The changing world of pensions

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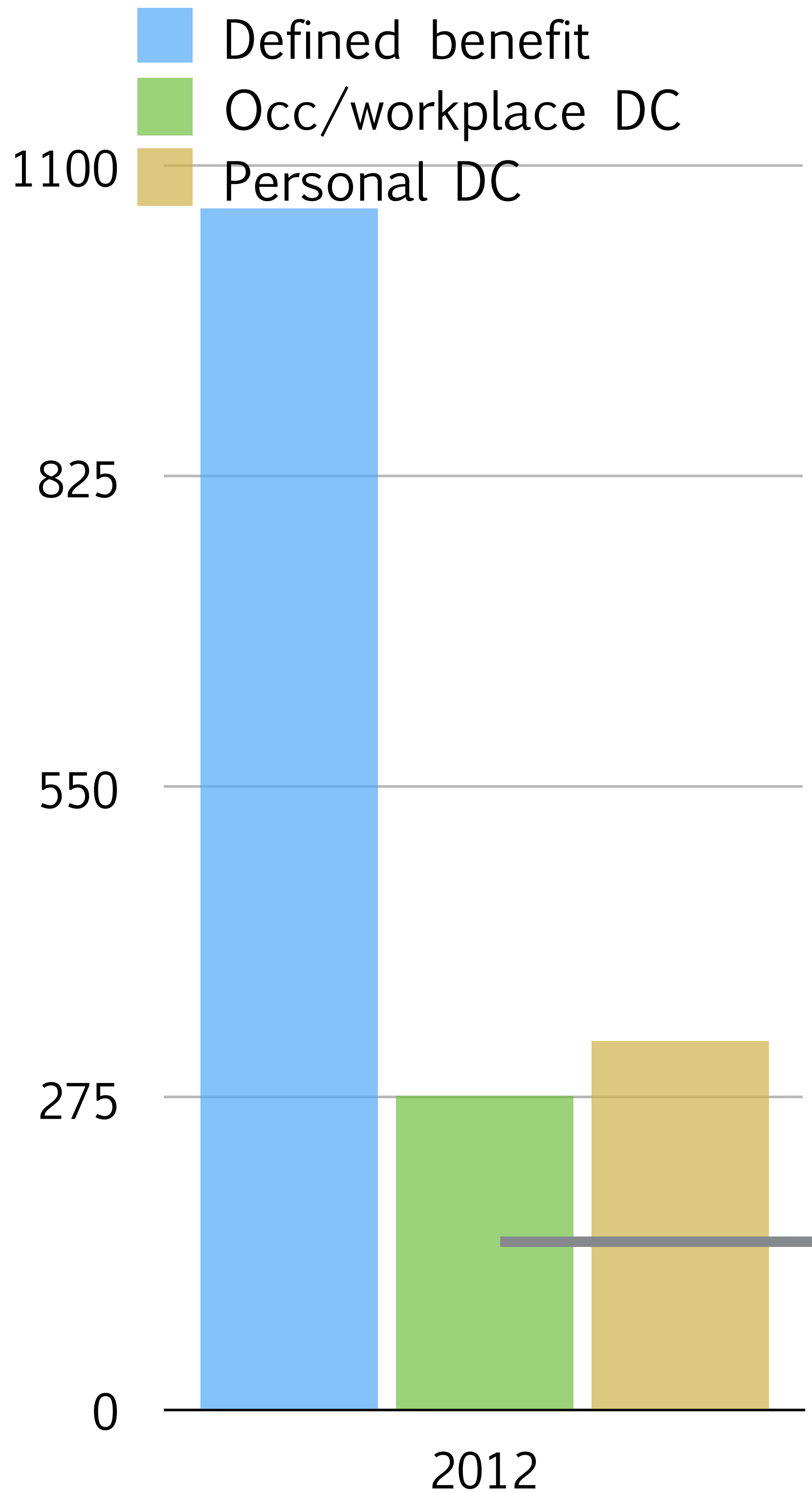
The size of the UK market



Major changes to the UK pension market

- Auto-enrolment;
- Collective Defined Contribution
- Removal of requirement to purchase an annuity
- Possible changes to local government pension provision

These changes are discussed on subsequent slides

The current structure of DC is discussed overleaf.

The report for the IPF, "Returning to the Core, rediscovering a case for real estate in defined contribution pension schemes" from which these statistics are taken, recognises that the value of £276 billion for occupational and workplace DC schemes may be unreliable. The 2012 ONS statistics gave a value of £386 billion at the end of 2010. Per the Pensions Institute, auto-enrolment is to increase DC AUM sixfold from c. £276bn in 2012 to £1,680bn in 2030.

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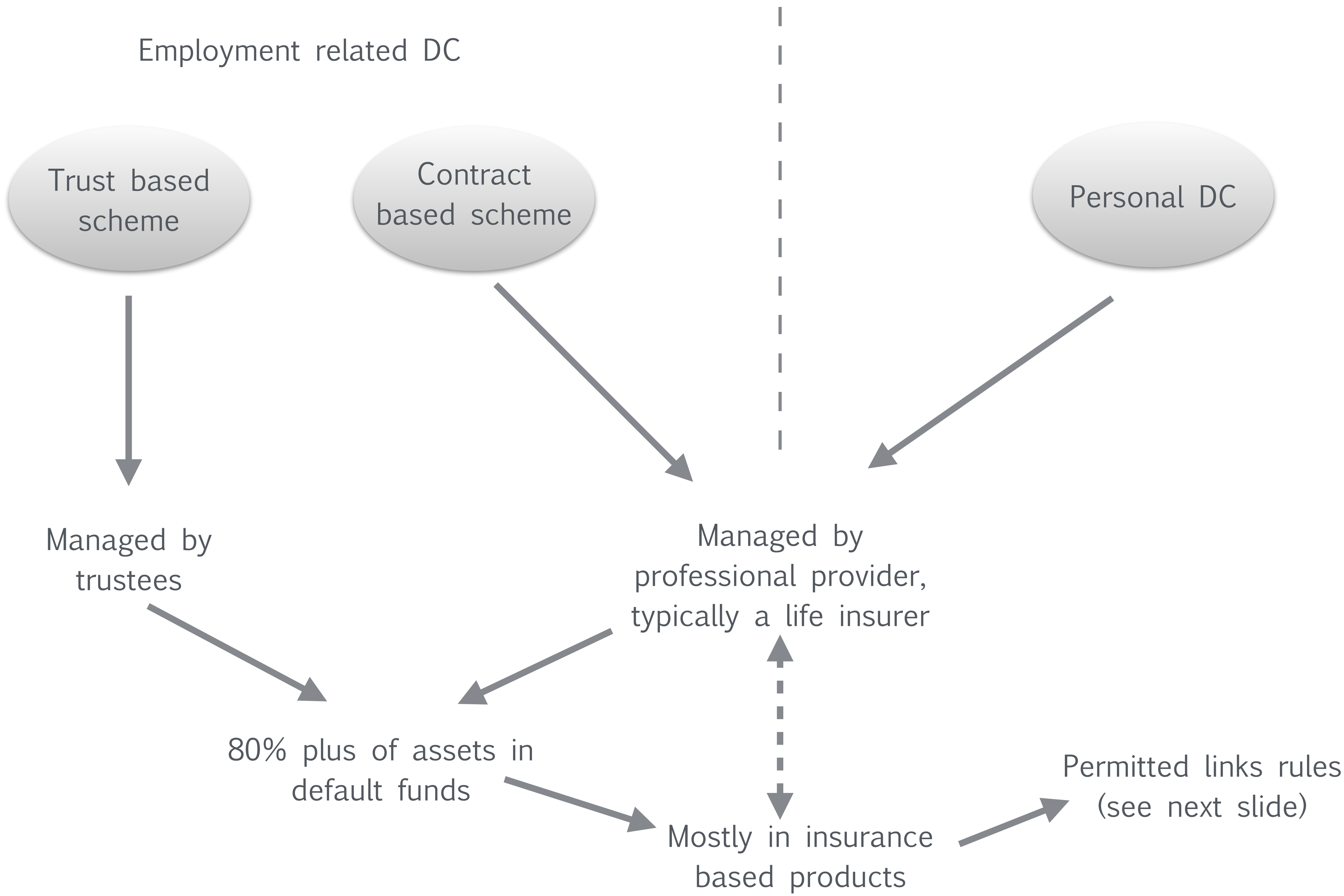
Defined contribution schemes



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Insurance permitted links rules

An insurer must not contract to provide benefits under linked long-term contracts of insurance that are determined:

(1) wholly or partly, or directly or indirectly, by reference to fluctuations in any index other than an approved index;

(2) wholly or partly by reference to the value of, or the income from, or fluctuations in the value of, property other than any of the following:

- (a) approved securities;
- (b) listed securities;
- (c) permitted unlisted securities;
- (d) permitted land and property;
- (e) permitted loans;
- (f) permitted deposits;
- (g) permitted scheme interests;
- (h) 1 [deleted]1
- (i) cash;
- (j) permitted units;
- (k) permitted stock lending; and
- (l) permitted derivatives contracts.

(a) in respect of a firm's business with institutional linked policyholders only, any of the following:

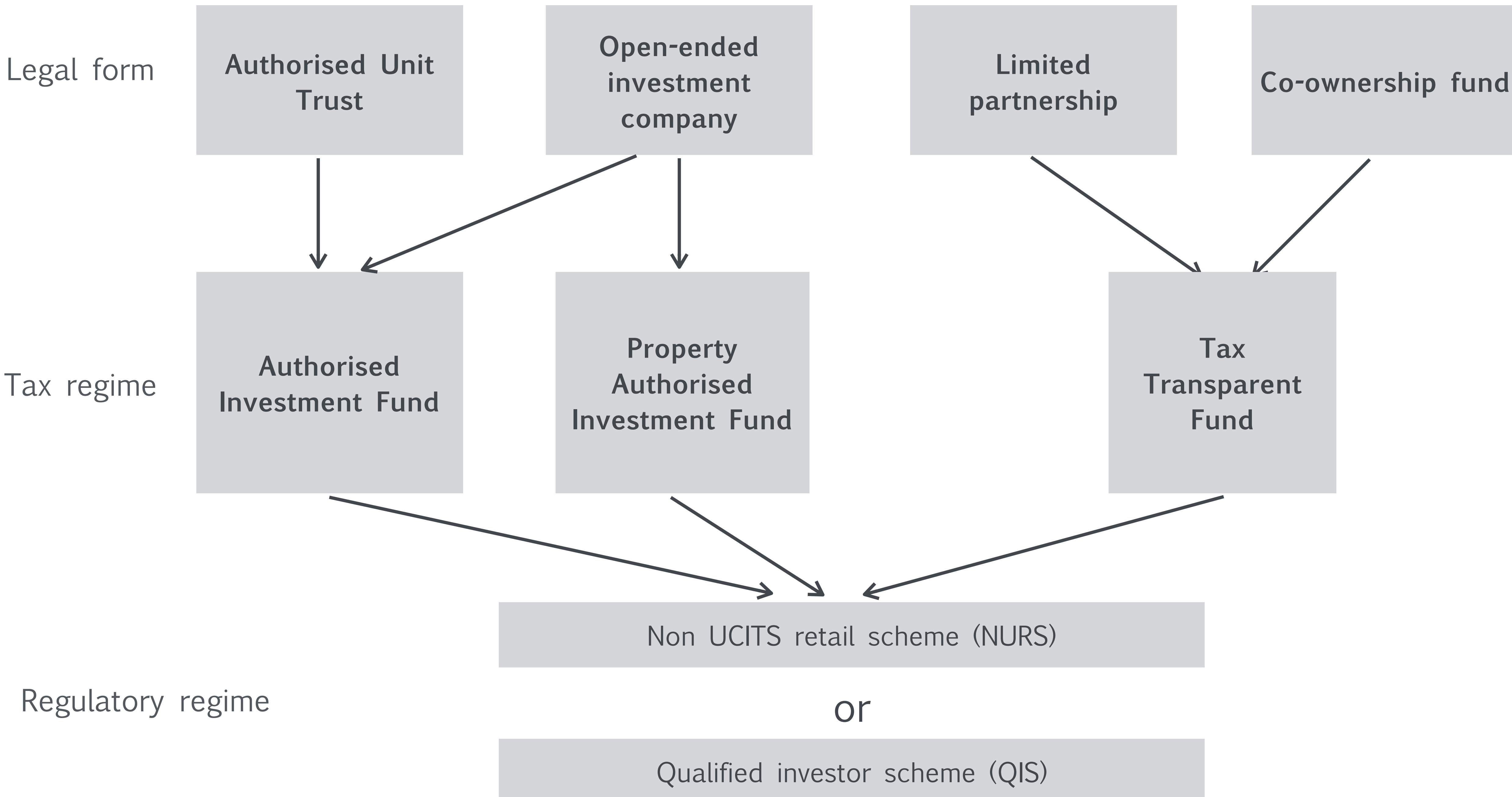
(i) a qualified investor scheme or its EEA equivalent;
(ii) any unregulated collective investment scheme that invests only in permitted links and publishes its prices regularly;
(iii) any of the interests set out in (b)(i) to (b)(iv);

(b) in respect of a firm's business with linked policyholders other than those described in (a), any of the following:

(i) an authorised fund;
(ii) a recognised scheme;
(iii) a scheme falling within the UCITS Directive;
(iv) a non-UCITS retail scheme;
(v) a qualified investor scheme or its EEA equivalent or any unregulated collective investment scheme that invests only in permitted links and publishes its prices regularly, provided that no more than 20% of the gross assets of the linked fund are so invested.

Trustees of DC pension schemes are regarded as "non-institutional" investors for the permitted links rules.

UK authorised investment funds (for real estate investment)



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Lobbying for changes to the permitted links rules

In late 2011 and early 2012 the FCA undertook a consultation in respect of changes to the permitted links rules for insurers. This was needed to comply with the EU Solvency II requirements and resulted in a relaxation of the rules for institutional investors.

AREF lobbied using the report "Unlisted Funds, lessons from the crisis" to argue for changes to the rules for non-institutional investors including retail investors and DC pensions schemes.

AREF

James Hopegood
CBU Policy
Financial Services Authority
25 The North Colonnade
Canary Wharf
LONDON
E14 5HS

15 February 2012

Dear James

Solvency II and linked long-term insurance business (CP 11/23)

We, The Association of Real Estate Funds,[1] welcome the opportunity to respond to the consultation paper and in particular to comment on your concerns over land and property as set out therein. We also appreciate your willingness to enter into a dialogue with us regarding the utility of QIS as an indirect property vehicle for linked funds.

The glossary definition of permitted land and property includes a provision for

The AREF report can be downloaded here:
http://www.johnforbesconsulting.co.uk/aref-report/

And the letter to the FCA here:
http://www.johnforbesconsulting.co.uk/download/i/mark_dl/u/4011659005/4607577533/AREF%20response%20to%20CP11-23.pdf

The lobbying efforts were not successful.

Major UK pension changes
Auto-enrolment and Collective Defined Contribution

Two major changes will significantly change investment by employer DC pensions.

Auto-enrolment

UK employers have to automatically enrol their staff into a workplace pension if they meet certain criteria:
- aged 22 to state pension age
- working in the UK
- earning over £10,000 a year.

Phased introduction, 2012 to 2018. Employers with more than 61 employees by 1st July 2014.

Phased introduction of contributions 2012 to 2018

Enrolment can be into an employer scheme or NEST (state scheme).

Potential six-fold increase in employer DC AUM by 2030.

Collective Defined Contribution

Queens speech announced introduction of Dutch style pension pooling to create occupational pension schemes somewhere between traditional DB schemes and current DC schemes. Rather than being run by each employer company with individuals holding an identifiable pot, schemes are pooled to create Collective Defined Contribution (CDC) scheme. Supporters argue this provides better returns due to economies of scale. Larger, collective funds would also potentially find it easier to deal with the EU IORP Directive (see later slide).

Importantly for real estate, removal of specific allocation of proportion of assets to each individual removes the pressure in current DC schemes to invest only in funds with daily pricing and daily liquidity. This would make investment in direct real estate and less liquid real estate funds a more viable proposition than is the case for DC schemes.

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Major UK pension changes
Consultation on changes to local authority pensions

This consultation was published on 1st May 2014 and runs until 11 July 2014. The objective is to reduce the cost of managing local authority pensions. It is based on a report by Hymans Robertson. Two key proposals:

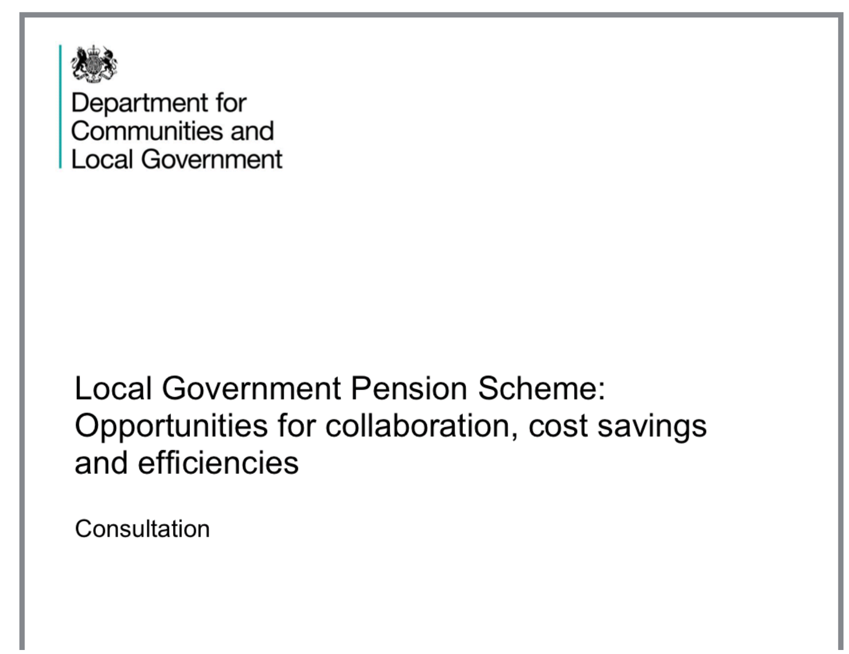
- Moving to passive fund management of all listed assets, accessed through a common investment vehicle.
- Ending the use of “fund of funds” arrangements in favour of a common investment vehicle for alternative assets.

The consultation proposes moving to two collective vehicles, one for listed assets and the other for alternative assets. The relevant consultation questions are:

Q1. Do you agree that common investment vehicles would allow funds to achieve economies of scale and deliver savings for listed and alternative investments? Please explain and evidence your view.
Q2. Do you agree with the proposal to keep decisions about asset allocation with the local fund authorities?
Q3. How many common investment vehicles should be established and which asset classes do you think should be separately represented in each of the listed asset and alternative asset common investment vehicles?
Q4. What type of common investment vehicle do you believe would offer the most beneficial structure? What governance arrangements should be established?

All the documents are available on the Department for Communities and Local Government website:

https://www.gov.uk/government/consultations/local-government-pension-scheme-opportunities-for-collaboration-cost-savings-and-efficiencies


Department for Communities and Local Government

Local Government Pension Scheme: Opportunities for collaboration, cost savings and efficiencies

Consultation

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Major UK pension changes
The end of the compulsory annuity

In the Queen's speech in June, it was announced that there will be legislation to effect the changes announced in the Budget in March allowing people to access their pension pot at age 55. Real estate would be a natural place to invest this.
Unfortunately regulation makes retail real estate funds unattractive (see slide on lobbying for changes to permitted links rules)

Longer term impact

The changes will have longer-term impacts for pension provision that will have an indirect impact on investment in real estate funds. These include:

i) The removal of the requirement to purchase an annuity will diminish the available investment capital of providers of annuities, including many traditional life insurance companies who are major investors in real estate as an asset class;

ii) The changes are likely to increase the attractiveness of defined contribution pension schemes. This makes it important for the real estate industry to develop more fund products that are suitable for the DC market..

iii) Conversely defined benefit schemes are likely to become less attractive. This may be compounded by the reaction of life insurance companies to the DC pension changes. Some commentators believe that life insurance companies losing their annuity business will move aggressively into the defined benefit pension scheme buy-out market..

These changes are likely to accelerate an existing trend away from DB pension arrangements and traditional life products to defined contribution provision, the consequences of which will be very significant for the real estate industry.

Full article: http://www.johnforbesconsulting.co.uk/budget-pension-changes/

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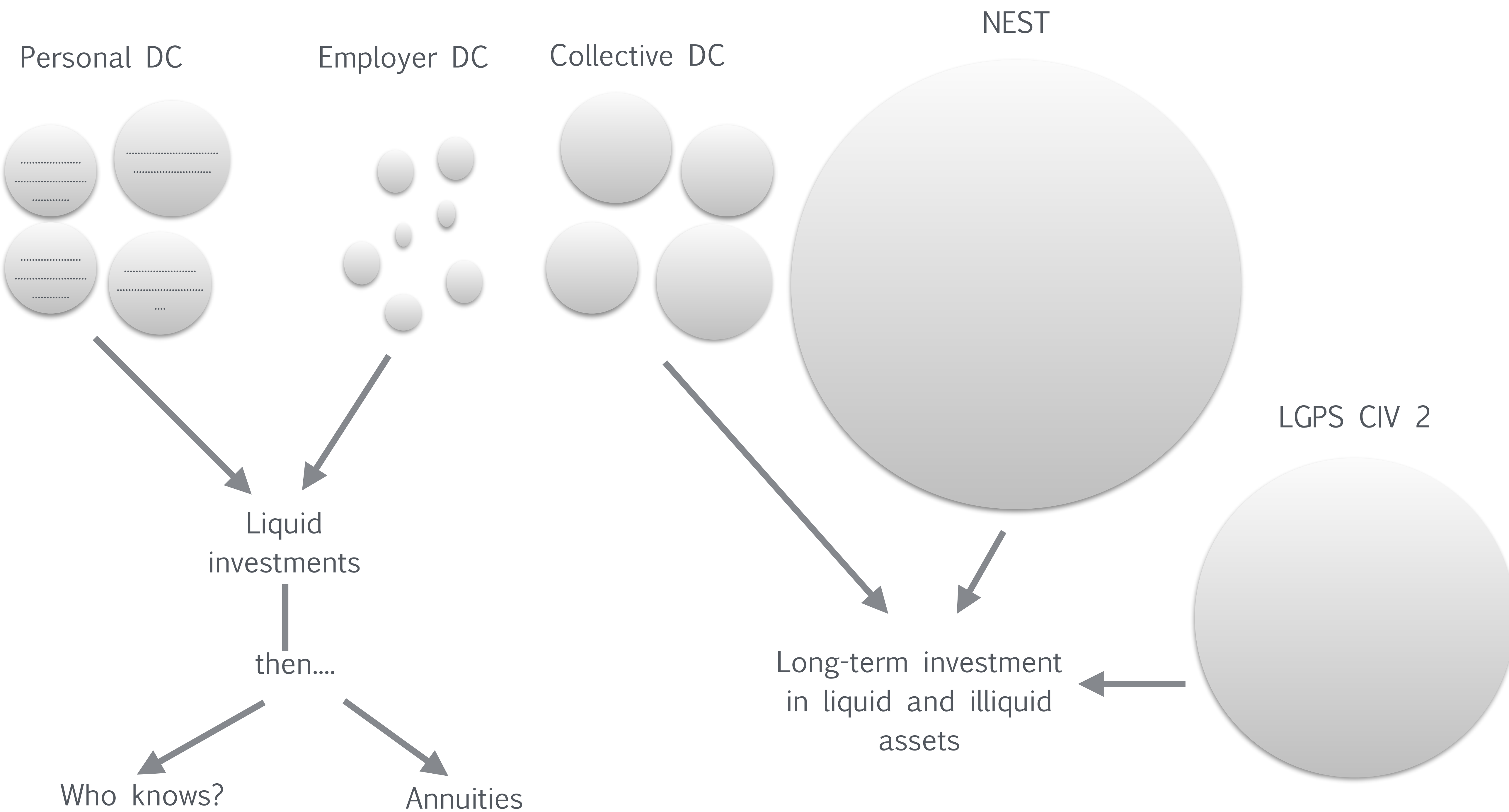
The shape of UK pensions post reform



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EU Insurance and pension investment in real estate

Asset allocations in EU pension and insurance companies, Euro trillion

Source: Colliers International

Allocation by EU regulated occupational pension and insurance companies to real estate as an asset class.

Colliers took data from EIOPA (EU pensions and insurance regulator) reporting (up to 2012), and supplemented this by analysing 14 of Europe's biggest pension and life insurers with investment asset totals of 54% of the EIOPA sample, based on data from balance sheets from 30th June 2013.

This gave allocations to direct property investment of:

- 2.86% to wholly owned assets;
- 0.6% to joint ventures

This equates to Euro 208 billion of gross assets.

The Colliers report, 'A New Era for Institutional Investment: From Risk Adverse to Risk Aware", to which John Forbes contributed, was published at MIPIM 2014 and can be downloaded here: http://www.johnforbesconsulting.co.uk/colliers-report/

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IORP

The EU Institutions for Occupational Retirement Provisions (IORP) Directive proposes Solvency II type provisions for pension schemes. Solvency II is the Directive that regulates insurance companies and comes into full effect on 1st January 2016. The main difference between IORP and Solvency II is that the Solvency Capital Requirements element in pillar i has been deferred for pension funds.

The three pillars of Solvency II

Pillar I: Quantitative aspects;

Pillar II: Governance and risk management;

Pillar III: Reporting and disclosure.

In a statement on 23 May 2013 Internal Market and Services Commissioner Michel Barnier indicated that the Solvency Capital Requirement elements are being deferred. Many people took this to mean indefinitely. According to a news item in IPE, http://www.ipe.com/eiopa-committee-chairman-confirms-2015-stress-tests-for-iorps/10002172.article stress testing could be picked up again in 2015.

Governance and transparency requirements remains also for pension funds under IORP and will have knock-on effects on investment managers

West Wycombe House

More details on Solvency II and IORP are here: http://www.johnforbesconsulting.co.uk/solvencyii/

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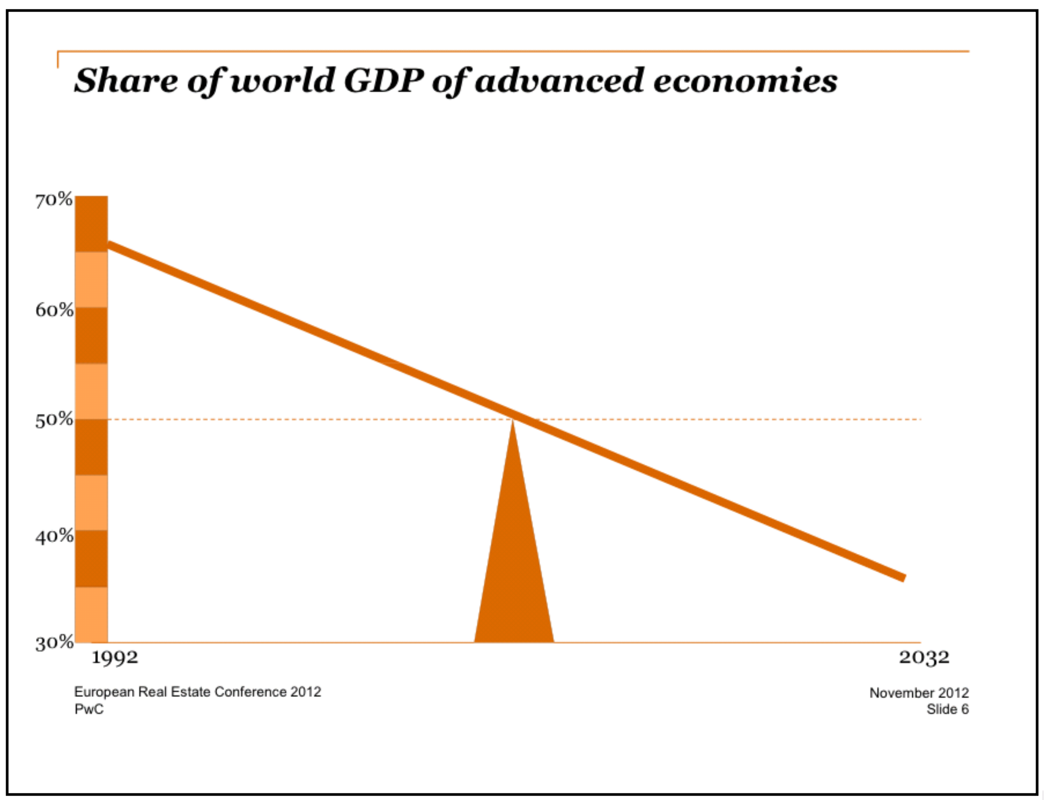
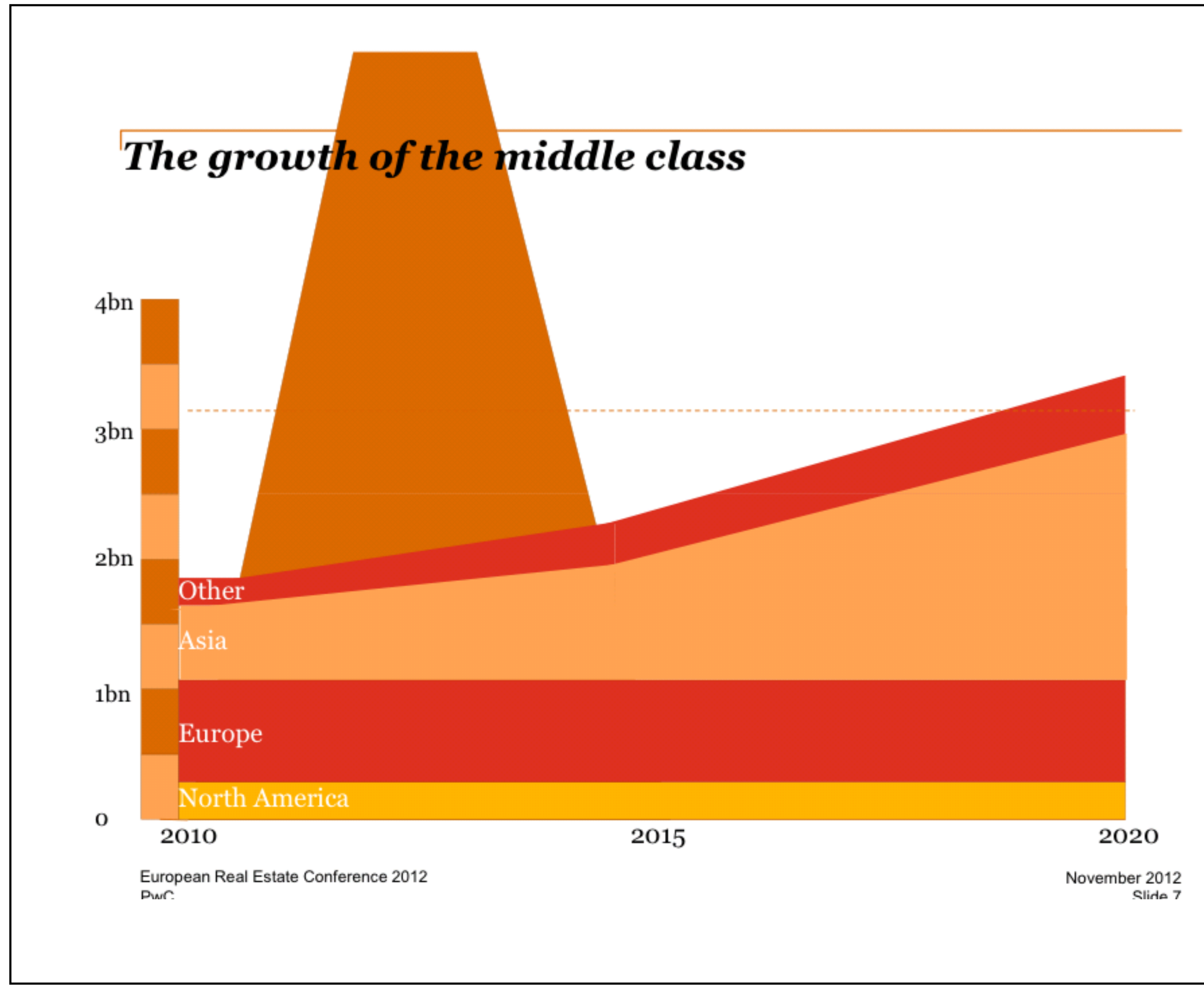
Tipping Point

Tipping point was the title of the keynote presentation by John Forbes at the PwC annual European conference in Frankfurt in November 2012, the theme of which was developed further in a series of conference presentations, webinars and articles.





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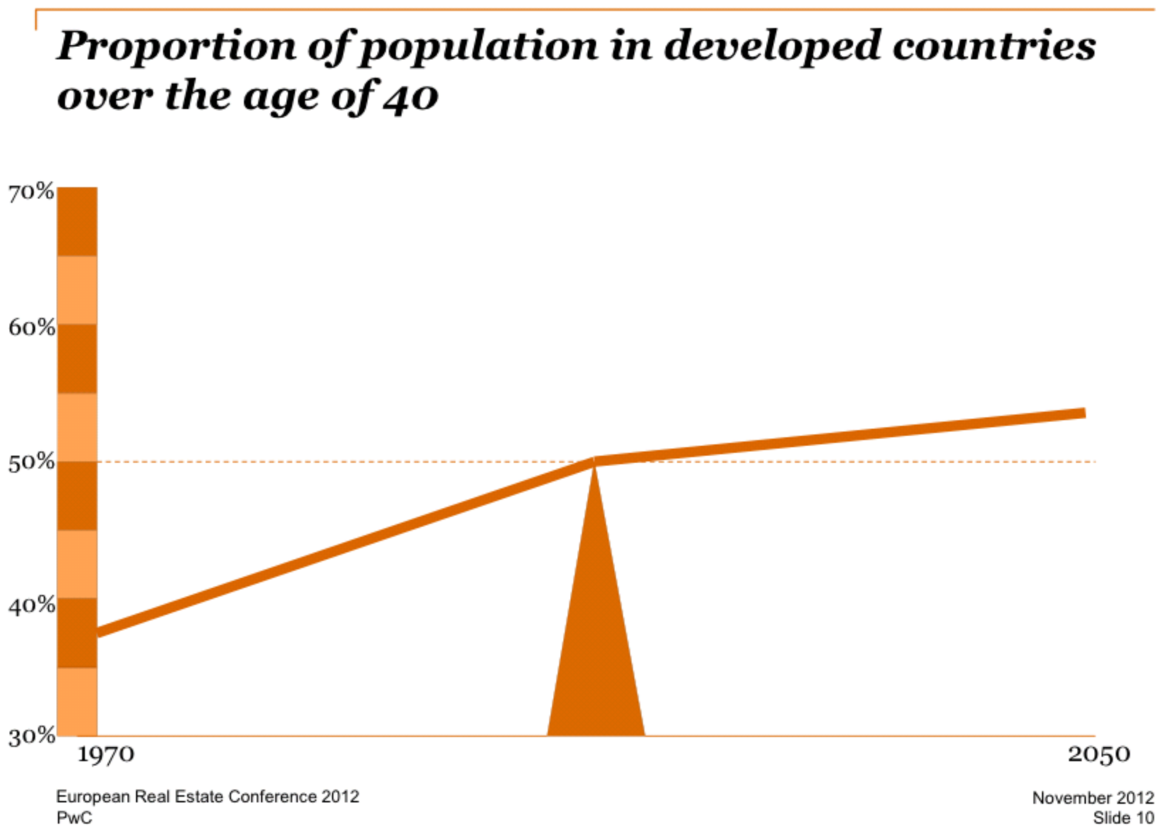
http://www.johnforbesconsulting.co.uk/tipping-point/

Ageing population in the developed world

Ageing population......

....has a major impact on pensions



US defined contribution pensions

As with other markets, there has been a move from defined benefit to defined contribution pension provision.....

Section 401K	Individual Retirement Account (IRA)
Employment related defined contribution pension scheme	Personal defined contribution pension scheme
On retirement s401 pension can be rolled into an IRA	

However, per research from Cerulli, published in the Financial Times, 9th June 2014, payments out of s401K schemes will exceed contributions in by 2016 as baby-boomers retire. For s401K and IRAs combined, payments out will exceed contributions in by 2020.

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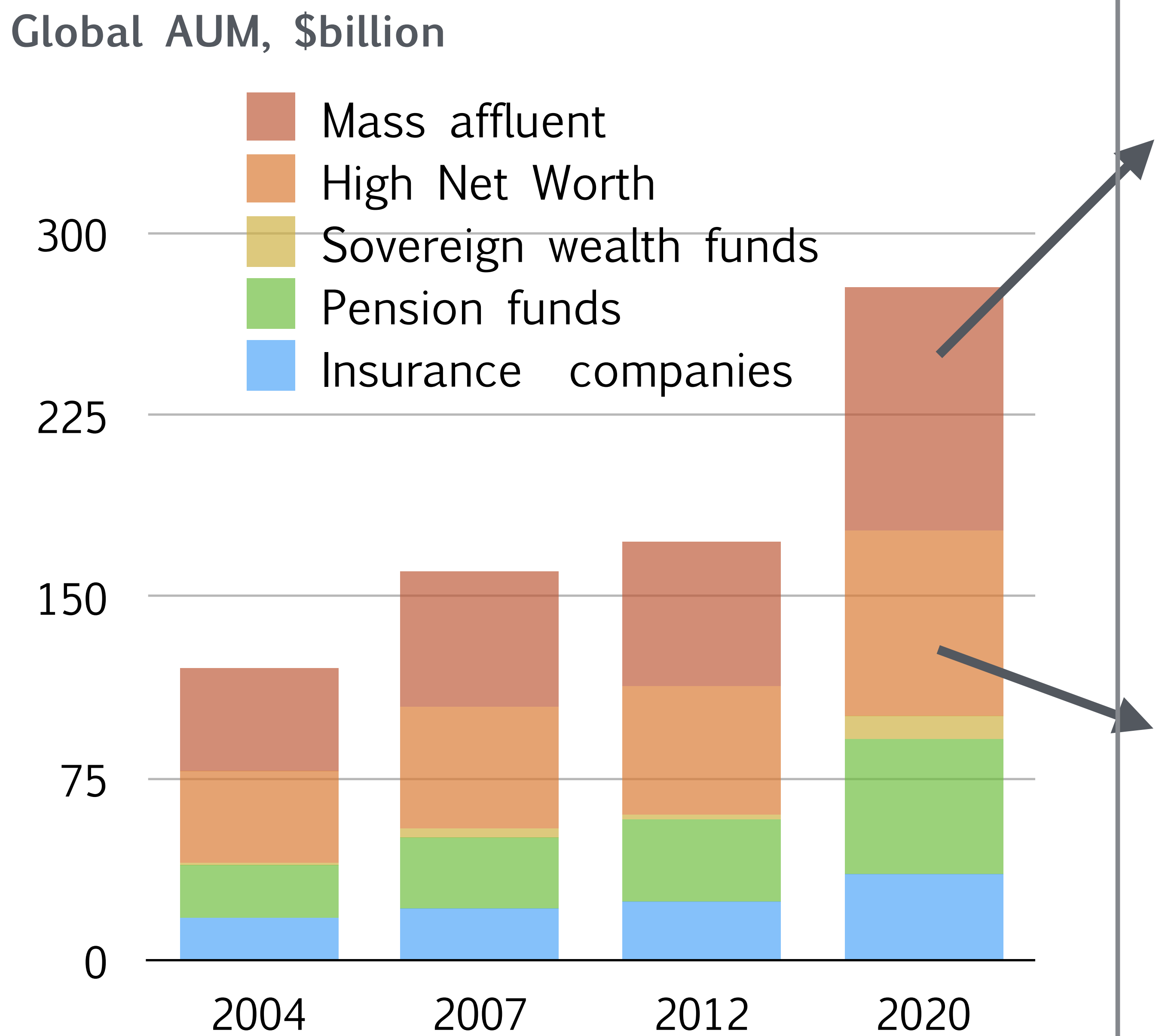
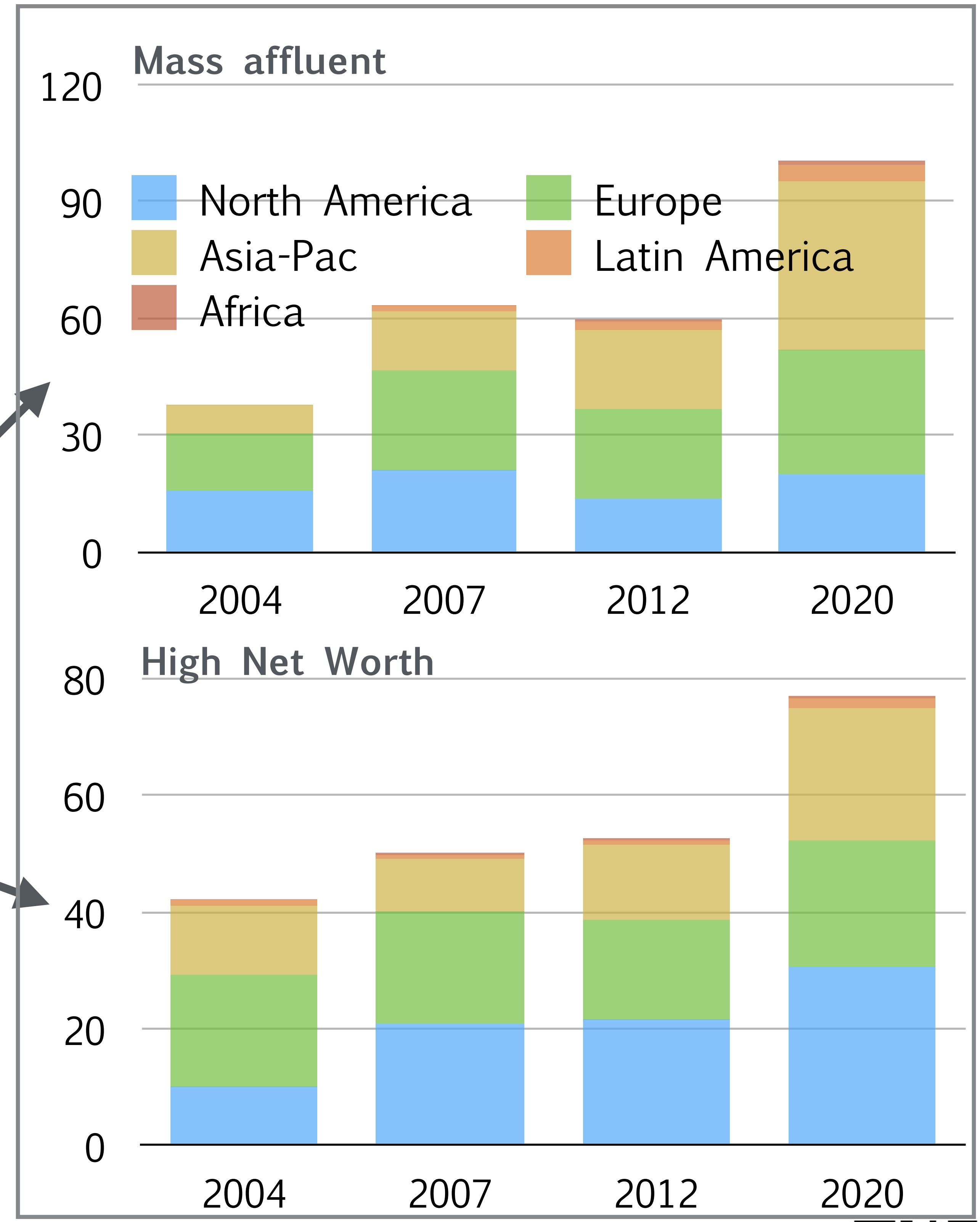
The globalisation of investment wealth

Per PwC, the largest rise in AUM for the broad investment management industry by 2020 will be the mass affluent in Asia-Pac.





Source: PwC

Note: there is some double-counting as HNWI and Mass Affluent money invests through pensions and insurance

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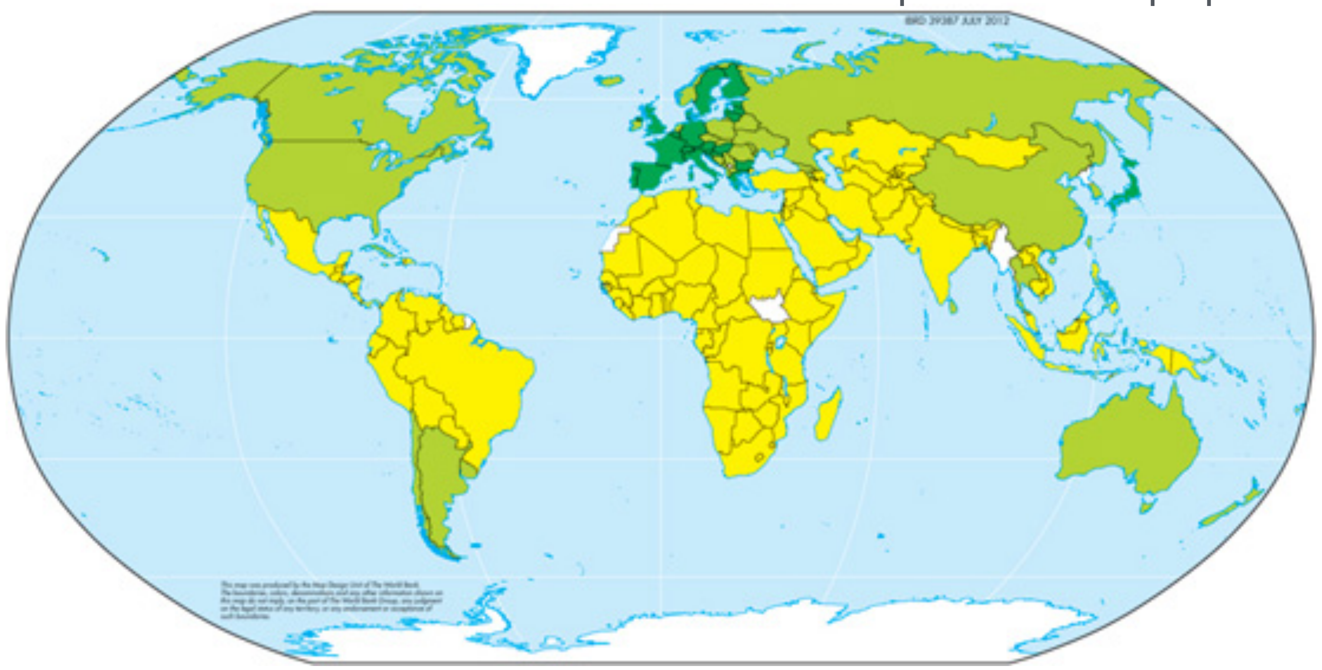
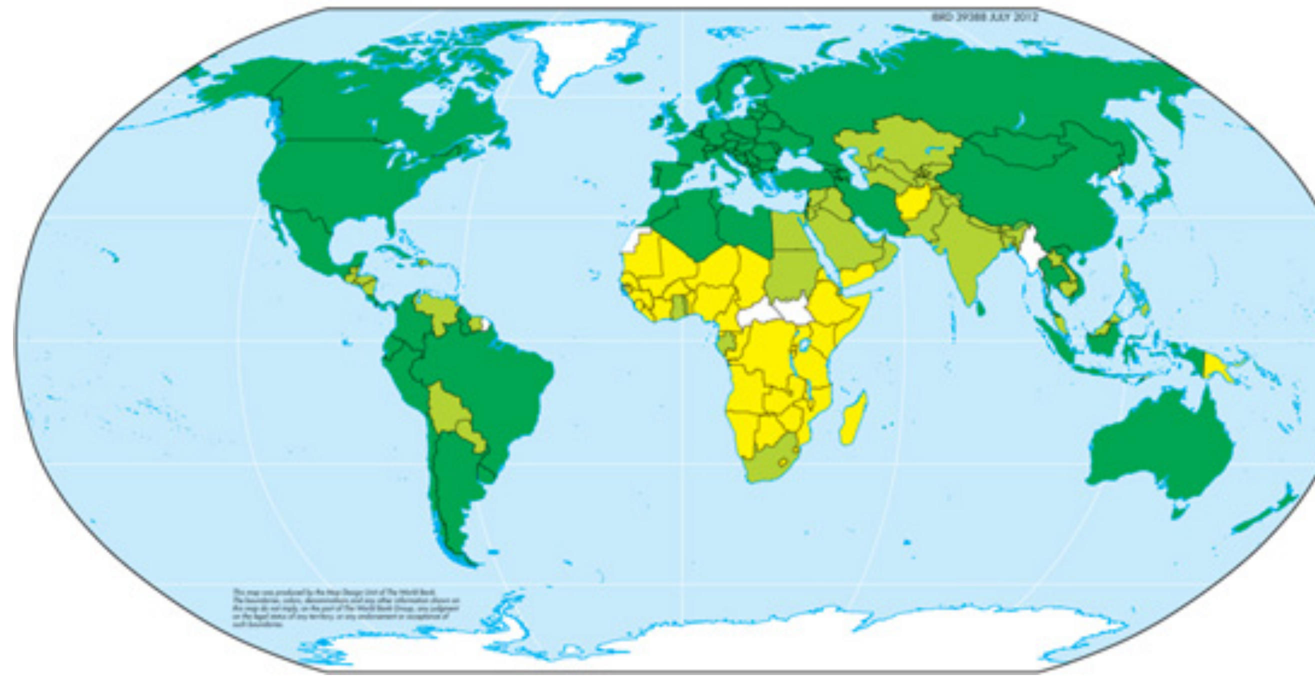
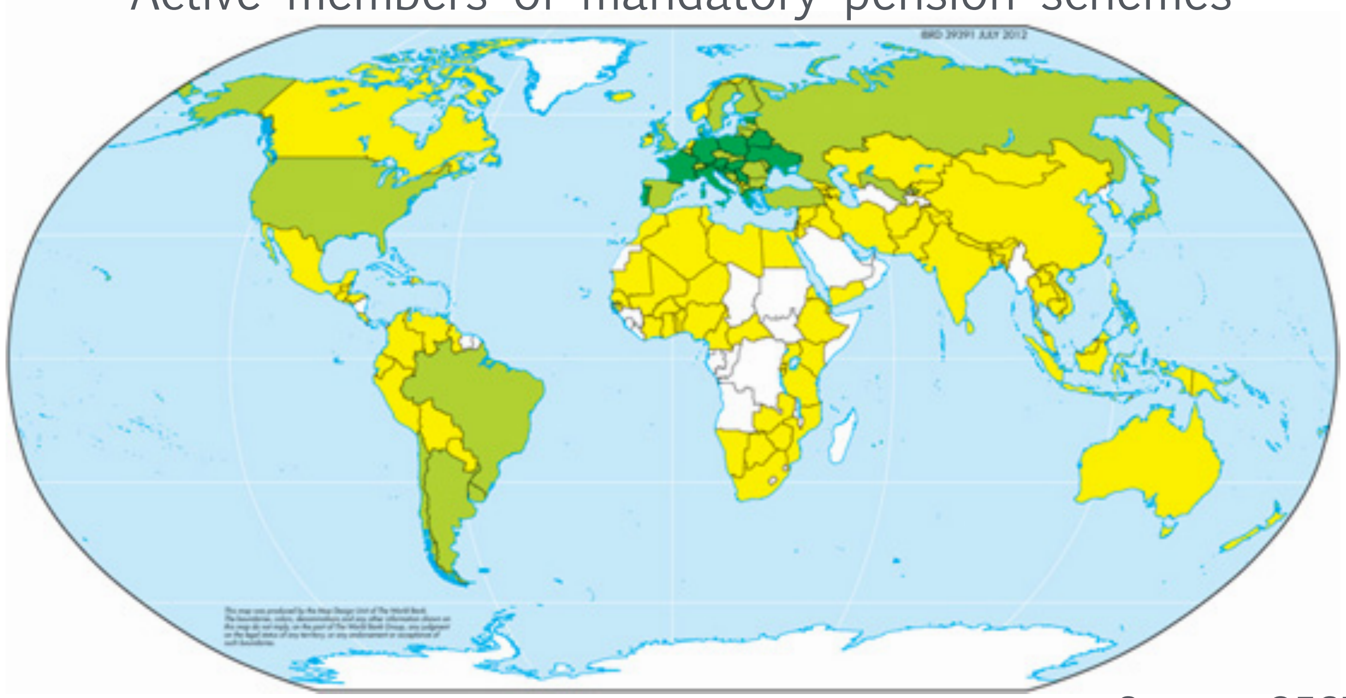
Global pension provision

2010 Proportion of population over 65 over 16%: 2050

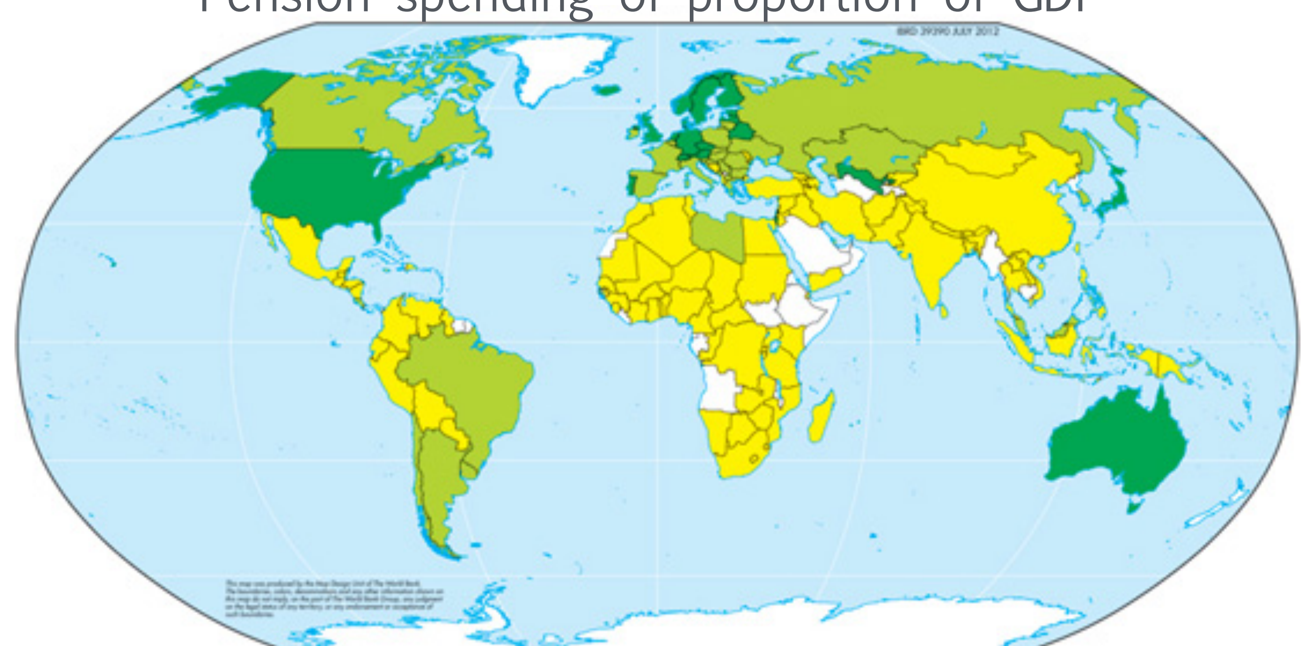




Active members of mandatory pension schemes



Pension spending of proportion of GDP



Source: OECD Pensions databank

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What does this mean?

The most rapid growth in wealth will be Asia-Pac mass affluent;

Mandatory pension provision in the region cannot cope long-term with ageing population:

The Asian mass affluent will look to other ways to provide for their retirement.

This creates a huge opportunity for the life and pensions industry that the real estate investment manager needs to follow.

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