

**Ian McKinlay:** Herding is not so bad if the herd mentality focuses on the right things. What is wrong with focusing more on the strategic asset mix or on a plan to wind your scheme up safely in 30 years? New funding regulations are going to drive that. To me, that would not be a bad thing.

**Steve Delo:** Of course, herding in the solutions being recommended might mean the average solution – ie one that is appropriate for an ‘average’ scheme – is chosen by the trustees, even though it is not necessarily appropriate for the individual scheme in question. That would not be good news.

**Rick di Mascio:** There is nothing wrong per se in herding. People can often do the right things collectively, but one of the problems is that they also tend to do the wrong things collectively, because it is fashionable. On the asset side, one of the main problems with herding is that people switch asset classes, typically, at the wrong time in the cycle.

**Neil Walton:** It is difficult to know when you are in a peak or a trough, so in advance you cannot say this is the wrong time.

**Rick di Mascio:** If we define it as making timing decisions, then herding, in a timing sense, across the industry, has been poor.

**Ian McKinlay:** You could paralyse yourself by not taking a decision because you fear making the wrong decision. There has to be a plan, and there has to be some momentum behind it. It would be good if a schemes thought about that, and tried to get themselves there. They do not need to do it tomorrow. Diversification is, perhaps, one answer to that. I would say think about diversification now, but alongside this, think about getting toward the endgame.

**Mike Anthony:** That is what Myners said.

**Ian McKinlay:** I am not sure Myners said that at all. He said: ‘I would like you to invest in private equity’.

**Mike Anthony:** No, that was the rationale behind his report: why are pension fund institutions not investing more in private equity? In fact, what he ended up saying was that trustees ought to look at a much wider range of asset classes than they have in the past.

**Ian McKinlay:** He did talk about strategic asset allocation, but he did not deal directly with the framework for making sure people are safe when they retire. Forget about the PPF for a moment – that is the ultimate insurance policy. How are we going to make sure that these people who work for us right now, are being looked after when they retire in 20 years?

**Rick di Mascio:** Balance and diversification

is important in the majority of cases. Even where you have a fixed and known liability, there are funds which have gone down the road of solely investing in a bond portfolio and assuming it has been totally immunised. They have then found, several years later, that they actually have a deficit, and the reason for that is because of mortality, even though they took good advice and embarked on what they believed was a sensible approach.

**Neil Walton:** We should not pretend that you can hedge something like longevity through an asset mix. You must recognise that you have an unhedgeable risk unless you go to an insurance company to pay them to take that off your hands. It is dangerous to blur the boundaries there. You are not covering yourself against longevity by investing in risky assets.

**Ian McKinlay:** A programmed purchase of an annuity is bond-like, but taking longevity off the table remains a laudable objective.

**Neil Walton:** Currently the only practical route is available through insurance companies, to take out that longevity risk.

**Mike Sarjeant:** Trustees have wanted to better understand and control the linkage between investments and the underlying liabilities for some time. The need to better control funding has increased over the last five years because the biggest contributor to under-funding has been various adverse, unforeseen financial events. Trustees now want to map where they are against their expected assumptions and other financial variables such as mortality. That way, they are better equipped to know when the funding rate is going to increase. Quite often smaller schemes need that more acutely than bigger companies, but it is more challenging to get that all sorted out for them.

**Neil Walton:** A lot of these things are very difficult to quantify, although certainly an attempt to rank them might bring some focus.

**Pádraig Floyd:** So even if a trustee board looks at a scheme-specific way of developing a strategy, and abandons a short-term view and looks at the potential length of its liabilities, they



Sarjeant: “Member trustees are often a good sounding board for issues and they ask questions which half of the people around the table would like to ask, but haven’t got the bottle”

are going to find it difficult to achieve that in the long term, unless they have a more diverse portfolio than the bond portfolio, which makes sense. But are they able to understand all the concepts we are discussing and even if they do, will they understand the nuances?

**Ian McKinlay:** I am optimistic. Three years ago there was not a decision by many trustees in smaller schemes – less than £50m, say – to invest in a portfolio of credit. Now that is much more a core holding, maybe 30% or 40% in many funds of that size. That required bodies of trustees to step up and actually to understand what a portfolio of credit actually meant. There is more sophistication and if you get professional trustees coming to the fore, as I think is bound to happen, then I am optimistic in the sense that trustees can embrace these ideas.

**Mike Anthony:** One should not underestimate the commitment of many trustees, particularly member-nominated trustees.

**Stuart Gordon:** Is there not a problem that choosing an asset allocation strategy based on the individual liabilities of the pension scheme is seen by too many trustees as a panacea? It is actually only one of the tools in the toolbox. Something which is often overlooked is flexibility. I worry about some solutions we see where trustees are tied into extremely long-term contracts and arrangements, which have ostensibly matched their liabilities until the company gets taken over, or the scheme gets closed down, or there is a change in longevity.

**Mike Anthony:** Is that not half the point of Myners? Even by default, trustees are going to be looking at investment issues on a much more frequent basis than they have in the past. If they have a strategy in place, they are not just going to sit down for five years. That is the fluidity and the flexibility of the strategy.

**Ian McKinlay:** What did you mean by ‘lack of flexibility’, in terms of strategies?

**Stuart Gordon:** I was thinking in terms of some of the liability-driven investment approaches, where trustees can be tied into very long-term swap arrangements, with very complex derivatives, which can be very difficult and inflexible to change.

**Ian McKinlay:** What sort of size of fund are we talking about here? Because if you go out and buy £10m worth of a pooled liability-driven investment (LDI) fund, that is a world away from buying £150m worth of exposures to a series of interest swaps with an investment bank. There is a big difference in “flexibility” there.

**Stuart Gordon:** It is entirely flexible if you