

WATSON WYATT, 2008. *Defining moments: the pensions and investment industry of the future.* London: Watson Wyatt.

UKSIF summary, 2009.

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I. Key points

- Survey methodology: 1-to-1 interviews with industry leaders, opinion survey (486 responses) and Watson Wyatt's research
- According to the 486 respondents (all from the industry) who participated in the opinion survey:
 - What they believe that will happen: alpha appetite to grow, talent shortages to stay, value of independent advice to rise, marketplace change and growth of absolute return
 - What they think that should happen: increased long-termism, stronger governance, more independence in advice, rise in ethical standards and separate going rates for alpha and beta
 - What they fear: DC underdelivers, undue short-termism, growth of regulation, over-complexity in investment products and over-complexity in derivatives
- **The current environment:**
 - Sovereign wealth funds have the potential to become role models of institutional funds by showing best practice in governance and strategy, addressing systemic faults and providing long-term capital to banking and hedge funds.
 - Investment consultants are critical to strengthen pension funds' governance. Competition in the sector will bring more choice and health.
 - The sub-prime crisis is a consequence of different and embedded factors: appetite for alpha, over-complexity of the chain, over-compensation of the short-term and high integration of the financial markets.

- DC in its current form is likely to under-deliver due to poor contribution rates, poor investment strategy and poor investment choice.
- **Trends for the near term (approximately 5 years) are:**
 - Pressure for talent (strong trend): demand for talent to meet funds' ambitions for skill-based strategies
 - Improvements in governance (slower trend): pension fund governance will have to adapt to uniquely complex circumstances in order to secure any competitive advantage
 - Product proliferation (strong trend): diversity of asset classes, growth of derivatives, alpha and beta separated
 - Extra-financial factors (slower trend): influence of responsible investing, activism and climate change as the strongest element
 - Shift to DC (slower trend): DC becomes the dominant global model, driven by demographics, regulatory environment and individualist social structure
 - Organisational change (strong trend): organisation to support trends (e.g. innovative designs for remuneration and ownership)
- **What should happen:**
 - Institutional investors should exhibit increased long-termism.
 - Institutional investors should spend more on internal governance resources.
 - A meaningful shift in incentive structures can only be accomplished with stronger asset owners as part of the process.
 - Ethical standards should rise.
- **Defining moments (current forces of change):**
 - Growth of absolute return investing and the corresponding decline of relative return investing
 - Boosting of governance resources
 - More complex model of risk management to be more representative of the real world
 - Expectation of a period of significant greater regulation to address the systemic faults of the market
- **Future trends (forces which will help to define the longer-term landscape):**
 - Investments should be seen as a journey
 - DC schemes must be developed.
 - Stronger pension governance can lead to economies of scale because they question the fee structures.
 - Emergence of new investment content offering higher efficiency (e.g. more exotic securities)
 - Financial crisis will continue

- Key competencies for investment managers are manufacturing, aggregation and distribution while, for intermediaries, they are advice and solutions.
- **Trends of the asset management worldwide (by Jefferies Putnam Lovell):**
 - Influence of retirement linked-products
 - Globalisations and the rise of Asia
 - Increasing demand for outcome-orientated products
 - Growing power of professional buyers
 - Recognition of the advantages of fund managers
 - Focus on core competencies
 - Convergence of traditional and alternative products
 - Proliferation of cheaper beta products
 - Pressure on long-only retail fund complexes
 - Use of performance fees
- **Opportunities for funds**
 - Better DC: develop the mechanisms to improve the DC model
 - Investment costs: though better governance, pension funds will be more aware of the cost structure and assume influence over costs
 - New investment content: growing list of innovations
 - Risk: Develop better risk management disciplines
 - Long-term: Funds adapting to longer-term strategies (mission, beliefs, benchmarking, mandates)
- The future will see the death of the current governance model, the current DC model, the cost spiral and the relative return investing. Besides, alpha and beta will be united with distinct going rates.

II. Key quotes

- “Important issues concerning these funds include transparency and governance. While some funds, such as Norway’s fund, provide exemplary disclosure standards, most of the SWFs do not disclose their investment objectives” (Watson Wyatt 2008, p. 8).
- “Consulting looks like it will undergo some of the biggest changes of any of the participants in pension fund management” (Watson Wyatt 2008, p. 10)
- “The problem resides in excessive competition, complexity and compensation. The industry’s ‘incentive structure’ is flawed - the rewards and sanctions facing industry participants are not appropriate and so participants are incentivised to act in ways that will ensure the system remains prone to periodic crisis” (Watson Wyatt 2008, p. 11)

- “In its current form, the expectation is that DC plans will deliver inadequate retirement income to large segments of the population” (Watson Wyatt 2008, p. 13)
- “Absolute rather than relative return mandates are increasingly the most relevant framing for a wide range of investors, including pension funds that have adopted liability driven investment (LDI) strategies” (Watson Wyatt 2008, p. 23)
- “Investing has always been about journeying, in the sense that the environment is evolving, and saving periods tend to precede spending periods” (Watson Wyatt 2008, p. 29)
- “Complexity makes effective regulation increasingly difficult.”
“Strengthened governance can discipline market players who are not providing sufficient value propositions” (Watson Wyatt 2008, p. 34)