



Asset Owners

# Pensions with Purpose

Meeting the Retirement Challenge

18 February 2016

Featuring the findings of the State Street 2015 Asset Owners Survey

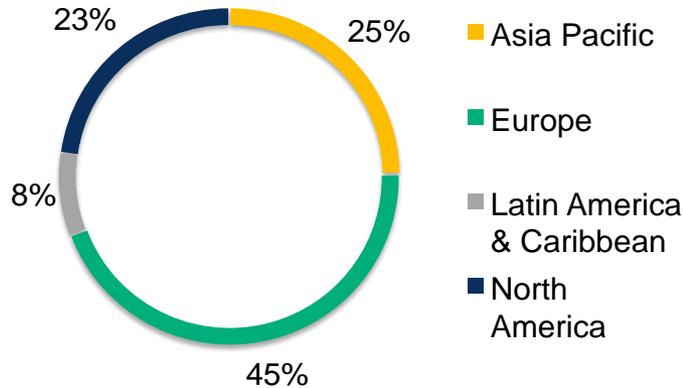
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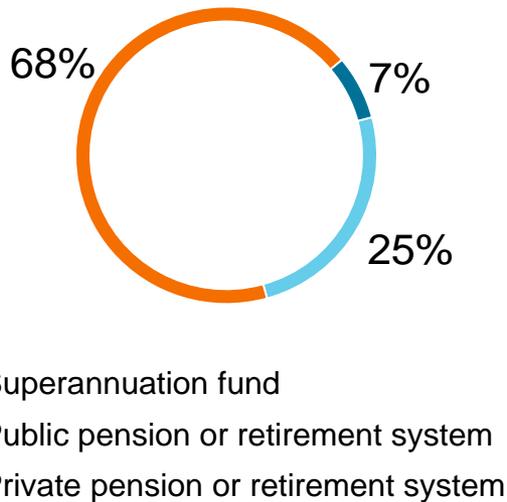
# Who Took the Survey?

400 Pension Fund Executives From 20 Countries Participated

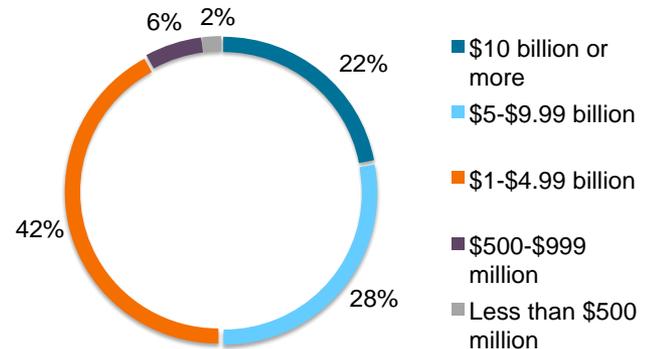
### Region



### Institution Type



### Range of Total Assets Overseen



# Overview

## Pensions with Purpose

Faced with aging populations and uncertain markets, the most innovative pension funds are proceeding with a confidence that comes from clear ownership of the challenges ahead



# Overview

## Pensions with Purpose

Faced with aging populations and uncertain markets, the most innovative pension funds are proceeding with a confidence that comes from clear ownership of the challenges ahead

**Own the Outcome**

**92%**

*Are taking concrete actions now to upgrade their governance*

**Own the Strategy**

**50%**

*Will increase exposure to real estate over the next three years*

**Own the Risks**

**36%**

*Are taking on more risk to boost their returns*

**Own the Efficiency**

**80%**

*Plan to merge multiple retirement plans, 35% within the next 3 years*

**Own the Talent**

**48%**

*Are expanding their internal risk teams*

# Own the Outcome

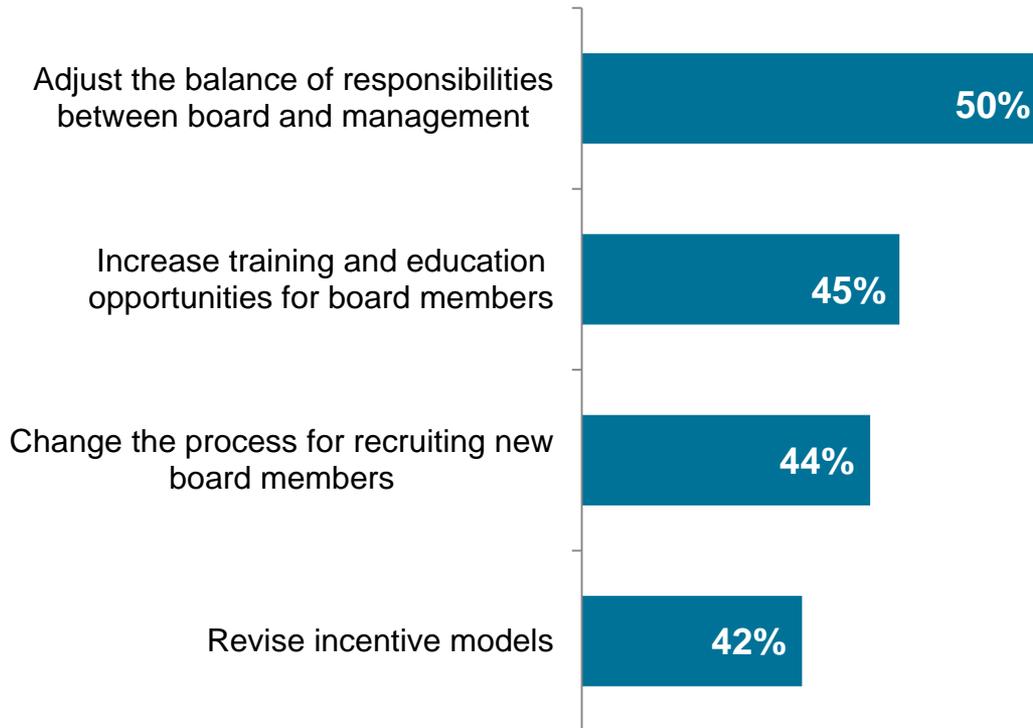
“Some boards have been adding independent trustees who have expertise in a specific area. There’s a lot more bespoke education happening, and boards are meeting more frequently to address issues where they’re unfamiliar.”

*Professor Gordon Clark,  
Oxford University*

# Pension Funds' Governance Models Are Set for Overhaul

## Every Aspect of Fund Governance Will Be Disrupted

### Top Governance Actions in 2016



92%

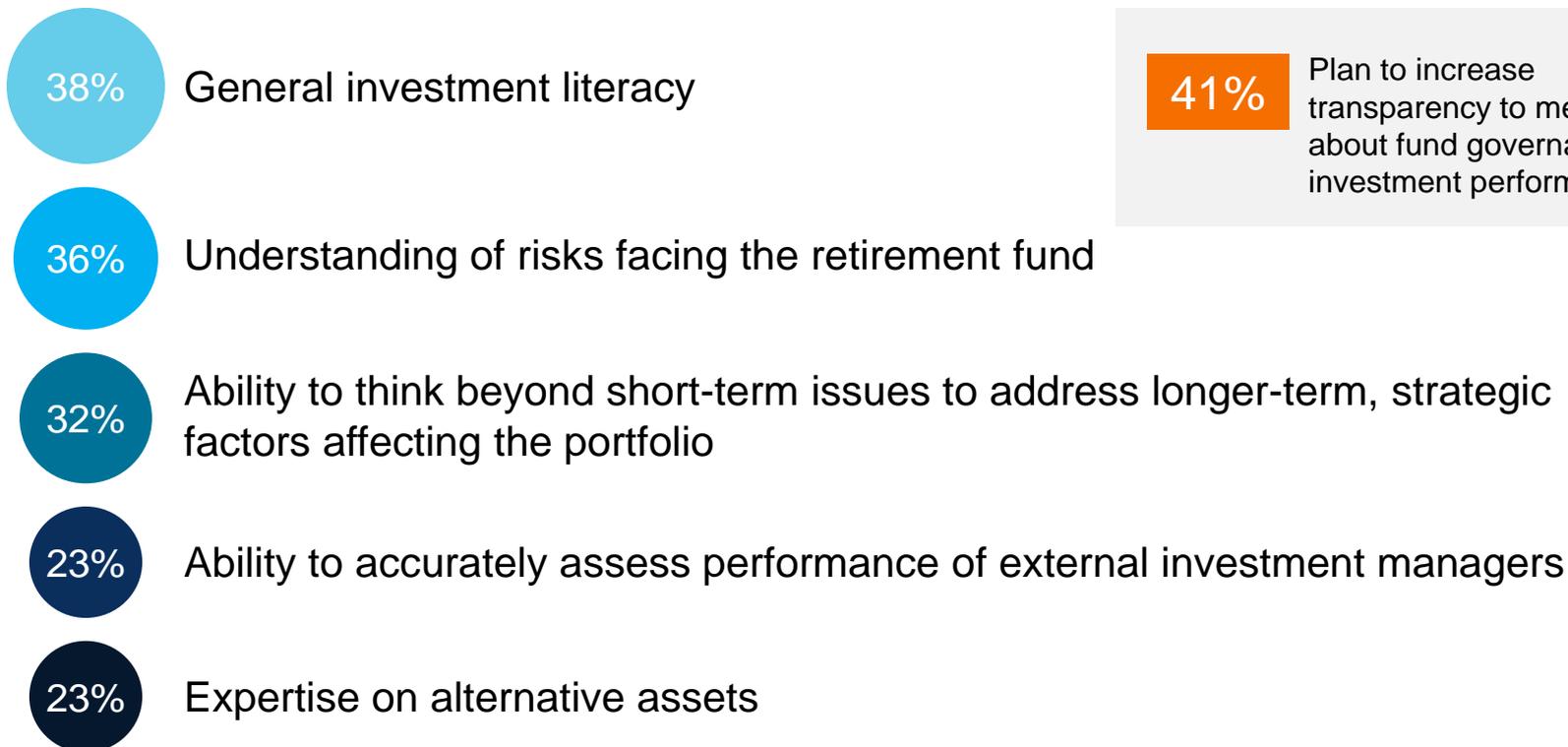
of funds will upgrade at least one of their governance aspects in 2016

Note: The base is all respondents whose funds have some defined benefit (DB) component.

# Enhancing Capabilities and Transparency Are a Priority

## Board Expertise is Not Perceived as Strong in Critical Areas

Respondents who believe their board has a high level of:



Note: 'High' = respondents scoring themselves 9 or 10 on a 1-10 scale.

# 'Governance Leaders'\* Are Ahead of the Pack

Whatever the Mission, Enhanced Governance Will Facilitate its Execution



## 7 Steps to Becoming a Governance Leader

- Optimizing balance of responsibilities – board vs management
- Increasing training / education opportunities
- Changing board member recruitment
- Revising incentive models
- Increasing transparency to members
- Increasing reporting frequency to board
- Increasing autonomy of investment function

Note: The base is all respondents whose funds have some defined benefit (DB) component.

\*A group of Governance Leaders have emerged in our survey. This group fully recognize the need to optimize their governance. They are taking actions to upgrade four or more areas of their governance models in the next 12 months.

# Own the Strategy

“Over the past few years we've ramped up private equity, and to a certain extent hedge funds. We've also been doing a lot more private real estate recently.”

*William Lee,  
Chief Investment Officer,  
Kaiser Permanente*

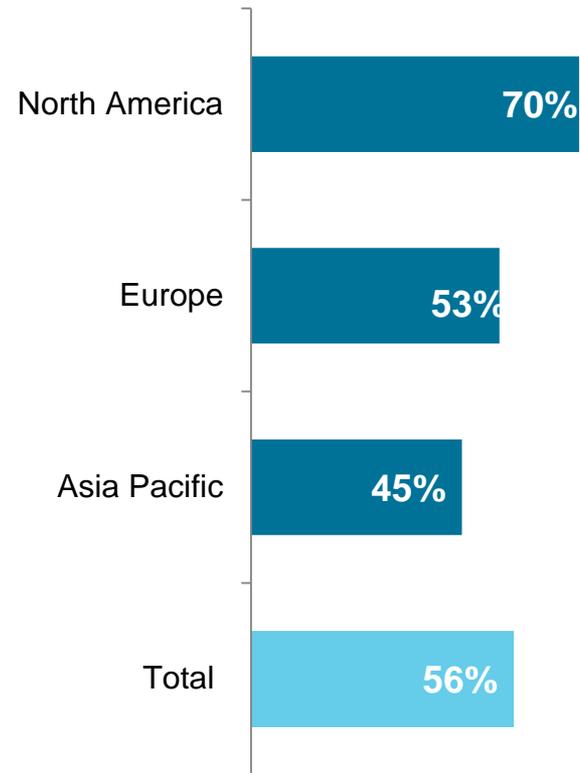
# Funds Are Transforming to Meet Their Future Obligations

More Than Half of Institutions Expect to Introduce a Defined Contribution (DC) Scheme in the Next Three Years



Note: The base is all respondents whose funds plans to introduce DC / hybrid.

## Regions Where Pension Funds Expect to Introduce DC Schemes Over the Next 3 Years

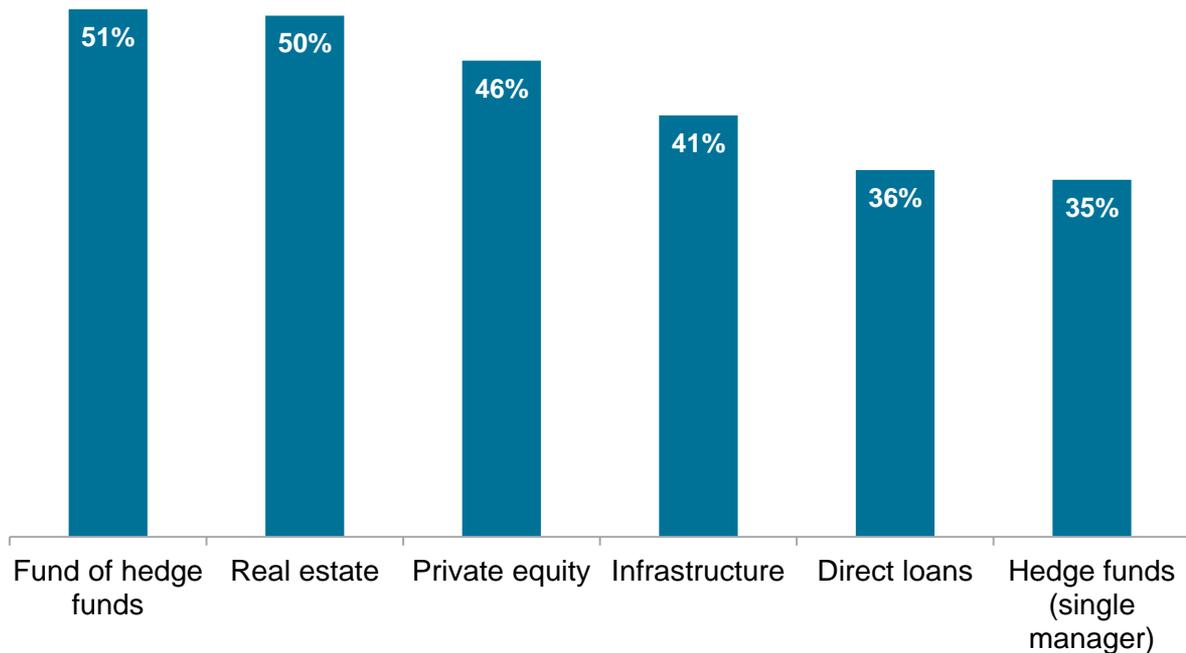


Note: The base is all respondents whose funds are defined benefit (DB) only.

# Alternatives Are Key to Boosting Returns

But Many Funds Are Not Confident They Have Full Transparency on the Risks

Funds Planning to Boost Exposure to Alternative Asset Classes Over the Next 3 Years



46%

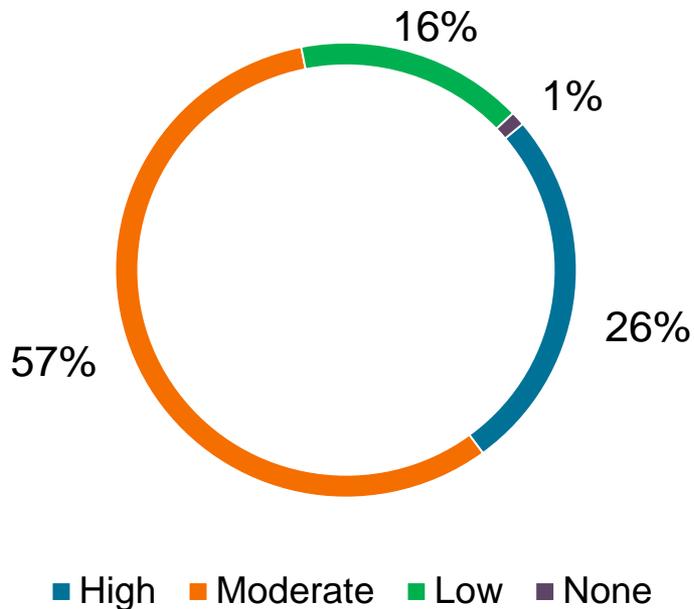
say they lack 'real transparency' on risks stemming from alternatives

Note: The base is all respondents whose funds have some defined benefit (DB) component.

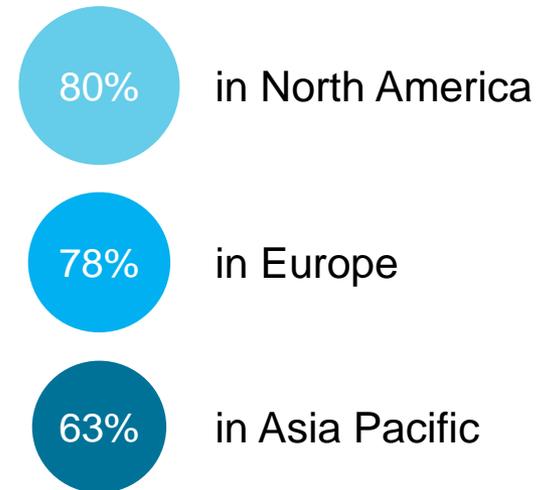
# Pension Funds Express Strong Interest in ESG

## Preparing Their Portfolios For the New Economy That Lies Ahead

Pensions' Anticipated Interest in Environmental, Social & Governance (ESG) in the Next 3 Years



Funds More Likely to Appoint a Manager With ESG Capabilities



Note: The base is all respondents whose funds have some defined benefit (DB) component.

Note: The base is all respondents whose anticipated level of interest in ESG investment is high / moderate.

# Own the Risks

“We’re experiencing the strongest ever demand for multi-asset class risk systems that aren’t just risk reporting tools, but risk management systems. That’s not something people thought about before.”

*Daniel Gerard,  
Head of Advisory Solutions,  
Asia Pacific, State Street*

# Pension Funds Face a Dilemma: Risk-On or Risk-Off?

Almost Half Are Easing Up on Investment Risk, But Some 'Return Hunters' Are Doing the Opposite

Which Best Describes Your Institution?

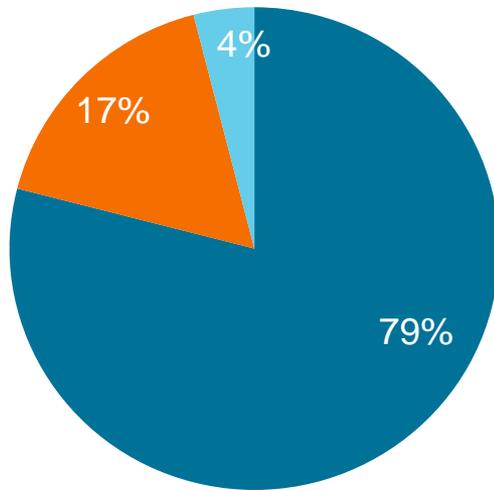


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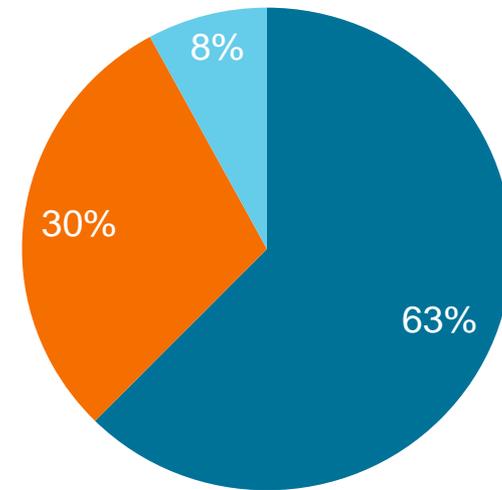
# Differing Risk Strategies Between Private and Public Funds

## More Private Pensions Are Decreasing Their Investment Risk Profile

'Risk Cutters'\*



'Return Hunters'\*



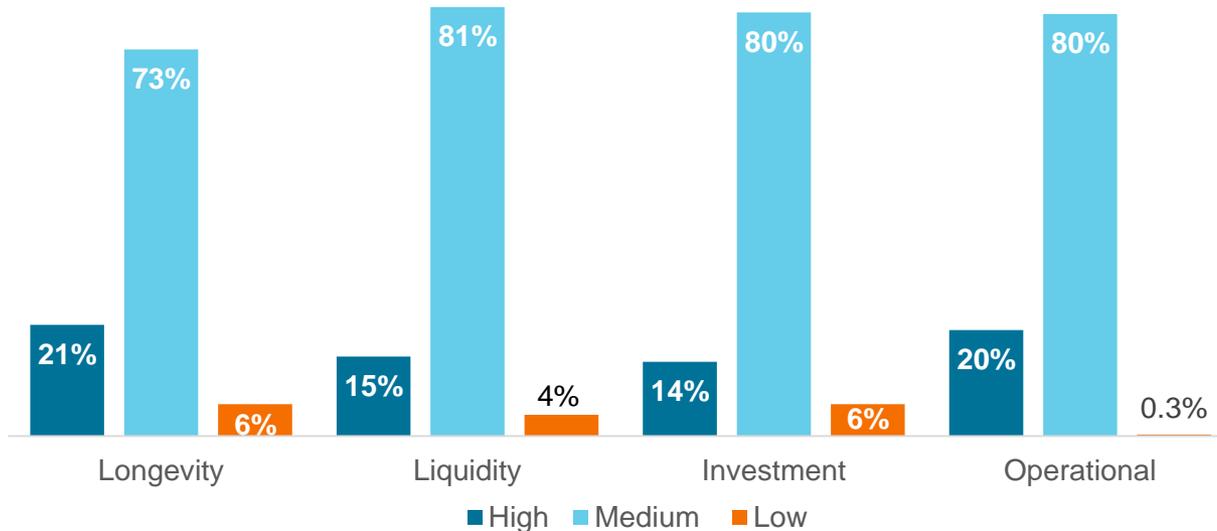
- Private pension or retirement system
- Public pension or retirement system
- Superannuation fund

\*Note: The base is all respondents whose funds have some defined benefit (DB) component.

# Only a Select Few Are Mastering the Risk Challenge

No More Than 20% Rate Themselves as Highly Effective at Managing Key Risk Areas

Effectiveness on Risk (Low, Medium and High)



Effectiveness at managing longevity, liquidity and investment risk\*:

- Large funds' scores are considerably higher than those of small funds
- Public pensions' scores are considerably higher than those of private pensions
- European funds' scores are slightly higher than those of other regions

Note: 'High' = respondents scoring themselves 9 or 10 on a 1-10 scale.

Note: The base is all respondents whose funds have some defined benefit (DB) component.

\*The differentials are smaller for operational risk.

# Own the Efficiency

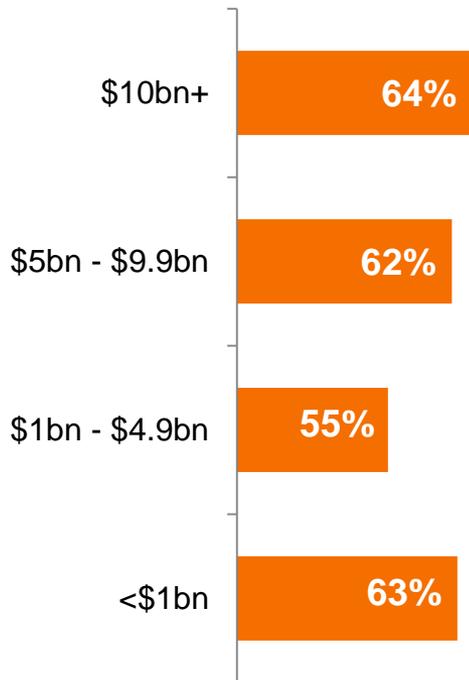
“We encourage all UK pension schemes to explore the sharing of capabilities and investment opportunities. If more schemes pooled their expertise together it would bring costs down but also increase the scope for innovation.”

*Iain Cowell,  
Interim Head of Investment Affairs,  
Pension and Lifetime Savings  
Association, UK*

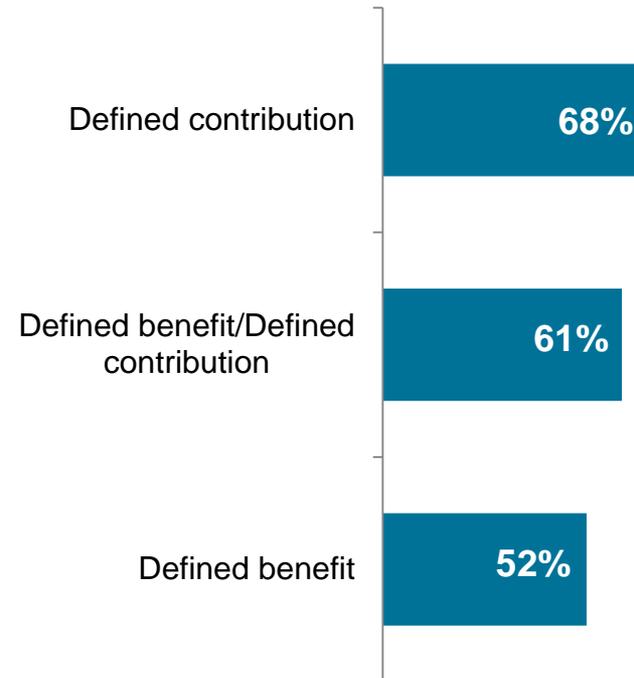
# Funds of All Sizes Are Under Pressure to Cut Costs

## Six in Ten Pension Funds Feel Pressure to Reduce Costs

Under Pressure to Cost-cut  
Across Fund Sizes



Under Pressure to Cost-cut  
Across Scheme Types



Note: The base is all respondents.

# They Are Consolidating to Boost Efficiency and Oversight

## Risk Cutters focus on cost benefits, Return Hunters on operational effectiveness

80%

of funds plan to merge  
multiple retirement  
plans – 35% within the  
next 3 years

### Most cited benefits of consolidation:

1. Reduced costs (24%)
2. Improved operational effectiveness (22%)
3. High standards and consistency of governance (18%)
4. Improved transparency on risk and performance (17%)

Note: The base is all respondents.

Note: The base is all respondents whose institutions plan to consolidate multiple retirement plans.

# Own the Talent

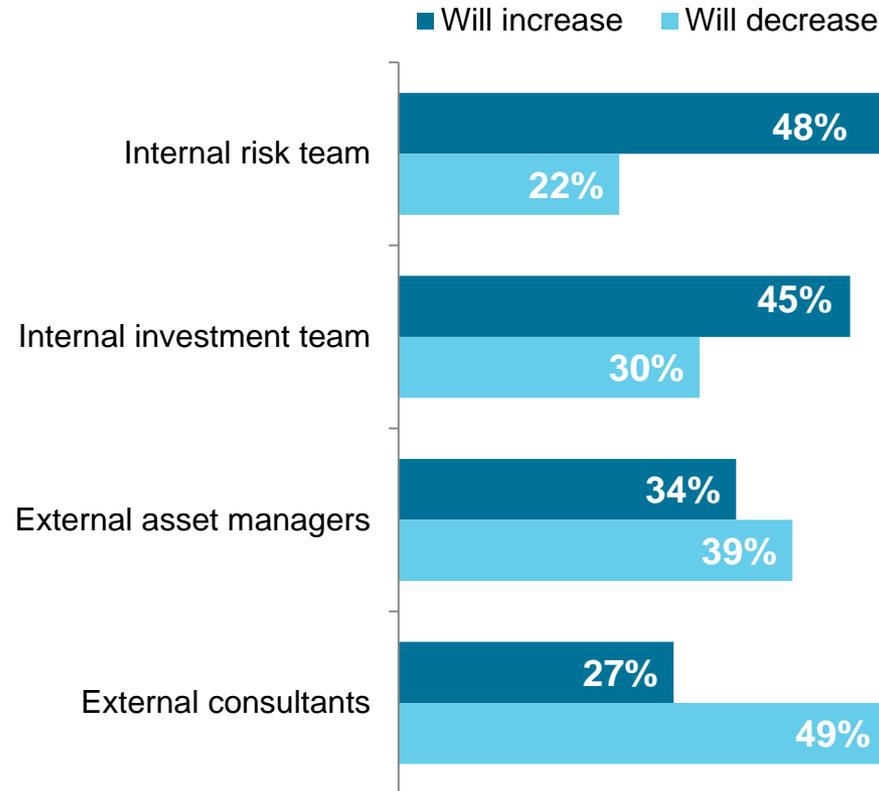
“We feel it’s more effective to manage our European equity portfolio in-house and bring in external help for developing markets.”

*Timo Ritakallio,  
President and CEO,  
Ilmarinen Mutual Pension  
Insurance Company*

# Pension Funds Are Bulking Up On In-house Expertise

## Funds Are Bringing Aspects of Their Investment Strategy In-house

### Resourcing Intentions Over the Next 3 Years



#### In-house talent is needed:

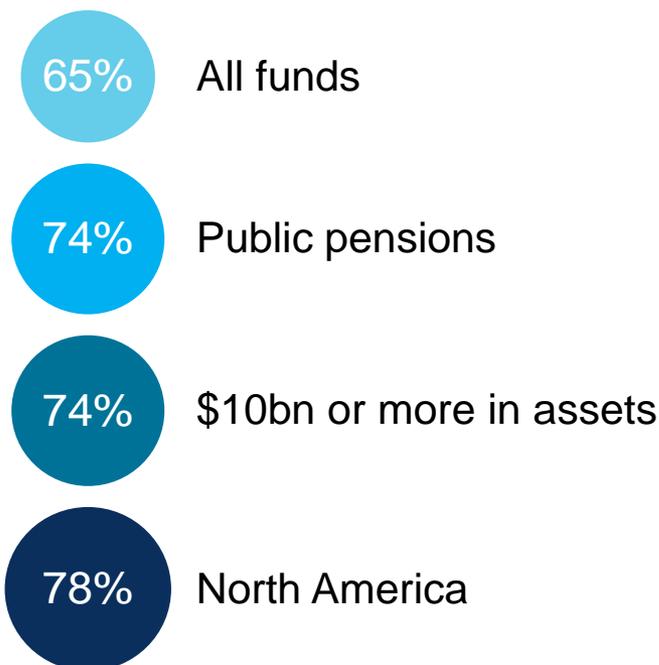
- Only 30% describe their in-house risk talent as very strong
- ESG investing expertise will be in growing demand (76% expect to increase ESG investing)
- 44% of funds will also seek to improve board expertise and recruitment processes

Note: The base is all respondents whose funds have some defined benefit (DB) component.

# But External Advisors Remain Indispensable

## Funds Seek Fewer But Better Consultant Relationships

Agree That Consultants Are Essential to Guiding Their Investment Processes



Note: The base is all respondents.

# Key Implications

“We see good governance as the means by which ideas on paper can be turned into actual investment returns.”

*David Aleppo,  
Head, DB Investment  
Advisory Services (UK), Willis  
Towers Watson*

# The Big Picture for Pension Funds

## Own the Outcome

- ✓ Improved governance will be key to delivering better retirement outcomes
- ✓ Boards must enable a clear mission for their investment teams
- ✓ The right balance of responsibilities must be set between the board and management teams

## Own the Strategy

- ✓ Pensions must adopt appropriate strategies to meet their long-term liabilities
- ✓ Sustainable investing is here to stay
- ✓ A plan's infrastructure has to evolve to meet members' needs

## Own the Risks

- ✓ Pensions should consider all risks individually and holistically
- ✓ Risk & performance metrics must be adjusted to fit higher-risk / return strategies
- ✓ Transparency of data on alternative assets is imperative to support higher-risk / return strategies

## Own the Efficiency

- ✓ Pooling funds can create scale to access previously inaccessible assets
- ✓ Pooling funds enables standardised approaches to governance
- ✓ Enormous room exists for process efficiency gains through better use of technology

## Own the Talent

- ✓ Funds need to offer competitive packages to attract needed talent
- ✓ Taking on greater risk entails improving internal risk capabilities
- ✓ Funds must be more discerning in how they use external consultants

For more information about how our solutions for pension funds, please contact:

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# Disclaimer

This survey is based on a State Street survey of 400 senior executives in the pension fund industry conducted by Longitude Research in October and November 2015. Respondents to the global survey included representatives of public and private pension or retirement systems, and superannuation funds across 20 countries. The quantitative research was supplemented by in-depth interviews with 43 pension industry experts from 13 countries.

The information in this document is accurate as of February 18, 2016.

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