view the development of a universal retirement saving system for people without supplementary pensions as an essential objective."

The Minister cited the systems in New Zealand, Australia and Singapore as examples which this country can learn from. This should be good news not just for those without supplementary pension coverage but for all involved in pensions in Ireland.

Unfortunately, Minister Varadkar went on to say that the development of a new, universal workplace retirement saving system will *"require a substantial multi-year programme of work and will have to be agreed, legislated for and phased in."*

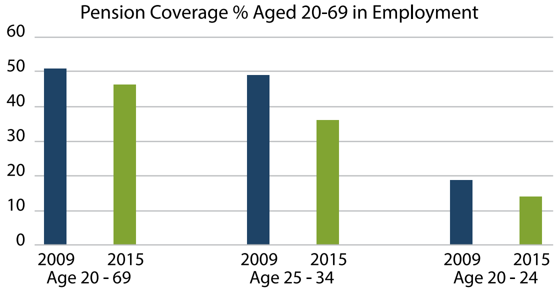
He added that work was ongoing on the potential model to be employed in this country. The question is, however, how many times that work needs to be repeated before action is finally taken.

The issue of inadequate supplementary pension coverage has been debated for decades and the concept of auto-enrolment has been under discussion since at least 2007 and the publication of the Government Pensions Green Paper that year.

That was followed in 2010 by the National Pensions Framework which set out "the Government's intentions for radical and wide-scale reform of the Irish pension system." In 2014, the commitment to introducing some form of universal scheme was restated with auto-enrolment the preferred option. This has been followed by an Interdepartmental Working Group which is also looking at the issue.

The overall situation has been deteriorating while these deliberations have been taking place. According to the CSO Quarterly National Household Survey overall supplementary pension coverage nationally was 51% in 2009 but had fallen to 46% in 2015. The figures for younger age groups are even more disturbing with coverage for 25-34 year olds standing at 36% and a quite alarming 14% for the 20-24 year old cohort.

2015 National Irish Household Pension Survey
Pension Coverage % Aged 20-69 in Employment



Source: Central Statistics Office, 30 May 2016

To date, there have been no indications of any reversal in this trend. But the problem is by no means intractable as the experiences of our nearest neighbour have shown. The UK had much the same issues as Ireland before it decided to establish a national auto-enrolment pension scheme.

When the scheme was introduced in 2012 coverage stood at just 47%. By the end of 2015 it had risen to 59%. This was quite a dramatic improvement experienced against the background of national austerity policies and stagnant wage growth; meanwhile Ireland's coverage was going in the opposite direction.

We should learn from the positive experience of the UK and waste no more time on further reports and investigations into auto-enrolment systems. In the UK the committee to investigate the matter took three years to complete its work and reported in 2005. The report was accepted in 2006 and it took a further six years to introduce the system.

We do not have the luxury of being able to wait any longer in Ireland. By learning from the UK experience we could reduce significantly the design and implementation phase and potentially have a universal national supplementary pension scheme in place within the next three to four years, or even earlier if the political will exists to drive the agenda.

The words of President Theodore Roosevelt are worth recalling when it comes to deciding what to do when faced with great problems: *"In any moment of decision, the best thing you can do is the right thing, the next best thing is the wrong thing, and the worst thing you can do is nothing."*

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Human Capital: An asset class in its own right

Vincent McCarthy
Head of Investment Consulting

You are wealthy. You just haven't realised it yet.

When we think about wealth we tend to focus on accumulated financial assets, i.e. savings, investments, pension, property or any other claim on ownership. Think of this as your financial capital. However, this is only one part of your overall wealth. The other component, often overlooked, is your human capital. Where financial capital is your accumulated monetary and physical assets minus liabilities, human capital is effectively your future earnings power.

In "Lifetime Financial Advice: Human Capital, Asset Allocation, and Insurance" (Roger G. Ibbotson, Moshe A. Milevsky, Peng Chen and Kevin X. Zhu) the authors note that *"the largest asset that most human beings have, at least when they are young, is their human capital—that is, the present value of their expected future labour income."*

Investing in your human capital

In 2009, I remember chatting with a good friend who was in Blackhall Place training to be a solicitor. Despite years of education, and having a primary and postgraduate degree, he was becoming disillusioned by the fact he was still struggling financially, living off the basic income trainee solicitors typically earn over the three years to qualification. He was tired of being broke and so he began to question whether all this education and training was worthwhile.

It was then I explained to him the concept of human capital. Rather than focus on his limited financial net worth at that point in time, I reassured him that he would be better served by considering his overall wealth with the inclusion of his largest asset, his human capital. Qualification as a solicitor would provide him with the potential to increase the value of this asset, a higher path of income growth and hence a higher present value of earnings. Effectively, this was an investment in his human capital.

As the authors I've referenced above point out: *"The education and skills that we build over this first stage of our lives not only determine who we are but also provide us with a capacity to earn income for the remainder of our lives".*

My friend is now a senior member of an in-house legal team at a prominent global asset management firm. He recently bought a home and his level of financial assets is increasing every year as he realises more of his human capital and plans for the next stage of his financial life cycle.

My anecdote is intended to highlight the importance of seeing the bigger picture in terms of your overall wealth and the benefit of investing in yourself to increase your future earnings power.

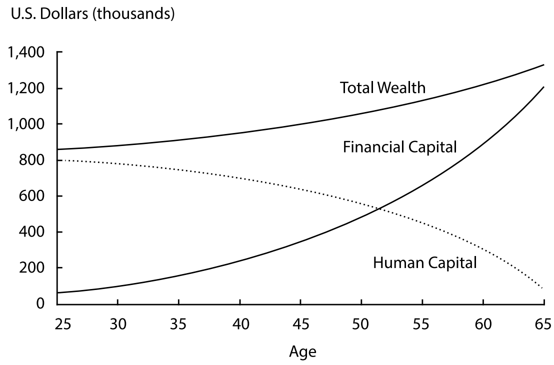
However, the concept of human capital also has important implications in terms of a person's overall asset allocation, as they move through the so-called accumulation working phase of life towards the retirement phase.

Human capital and asset allocation

"If asset allocation is indeed a critical determinant of investment and financial success, then given the large magnitude of human capital, one must include it."

Think of your human capital as a stream of future income, to be realised over time. For a young person in the early part of the accumulation stage, it will form a large part of their overall wealth. However, for someone close to retirement their human capital will make up only a small portion of their overall wealth.

Expected Financial Capital, Human Capital, and Total Wealth over Life Cycle with Optimal Asset Allocation



Source: "Lifetime Financial Advice: Human Capital, Asset Allocation and Insurance"

Ibbotson and his co-authors make the point that: *"Human capital should be treated like any other asset class; it has its own risk and return properties and its own correlations with other financial asset classes."*

The certainty of that stream of cash flows will also factor in to the risk level of that human capital. In other words, for someone working in the public service their human capital could almost be considered a risk-free asset, given the low likelihood of ever being made redundant. They should balance this by taking more risk with their financial assets in the context of an overall asset allocation.

However, if that same person was working in a job much more correlated to the stock market, human capital theory would suggest that they should invest much more of their financial assets in fixed-income or other asset classes less correlated to equities.

This idea might seem novel but the reality is that sometimes the best financial advice is simply common sense. Think about many of the builders burnt by the property crash. Their source of future earnings was reliant on the construction boom yet they continued to invest their realised earnings in assets highly correlated to the same factors, often more property and bank shares.

The same holds true for people who are awarded shares of their company, which can become a major component of their overall wealth. In this scenario, the value of those shares and the certainty of their future earnings are highly correlated. I recall advisors I worked with at Merrill Lynch in 2006/2007 who had the majority of their net worth in Merrill Lynch shares. Hence, they suffered on both fronts during the 2008/2009 crash. The value of their shares and their income plummeted at the same time.

"Think of financial investable assets as a defense and protection against adverse shocks to human capital (i.e. salaries), not an isolated pot of money to be blindly allocated for the long run."

Wealth is typically built by adapting a concentrated investment approach but wealth is protected by sensible diversification.

Human capital and financial planning

Human capital theory also provides a more holistic basis for financial planning. Rather than simply focussing on the diversification of financial assets, which is the focus under traditional portfolio analysis, human capital theory provides a framework that looks to hedge the risk factors associated with human capital:

1. Earnings risk
2. Mortality risk
3. Longevity risk

Earnings risk can be hedged by saving more and converting human capital to financial capital. As explained above, one can balance the implicit risk level of your human capital against the risk taken with one's financial assets.

Where one has dependents, life Insurance is the "perfect hedge" against the worst case scenario of death, whereby you have dependents reliant on your future earnings.

"Term life insurance and human capital have a negative 100 percent correlation with each other in the "living" versus "dead" stakes; if one pays off at the end of the year, the other does not, and vice versa. Thus, the combination of the two provides diversification to an investor's total portfolio."

The value of your human capital will provide a guide for the level of insurance needed.

The third risk to be considered is longevity risk - the risk of outliving your financial assets. Given the shift from defined benefit pension schemes to defined contribution pension schemes, members now have a greater personal responsibility to allocate retirement savings appropriately to generate enough income for retirement, in the context of increasing life expectancies. Ibbotson and his co-authors of "Lifetime Financial Advice" make the case for lifetime-payout annuities in managing longevity risk. However, there are a multitude of factors to be considered when determining their appropriateness.

Conclusion

Wealth is made up of two components, financial capital and human capital.

The working stage of life – the accumulation phase – is where individuals convert their human capital into financial capital. Saving is the method by which individuals replace depleted human capital with financial capital, to be invested to meet future consumption needs in the retirement phase of life.

A higher savings rate and an earlier start, to allow for the benefit of compounding, can help ensure sufficient human capital is converted to financial capital to meet retirement needs. Life insurance can protect dependents against an unforeseen death while lifetime payout annuities can help protect against longevity risk.

The proportion of human capital and the certainty of that human capital should be considered when making asset allocation decisions with your accumulated financial capital.

Investors are advised to manage correlations between human capital and financial capital, whereby a high correlation can result in a double hit for individuals in the event of an external shock, e.g. 2008/2009 financial crisis.

Finally, predicting the performance of financial assets over the coming years is notoriously difficult. However, the one asset you can control and influence is the value of your human capital. It is never too late to increase its value – through education, travel or any other form of personal development. Invest in yourself!

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A question of balance

Declan Keena
Head of Actuarial

Declan Keena cautions pension scheme members to think carefully before making a decision on their options at retirement.

It can be argued that more choice is always good. Freedom of choice is fundamental to our society and our economic system, however, society generally puts in place checks and limits to prevent people making wrong or harmful choices. This also applies in the financial world - there are limits on how much home buyers are allowed to borrow, certain countries attempt to outlaw gambling and there are strict rules governing what we are allowed to do with our pension funds on retirement.

For members of defined benefit (DB) schemes, these rules have changed quite significantly in the last year. From a position where an individual on retirement only had the choice of how much to take in a lump sum they can now decide whether they want to take the remainder as a pension or invest in an approved retirement fund (ARF).

Of course, this is to be welcomed. There is no such thing as a "one size fits all" solution in the pensions world. Everyone's needs and aspirations are different and these have to be taken into account when making decisions. However, the choices on offer must be approached with caution. The most recent change opens up the prospect of people making poorly informed and therefore bad decisions.

When compared to the returns which were available back in the 1980s, an income for life could be seen as representing very bad value today, but the 1980s was a decade of double digit inflation and economic stagnation in this country so no sensible comparison can be made.

ARFs have only been available for less than 20 years and have received largely positive press over the period. They allow for a wide range of investments across different asset classes in accordance with the risk appetite and need for return of the investor. They also give the investor a sense of control over their own destiny. This has led to an unfortunate situation where a view of "an income for life bad, ARF good" has developed among many pension scheme members. Such binary views are never wise when it comes to investments and could lead to people making very poor choices indeed.

Professional advice should always be taken before making such a decision. For example, it is not generally appreciated that a pension from a DB scheme offers a "guaranteed" income for life (to the extent that the DB scheme can continue to pay the pension) while an ARF may actually run out at a certain date. People may be willing to bet on their own mortality but they should understand the consequences of outliving their own expectations.

The table below sets out some of the features of each approach:

DB Pension (Annuity)	ARF
"Guaranteed" income for life	Flexibility to withdraw your savings as required.
If you live longer than expected, you will receive good value for money.	If you live longer than expected or investment returns are poor your fund may run out before your death.
If you die shortly after retirement your pension will die with you (some schemes provide spouse's pensions).	On death any remaining funds will form part of your estate.
You are not required to make any investment decisions.	You control the investment of your fund.

The security of the DB scheme and the adequacy of assets to meet pensioner liabilities now and as the scheme matures will also be a consideration.

The availability of an option to invest in an ARF at retirement for members of DB schemes is definitely to be welcomed and will almost certainly offer superior outcomes for many members. However, nothing is guaranteed and the most careful consideration of all the pros and cons must be undertaken before such a choice is made.

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Supporting decisions in a changing world

Gary Morrissey
Head of Business Development

Gary Morrissey outlines Invesco's best in class range of member information services.

Increased member engagement with their schemes is an encouraging feature of the pensions landscape in recent years. The current historically low interest rate and bond yields coupled with an ever widening range of choices for scheme members at retirement place a premium on the provision of information and decision support tools.

Member education and engagement is vital in all of this. But it is clearly impractical to expect HR and finance departments to take on the role of acting as pensions and investment advisers to large numbers of employees.

That is the reason why Invesco has invested heavily in the development and provision of best in class information services for scheme members, trustees, HR departments and employers.

At the heart of this is our InvescoOnline member information service which gives members access to their pension information anytime and anywhere they wish.

Our forecasting calculator allows members to examine the potential impact on their income in retirement of different investment choices.

One particular feature is the facility for members to see the precise asset allocation of their portfolio, regardless of how many funds they might be invested in. InvescoOnline looks behind each fund to its asset allocation and aggregates this information across the member's total portfolio.

This feature can also be used to see in advance the effect on asset allocation of switching between different funds. This enables members to make informed choices when it comes to switching funds. If a member is in a lifestyle strategy which automatically switches out of equities and into cash and bonds as they approach retirement, they can easily monitor these changes over time and seek advice where necessary.

InvescoOnline, along with the other information services and portals offered to clients and scheme members, are important decision support tools but, sophisticated as they might be, they can never truly replace face to face advice. In this regard Invesco offers a range of workshops, group presentations, and one-to-one advisory sessions to ensure that scheme members receive the support they need to make informed decisions in relation to their pensions.

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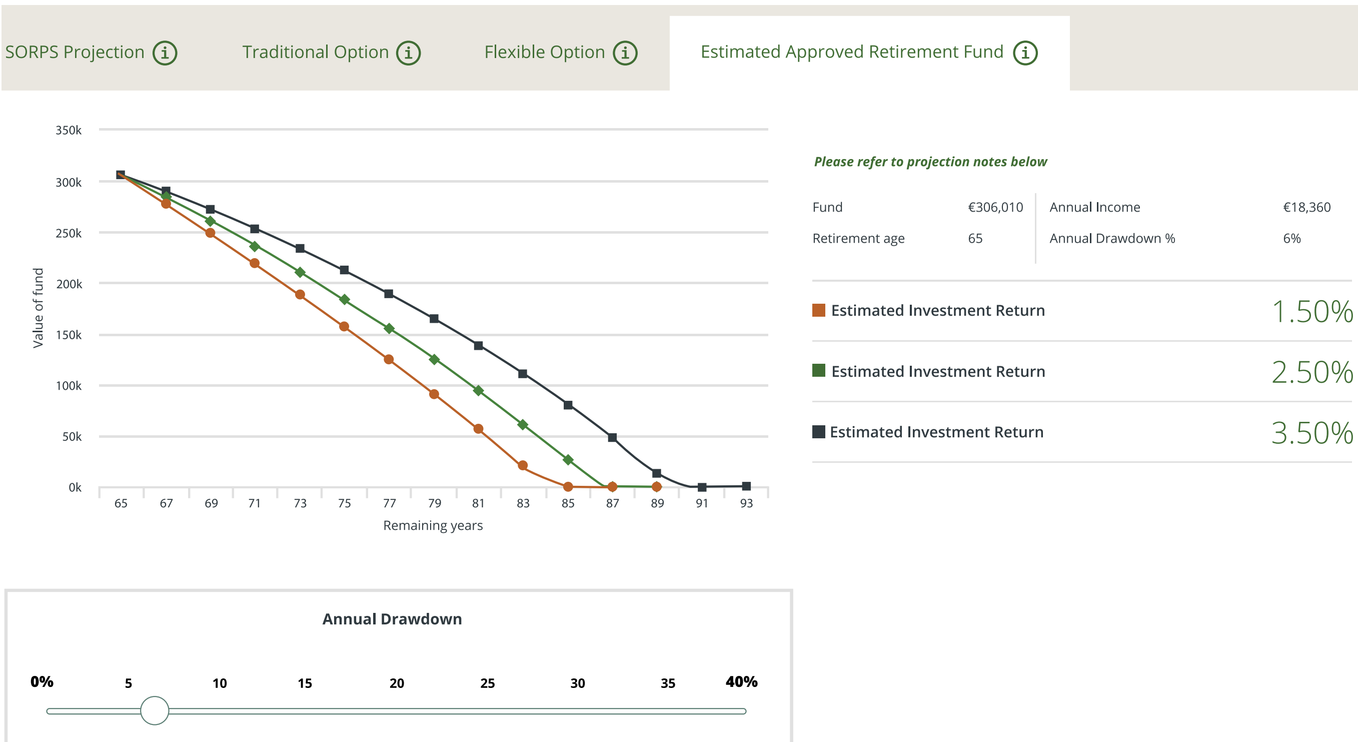
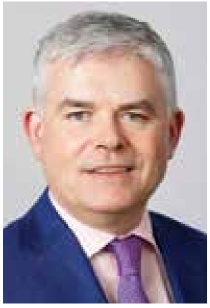


Adjusting to a new reality



Brian McGarry
Director

Brian McGarry explains how the landscape for pension scheme members has changed out of all recognition over the past decade.

Members have had to contend with the global financial crisis, the Government Pensions Levy, extreme market volatility and a near collapse in bond yields. They have also seen the retirement age for the State pension extended to up to 68 for those born after 1st January 1961.

The challenges created by this new environment are by no means insurmountable but they do require a fairly radical change in approach on the part of scheme members. Members have to become much more actively engaged with their pension investments if they are to achieve their retirement income objectives.

This means adopting a strategy tailored to meet individual lifestyle needs in retirement. In some ways this could be described as a "pensions by objective" approach.

This will require significant changes on the part of scheme members, many of whom have grown accustomed to taking a hands-off approach to their pension. A low risk investment profile would have been seen as quite acceptable when returns from relatively low risk asset classes such as cash and bonds were at reasonable levels.

In the current era of negative interest rates and low bond yields that is no longer the case and unfortunately it doesn't look like this will change in the foreseeable future. This means that an investment strategy which might have delivered your pension goals even five years ago will not be fit for purpose in today's climate.

Furthermore, members' pension goals have also shifted. The increase in the State retirement age means that those retiring from 2026 will have to factor in the loss of more than €36,000 in income over three years; and double that for a married couple.

One of the main difficulties in this regard is the low level of pension and retirement awareness amongst employees. Recent research has shown that less than a third of Irish people know how much they will need to live on in retirement. Many are not even aware of how much they will receive from the State pension and less than 1 in 2 have made any provision for income in retirement to supplement this shortfall.

This presents a challenge to employers, as well as scheme members. Companies want their employees to have an adequate income in retirement and to get the best outcome possible from their pension investments.

This requires a redoubling of efforts on the part of pension providers in order to maximise member engagement from the earliest stage possible. This starts with personalised communications to members to make them aware of their current position and what their current arrangements may offer them in retirement. But it must go further than that.

Members need to be educated in relation to their investment choices, how they relate to the achievement of their pension objectives and the risks involved.

At Invesco we offer all of this as well as a suite of multi-asset investment funds which are designed to deal with market volatility yet deliver reasonable returns for almost every risk appetite.

The crucial issue for scheme members is to make the right choices for their individual circumstances. These choices change over time as circumstances change and so should be revisited intermittently. If there is one thing we have learned over the past decade it is that change is the only thing we can be certain of. Scheme members should therefore take independent financial advice on an ongoing basis to ensure that their pension investments are properly aligned to their retirement goals.

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Master Trusts – the future

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Background
Over the last 12 months, the Pensions Authority, particularly in its reform and simplification consultation[1], has stated its desire to reduce the number of occupational pension schemes in Ireland. The Authority envisages that as a result of its reform proposals, master trusts are likely to become a much more common means of pension provision[2].

The Pensions Authority has also increased its focus on trustee governance and master trusts will provide an opportunity for small schemes to benefit from the expertise of a professional trustee at a relatively low cost and thus relieve the many voluntary trustees from the very onerous obligations of this role. Master trusts will also be able to exploit economies of scale, thus reducing financial and regulatory costs and thereby enhancing their efficiency and effectiveness.

Regulation
There are a small number of master trusts currently operating in Ireland but there is no specific authorisation process other than the current regulatory regime. There is no statutory definition of a master trust and no specific regulation relating to such trusts in this jurisdiction. The Pensions Authority appears to welcome the advent of master trusts in the Irish market but has identified additional qualifications that may apply to master trusts[3] effective from September 2018[4]. These include requirements for the trustee to be a designated activity company with a prescribed minimum capital and for the company directors to have minimum qualifications and experience. Independent trustee directors may also have to be appointed.

The Pensions Authority and the Irish government may also draw on the provisions of the recently published UK Pension Schemes Bill which will provide for the authorisation and regulation of master trusts in the UK and is expected to become effective in October 2018.

Under the UK Bill, a master trust operating in the UK will need to be authorised by the UK Pensions Regulator who must be satisfied that the persons involved in operating the trust are fit and proper; that the scheme is financially sustainable; that each scheme funder meets specified requirements and the scheme has an adequate continuity strategy. The Regulator will also examine a master trust's processes and systems to ensure they are sufficient and will consider specific matters set out in regulations which may include: the IT systems supporting the administration of the scheme; standards concerning the quality and security of data; records management; investment decisions; risk management; and the appointment of advisers.

Pension provision
Master trusts are likely to become more common if and when a Universal Retirement Savings Scheme (or auto-enrolment) comes into effect. Master trust arrangements are suitable vehicles as they are occupational pension schemes of which contributing members may be employees of unrelated employers.

Certainly, auto-enrolment in the UK has seen considerable growth in the number of master trusts with over half of employers choosing to avail of a master trust to provide pension arrangements for their employees. There are now approximately 100 defined contribution master trusts operating in the UK.

There are, of course, challenges to overcome with master trusts and many of these have already been identified by the Pensions Authority. For example, and not inconsistent with other trust based occupational pension schemes, conflicts of interest may arise where a company operating a master trust is also providing other services to the trustees. The Pensions Authority, as part of its proposed authorisation process, will expect a master trust to have procedures in place for dealing with these conflicts[5].

There may also be risks that when employers are not the sponsors of master trusts, employers and their employees may become detached from the scheme and the benefits available to members and fail to become engaged participants. The Pensions Authority is therefore proposing, as a pre-condition of authorisation, that the administrator of the master trust must make arrangements for member and employer participation through communications, meetings or a consultative forum[6].

Finally, there are potential issues around the remuneration of both the sponsor and service providers and ensuring that any charging structures are transparent. In this regard the Pensions Authority has indicated that master trusts may be required to have a policy in place to control charges and remuneration.

Conclusion
Master trusts have the ability through economies of scale, to greatly improve pension coverage (especially in the context of auto-enrolment), reduce costs and provide a better pensions outcome for members. Invesco established the Invesco Master Trust in June 2016.

For information about the Invesco Master Trust contact

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1 Pensions Authority - Reform and simplification of supplementary funded private pensions consultation document 18 July 2016
2 Ibid, p.13,
3 Ibid.p31,
4 Ibid. p.35,
5 Ibid p.31,
6 Ibid.p.31

Financial Planning – What should I be doing ?

Mićeál Gunning
Director

Financial Planning is one of those things that people know they should do but often wonder why writes Mićeál Gunning.

In many cases this is because the process is made too complicated and opaque or the goals are too vague for an individual to properly take ownership of their own financial plan.

This has led to many people being ill-prepared financially for the various milestones they will meet over the years. The Invesco Financial Planning service is specifically designed to tackle this issue and provide solutions tailored for the precise needs and lifestyle requirements of our clients.

Financial planning is a process which assists individuals in closing the gap between the life they have now and the life they want in the future. Ideally it's the process of uncovering what a client wants to do or achieve financially, for themselves and their family, and then ensuring that they and their family enjoy the life that they want to live.

Invesco's structured six stage financial planning process works by taking a holistic approach to a client's needs and circumstances and helping them to meet their life goals and priorities.

Initial meeting
It starts with an initial meeting where the financial planning team gets to know the client and their overriding financial goals and objectives. We try to get an understanding of our clients desired lifestyle for the future.

Discovery
We also go through a comprehensive information gathering session which includes all sources of income, debts, investments, pensions, protection benefits, employee benefits, family circumstances, health background and so on.

Analysis and evaluation
The information from the discovery session is used to compile statements of current net worth detailing the client's assets and liabilities; an income and expenditure account containing an analysis of their current financial situation as well as estimating future income and expenditure needs.

Detailed recommendations
We present our financial planning recommendations to the client based on their specific needs and objectives and the analysis conducted. We utilise lifetime cash flow forecasts, availing of the latest technology to illustrate a current cash flow position including all expenses and taxes due, along with long term forecasts right up to pension age and beyond.

We also prepare detailed "what if" scenarios at this stage which cover both short and long term eventualities such as early retirement, family holidays, sending children to college, gifting money to loved ones or making charitable donations. These assist clients to understand the implications of future financial decisions and steps to be taken now, to cater for various scenarios should they arise.

Protection planning forms part of the process and we show the impact of death or illness on clients and their families. We also carry out an estate planning exercise to illustrate the potential tax liability when an estate is passed on and devise strategies to maximise tax efficiencies.

We illustrate the level of return required from investments to reach the client's goals and objectives. This is followed by a planning session where, based on the various scenarios modelled, we agree on the optimum financial plan for the client.

Implementation
At this point we work with clients to select the most efficient options to implement their individual financial plan whether this be reducing investment risk within portfolios, increasing savings or pension contributions, establishing gifting programmes for family.

Ongoing review & planning
Financial planning is not a one-time exercise. Our lives are subject to constant change and it is of utmost importance that plans are reviewed at least annually to allow for changing circumstances and external factors. We work with clients not just to monitor progress but also to provide coaching and support to help them achieve their goals and their desired lifestyle.

Ultimately, we help our clients to understand how much they will need to fund the lifestyle they want for the future and put the necessary structures and plan in place to help them achieve this.

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Broadening the options range

Andy Kelly
Director

The latest changes for members of defined benefit schemes are explained by Andy Kelly.

A very important change to the options available to members of defined benefit (DB) pension schemes came into effect on 22 June 2016. From that date DB scheme members became entitled, at retirement, to transfer their pension benefit into a buy-out bond (BOB) and to use this bond to purchase an approved retirement fund (ARF).

Prior to this, the option to invest in an ARF was only available to defined contribution (DC) scheme members and those with PRSAs or personal pension arrangements. While the option to transfer their pension benefit into a buy-out bond did exist for DB scheme members they could only use this bond to purchase an annuity.

Members of DB schemes are now able to choose between drawing down a lump sum based on their final salary and service and using the balance of their fund to purchase an annuity or taking a lump sum based on 25% of the total value of their fund and retaining the balance for investment in an ARF.

This is certainly a welcome change as it opens up new possibilities for DB members at retirement. For many people the principal attraction of an ARF is the greater degree of control it gives them over their pension. An ARF is a tax efficient post retirement fund which can be invested in various asset classes such as shares, property, bonds and cash in accordance with the risk appetite of the investor.

An ARF also offers flexibility as you can withdraw income when required. Any growth in your ARF is tax-free, however withdrawals from an ARF are taxable (subject to PAYE, USC and PRSI). In the event of an ARF holder aged 60 or over not making any withdrawals the Revenue Commissioners will assume they have withdrawn 4% each year (for those under 71 years and whose fund is less than €2 million) and they will be taxed and charged USC on that amount.

A frequently asked question is what happens to my ARF if I die?

You are free to leave funds in your ARF as an ordinary part of your Estate. If you leave the funds to your husband or wife, the funds are transferred to their name, and can remain invested. In all other cases the funds are wound up and the proceeds are passed to your Estate. Your dependants may have to pay tax depending on who inherits the funds. The table below is a summary of the tax rules applying after your death.

When choosing an ARF investors have to consider a number of factors. The first being their own attitude towards risk. What appears to be an attractive balanced and mixed investment portfolio may not deliver the returns required to provide a reasonable income in retirement. That will result in the ARF holder depleting the capital and the ARF actually running out over time. There is no case for taking unwarranted risks at this crucial time and as with any investment professional advice should be sought before making any decision.

The option to purchase an annuity remains open to those who decide at a later date that they need a secure and regular income. Indeed, by opting to wait they may be able to avail of a higher annuity rate for the same lump sum as they will be older and bond yields may have recovered in the interim.

It is also important that when establishing an ARF that there is clarity and transparency in respect of charges. Independent professional advice is essential before making a decision.

Invesco's team of investment advisers can help guide DB scheme members to the options which best suit their circumstances and attitude to risk.

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Approved Retirement Fund Inherited By	Income Tax Due	Capital Acquisitions Tax Due
Surviving husband or wife	No tax is due on the transfer to an ARF in the husband's or wife's name	No
Children under 21	No tax is due	Yes (normal limits apply)
Children 21 and over	Yes, at 30%	No (depending on certain conditions)

A solid investment

Paddy Swan
Director

Paddy Swan looks at the growing popularity of infrastructure as an investment asset.

Global listed infrastructure typically delivers most of the upside in rising markets whilst falling by significantly less than global equities during periods of decline. Below we take a closer look at how infrastructure as an asset class can increase portfolio diversification.

Although it is a relatively new asset class, infrastructure has become an important part of investment portfolios because of its unique set of features. The term 'infrastructure' refers to the underlying framework that provides essential services to modern societies, such as electric power/gas generation and distribution facilities, sewerage and water systems, major road, rail, air and sea links, and telecommunications installations. The concept can be extended to include social infrastructure such as schools, hospitals and prisons.

Because infrastructure assets provide essential services, demand is stable with a relatively low sensitivity to the broader economic cycle, supporting infrastructure earnings at times when more cyclical businesses can struggle. This coupled with pricing that is generally regulated or contracted and hedged to inflation allows infrastructure assets to generate highly resilient and predictable cash flows. This can translate to a strong source of dividend income and an inflation hedge for a diversified portfolio.

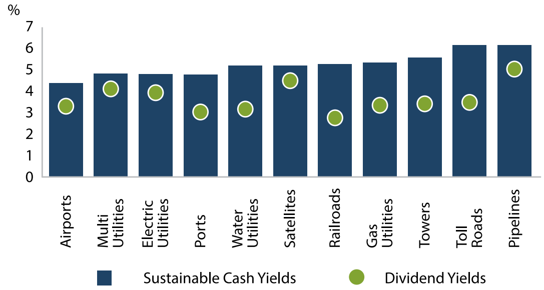
Infrastructure is a global market, with huge opportunities also in the refurbishment/replacement of existing infrastructure, in both the developed and developing worlds. As such, infrastructure is a major growth story. Overall, close to US$78 trillion is expected to be spent on infrastructure globally between 2014 and 2025, with the Asia Pacific market representing almost 60% of this spend.

Reasons to invest in global listed infrastructure now

- It provides inflation protection and structural growth which is less dependent on economic cycles.
- To diversify returns within an investment portfolio.
- Gain a liquid and diversified exposure to infrastructure assets.
- To benefit from strong demand for scarce infrastructure assets as pension funds increase exposure.

Infrastructure for the 21st century

After eight years of austerity, governments around the world are beginning to realise that they need to invest in their economies if they are to retain their competitive advantage and build an infrastructure fit for the 21st century. Some of the projects already underway are incredibly ambitious. China's multi trillion 'One Belt, One Road' initiative aims to connect China with the world, while the European €315 billion 'Juncker Plan' is targeting



roads, rail, housing and hospitals across the continent. The American Senate recently passed the $305 billion US Highway Bill and Donald Trump targeted infrastructure spending as a key platform initiative during his election campaign. In the United Kingdom, Philip Hammond, the newly appointed Chancellor of the Exchequer, announced that he too will loosen the purse strings in the wake of the 'Brexit' referendum result.

Building on recovery

In 2015, the Irish government unveiled an infrastructure and capital investment plan entitled 'Building on Recovery' which is to total €42 billion over the period 2016 to 2021. The focus is to increase spending on a wide range of strategic initiatives which include developing the water system and building housing, schools and hospitals. These projects are likely to be financed through a combination of public and private partnerships. As Government tax bases decline, the philosophical drive to privatisation and the demonstrated greater efficiency from the private sector means that this sector is increasingly being tasked with building and operating these investments.

While only large investors can contemplate direct ownership of infrastructure assets, the development of specialist listed infrastructure funds allows smaller investors to participate. This asset class is projected to grow substantially as countries upgrade or build new infrastructure and seek public investment to support these projects.

In summary, infrastructure investments may deliver:

- Lower volatility than equities
- Inflation hedging
- Interest rate resiliency when compared to bonds

As such, these investments warrant consideration for inclusion in a diversified portfolio.

Paddy Swan

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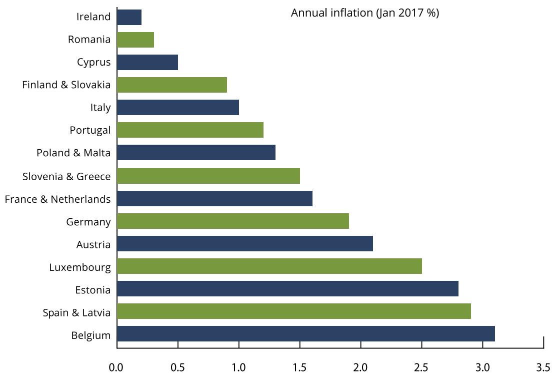
Inflation – why some may be needed

Richard White

Senior Investment Consultant

Richard White discusses the advantages and disadvantages of inflation.

For the first time since 2013, every Eurozone economy has recorded positive inflation. This is well aligned with the broad-based recovery seen in the composite Purchasing Managers Index, a gauge of economic activity, which according to data released in February is rising to the highest level in almost 6 years.



Source: Bloomberg

Inflation occurs when there is a sustained increase in the general price level. Traditionally, high inflation rates are considered to be damaging to an economy as they create uncertainty and can wipe away the value of savings. However, most Central Banks target an inflation rate of 2%, suggesting that low inflation can have various advantages to the economy.

Inflation and investors

Keeping a close eye on inflation is most important for fixed income investments (i.e. deposits and government bonds), as future income streams must be discounted by inflation to determine how much value today's money will have in the future. Inflation, whether real or anticipated, is what motivates stock market investors to take on the increased risk of investing in the hope of generating the highest real rates of return. Real returns are the returns on investment after taxes, inflation and other costs are taken into account.

So how much inflation is "too much"?

This question opens a huge debate argued around the world by Central Bankers and economists alike. There are those who insist that advanced economies should aim for zero inflation, or in other words, stable prices. However, the general consensus is that a little inflation is actually a good thing.

The strongest argument in favour of inflation is the case of salaries (labour costs). In a healthy economy market forces may require reductions in real wages (wages after inflation) to retain competitiveness. For example, a 2% wage increase during a year with 4% inflation has the same net effect as a 2% wage reduction in periods of zero inflation. This is the primary reason that most economists today agree that a small amount of inflation, about 1-2% a year, is more beneficial than detrimental to the economy.

Other advantages of inflation:

1. Deflation (a fall in prices – negative inflation) is very harmful. When prices are falling, people are reluctant to spend money because they are concerned that goods will be cheaper in the future. Deflation increases the real value of debt and reduces the disposable income of individuals who are struggling to pay off their debt.
2. Moderate inflation makes it easier to adjust relative prices. This is particularly important for a single currency area like the Eurozone where devaluation is not an option to regain competitiveness.
3. Inflation can boost growth. At times of very low inflation the economy may be stuck in a recession. Arguably targeting a higher rate of inflation can enable a boost in economic growth, however this view is controversial.

Other disadvantages of inflation:

1. Inflation leads to a fall in the value of money and makes savers worse off in real terms if inflation is higher than interest rates. High inflation can lead to a redistribution of income in society and often it is pensioners who lose out most during inflationary periods.
2. Inflationary growth tends to be unsustainable. It leads to a damaging period of boom and bust economic cycles. For example, the UK saw high inflation in the late 1980s, but this economic boom was unsustainable and when the government tried to reduce inflation, it led to the 1990-92 recession.
3. Inflation can make an economy uncompetitive. A relatively higher rate of inflation in a country can make their exports uncompetitive, leading to a current account deficit and lower economic growth. This is particularly important for countries in the Eurozone where devaluation is not an option.

To conclude, a modest level of inflation may be a good thing, or even necessary. However the return of inflation, albeit at a low level, is a reminder to investors, and in particular pension investors, of the need to maintain the real value of their savings.

Richard White

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Taking care of your Business

John Lucey
Director

John Lucey looks at the need for owners and shareholders to constantly review the protection arrangements for their business.

Contemplating what might happen in the event of your death or serious illness, or that of a business partner is not a comfortable thought. It is understandable that business directors and partners are focused on the running and growth of their business and may give little or no thought to their death or serious illness. The loss of their expertise may have an immediate and devastating impact on the business but it also raises the question of succession and who may take over their share and role in the business. Therefore, it is not surprising to find many people either have inadequate or inappropriate arrangements in place to cover these eventualities.

For surviving directors or partners there are a number of particular difficulties which can arise. A new partner may not be familiar with the business and could have very different ideas on the direction of the business and how it should be run. This may lead to a loss of control as well as damage to the business arising from director agreements.

The families of the deceased can also face difficulties. There may not be any member of the family adequately qualified or with the appropriate experience to join the business. They may not have a ready market for their shares should they wish to sell them and the surviving directors may not have access to funds in order to buy them out.

This is a very unsatisfactory situation for all concerned. The business is at the loss of a leader, a family is in financial distress, and there is uncertainty regarding the future ownership of the company.

The protection solution
One solution which can meet everyone's needs in such situations is for the business to take out a life insurance and serious illness policy for each director. These policies would pay out on the death of a director or in the event of them being incapacitated by a specified serious illness.

At the same time, the company would enter into what is known as a contingent purchase agreement. In the event of the death of a director covered by such an agreement, the company would use the proceeds of the insurance policy to purchase their shares. It is then open to the company to either cancel the shares, which would have the effect of increasing the proportionate shareholding of the surviving directors. Alternatively the shares can also be held in the form of treasury shares which would allow for their later resale to an investor who the surviving directors believe would be good for the business.

However, protection should not be limited to shareholders or partners. Key person insurance allows a partnership or company to plan for the potential financial loss that it may suffer on the death or serious illness of a key employee without the attendant share purchase agreement.

These are just a few examples of the type of protection which can and should be taken out for businesses. Ensuring the survival of your business, either when you pass it on to your children, or in the event of a partner dying or becoming seriously ill, requires careful planning.

Invesco can help you put in place arrangements to suit your firm's individual circumstances which will ensure the continued success and profitability of your business.

For further information on business protection contact ***John Lucey***

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