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Paper: Why is managing a successful pension scheme a bit like managing a successful football team?

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What are the similarities between a defined benefit pension plan and a football team? On the face of it, you could be forgiven for thinking not very much. After all, the football world is populated by overpaid, badly behaved, play acting prima donnas. A far cry from the sober and serious world of defined benefit pensions, where trustees devote huge amounts of their time in the interests of others, for little or no financial reward.

However, although off the pitch the two worlds would seem to be very different, on it, I believe, there are some interesting analogies that can be drawn.

Let's start with the defence

When a football team has been struggling and relegation looks likely, a new manager is often appointed in the hope that they will be able to 'turn the club around'. Invariably that process will begin with a focus on the defence, because it is difficult to win football matches if the team is leaking goals. New defenders may be brought in, perhaps a new defensive coach might be appointed and new tactics might be employed to give the team a solid basis from which it can build.

Today it is widely recognised that pension schemes face two types of risk: those that are rewarded and those that are unrewarded. Leaving a scheme exposed to the unrewarded risks represented by interest rates, inflation and longevity is arguably analogous to entering the field of play with a shaky keeper and a shoddy back four. Over the last ten years or so, many schemes have sought to eliminate these unrewarded risks by hedging them as far as they can. In doing so they are effectively endeavouring to give their scheme a solid foundation on which a successful investment strategy can be built.

Creative midfield

In football, once the defence has been stabilised the focus turns to scoring the goals that will ultimately bring the team success. This will require a well organised midfield and forwards capable of sticking the ball in the back of the net. For a pension scheme its midfield is arguably its strategic asset allocation, since a successful midfield quartet will support both the defence and attack, set the team's tempo and, hopefully, drive it to victory. A scheme's strategic asset allocation should play an equivalent role.

In the 1990s strategic asset allocation was fairly unsophisticated. Broadly speaking schemes allocated the proportion of their assets necessary to cover current pensioner liabilities to gilts; while the remainder was allocated to the asset class that seemed to have the highest expected return – equities. To some extent, you could say that schemes were playing the 'long ball game' – a tactic that basically involves propelling the ball as soon as possible to a big centre forward.

But tactics are now far more sophisticated. Indeed, accusing a team of adopting long-ball tactics is now seen as an insult. Similarly, strategic asset allocation is now



more sophisticated. Schemes have diversified their asset base in the hope of achieving 'equity-like returns' with 'bond-like volatility'. Some risk asset classes may lend support to the scheme's defence, such as RPI-linked long leases, while others will be more focused on achieving higher returns, like hedge funds and private equity. But blending these asset classes together to produce a successful strategic asset allocation result requires careful consideration of this asset mix and in particular the correlations between these asset classes and the scheme's liabilities.

Star striker

Feeding off a solid defence and the creativity of its midfield, most successful football teams also have a goal scorer with a proven track record that can finish off the creative work of the midfielders. Arguably, the active fund manager is the scheme's striker. The addition of 'alpha' to the returns generated by the asset classes may be the vital ingredient needed to get the ball over the line, which in pension terms means meeting all the benefits as they fall due.

Management tactics

Finally, success in football will always be down to more than just the players on the pitch. In particular, the manager and their support staff will normally play a big part. Good football managers are flexible in their tactics, and can make shrewd substitutions that turn events in their favour during the game. They may also need to take risks, bringing on a young, unproven player in place of a formerly reliable stalwart that no longer seems to be producing the goods. And they will need to keep an eye out for new talent at home or in overseas markets, as the season progresses.

The analogy should be clear: trustees' approach to the management of their scheme must evolve with financial market conditions, after all you don't play the same way against Barcelona as you do against Stoke. For example, asset classes that may not be part of the current mix, could become available at an affordable price that will produce the necessary returns, while new asset classes may also become available. Trustees need sufficient investment expertise and the governance structure necessary to introduce new asset classes. This is because investment opportunities are often very fleeting; delaying the decision to invest often means accessing the opportunity at a less attractive price or missing the opportunity entirely. It is the equivalent of bringing on a substitute late in the game when they can have no real impact on the outcome. Like a good Premiership manager, pension scheme trustees and their advisors should always be on the lookout for ways of strengthening their squad.

Avoiding relegation

Back in the mid-2000s, pension schemes that effectively, though presumably unintentionally, adopted the approach of a successful football team - hedging interest rate and inflation risk, combined with intelligent strategic asset allocation and who were likely to be competing for a place in the Pensions Champions' League.



Meanwhile those trustee boards that left their goal wide open to the devastating impact of falling interest rates, in favour of the equity market long ball game, are now almost certainly rooted in the pensions relegation zone, contemplating cutting benefits and hooked upon higher contributions from their scheme sponsor and from their members.

Arguably the biggest dilemma for those pension schemes struggling against relegation is what to do about their defence. Many may wish to shore up their defence but not at any price. So, schemes have put off implementing a liability hedging strategy in the hope that the very low interest rate environment will eventually 'normalise'. A normalisation of interest rates would benefit many pension schemes that have either only partially hedged their liabilities or have not hedged them at all. And this is where the analogy with a football team breaks down a little, although it can be said that leaving liabilities unprotected is like having a suspect defender who has the potential to score goals as well as defend. Being imperfectly hedged against interest rates in a rising interest rate environment could rectify the perilous position of many a scheme.

In contemplating the state of their defence, many trustees and their advisors are currently faced with the following dilemma: risk blowing their transfer budget on an expensive central defender today, or leave their shaky defence as it is and hope that it improves of its own accord.

Key Points:

- **Pension schemes face unrewarded risks from interest rates, inflation and longevity;**
- **Trustees must control an ongoing balancing act between managing risk whilst generating enough growth to meet scheme liabilities;**
- **Evolution in the sophistication of asset allocation means the asset mix is considered alongside how external economic influences may affect future liabilities.**