PROFESSIONAL PENSIONS

Schemes must be aware of where value is being missed

Mark Proffitt highlights how pension schemes risk missing out on significant value during corporate action elections

AT A GLANCE

- Schemes missed out on as much as $600m in just one corporate action type
- Effective decision-making is vital in recouping this value
- Technology will play a vital role in bringing more efficiencies in this area

Pension funds in the UK are facing significant challenges, with aggregate pension deficits at their highest level in the last five years. Contributing factors include low interest rates, falling bond yields and high levels of liability for legacy defined benefit schemes.

The Pensions Regulator and the Pensions & Lifetime Savings Association (PLSA) provide guidance for trustees, with increasing focus on fiduciary responsibility, transparency on costs and improving returns and value for scheme members.

On 18 November the FCA published its interim report on asset management cost disclosure and improving transparency. Its chief executive Andrew Bailey stated: "We want asset managers to ensure investors receive value for money through pursuing energetically their duty to act in their customers' best interests". These are positive initiatives that should ultimately benefit pension scheme beneficiaries, but there may be other ways to improve returns.

Speaking at the PLSA Investment conference in 2015, Tesco's group pensions director Ruston Smith highlighted increasing pension liabilities, the need to "invest smarter" and "create every ounce of value" to improve outcomes for scheme beneficiaries. Pensions should focus on improving returns across the investment value chain and a "policy of marginal gains" to squeeze out additional value.

Where can these gains be made and what is the potential impact for pensions?

Missing out on value

Our research suggests there is significant intrinsic value in pension fund assets that is being missed in corporate action elections on dividends and other events requiring an election to be made like rights issues and tenders.

These corporate actions require a decision to be made and pension funds rely on their investment manager to make the elections as part of the investment management mandate.

According to our data, the total value missed in just one corporate action type, UK scrip dividends, last year amounted to $600m (498m), which presents a significant value opportunity for UK pension schemes.

Scrip dividends are offered by a number of companies in the FTSE, including BP and HSBC. Investors are offered a choice to receive the dividend in cash or additional shares, with one choice normally worth more than the other. There are other types of corporate actions including rights issues and tender offers, which also provide significant opportunities to improve investment performance.

Optimising the value embedded within corporate actions through effective decision-making has often been overlooked as the industry tries to improve processing, but the incremental value can be significant with a very positive impact across the investment value chain.

In-house investment teams and external managers have to process and elect on an increasing volume of corporate actions – there are over a million corporate actions per year across world markets, generating an estimated three million announcements with approximately one-third of these having voluntary aspects and therefore requiring an election decision.

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Investment operation departments have to process these and seek a decision from the fund manager within the custodian's deadline to report to the depository. The timelines, processing demands and the ability to optimise the dividend elections therefore present many challenges that are difficult to overcome without the relevant data and sophisticated technology.

As a result the common route is to apply a default election. In the case of scrip dividends this means accepting the cash dividend and foregoing any value available by electing for the alternative stock election.

With the technology now available there is no reason why this value should be missed. Like many inefficiencies across the financial sector, old problems are being fixed with new technologies.

In this particular area we developed technology for asset owners, asset managers and their service providers to use as a 'safety net'.

This ensures the optimal election decision is always passed through to the custodian or depository and any available value passed back to the fund. This is not interfering with the investment management mandate but it provides an effective safety net and confidence for the pension fund that they are not missing value that is available to them.

Finding value and identifying opportunities by improving efficiency across the investment value chain is becoming more of a focus for trustees and investment teams. Avoiding sub-optimal elections on corporate actions will not solve deficits at a stroke but it is part of the solution to add basis points to performance and reduce costs.

Technology innovation can reduce complexity and risk by reducing manual processes and freeing up capacity in an industry stretched by regulation and looking for ways to add value to investors and beneficiaries.

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