

Investment Today

A SPECIAL REPORT

Investing ethically for the future

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REMEMBER THE days before the dot.com boom, when start-ups such as Google and eBay were consigned to specialist niche technology funds, largely unknown to the majority of investors? Now they're household names.

So could today's fledgling green and sustainable technology companies be the household names of tomorrow?

"That's the question fund managers and savvy investors are facing," says Ken Owens of PricewaterhouseCoopers. "In 10 years' time, are some of those new green companies going to be global players? The answer is yes."

It's that possibility that's driving a surge of interest in socially responsible investment (SRI) funds, funds that focus on sustainability in the broadest sense – and to that extent sometimes even overlap with Shariah-compliant Islamic funds, another growth sector.

"We're seeing a lot of new funds being set up to focus, for example, on clean technology, energy, water, and anything to do with climate change and carbon trading," says Owens, a partner with PwC Asset Management.

The scale of that interest is illustrated by the fact that SRI funds now represent around 18 per cent of the European asset management industry, rising in value from \$10 billion to \$26 billion over the past two years, according to Milan-based financial research experts, Mercati Finanziari.

Globally, that figure rose from \$23 billion to \$68 billion between 2003 and 2008, with institutional investors making up 94 per cent of the clientele – with the notable exception of Switzerland, where the high proportion of wealthy individual investors brought the split in at around 50/50.

It remains difficult to assess the performance of ethical funds compared with their traditional counterparts because SRIs haven't been around very long and the development of new products has been particularly swift.

However, a recent report by Cer-



Ken Owens, partner with PwC Asset Management

ulli Associates did show that even during the volatility of 2008, SRI fixed-income funds held their own against the broader competition.

"These are the companies of the future," confirms Owens. "There's a lot of interest and a lot of money coming into the sector."

"If I want to guarantee my retirement fund in 20 years' time, I need to invest in companies that will be around. The sectors that will grow fastest are those producing technology the world is going to need."

SRI funds typically avoid investments in businesses such as alcohol, tobacco, gambling, adult entertainment or weapons, for instance – something they have in common with Shariah-compliant Islamic funds.

The single most important fact behind the growth of these funds is their potential: around one-quarter of the world's population is Muslim, but only about 1 per cent of global financial assets is held in Shariah-compliant investments.

However, that is changing rapidly. The market for Shariah-compliant investment products is growing at 15 to 20 per cent a year, and equity fund assets alone are expected to jump from \$15 billion in 2008 to \$53 billion in 2010.

So quickly has the market been expanding that PwC already employs more than 20 professionals at its Dublin office specialising in Islamic finance, says Omer Khan, a consultant with its Islamic Finance Practice, which recently published *Shariah-compliant Funds: A Whole New World of Investment*.

"This is a very specific investment market we know and understand very well," says Khan. "We can advise fund managers on how to set up Shariah investment products here at the IFSC. We expect the experience with these types of products to be very exciting."

Owens agrees. "There's huge growth potential here. And, from an investment analysis perspective, these funds tend to be attractive because the companies are less leveraged, the Shariah boards that oversee investments look carefully at their gearing and debt before they're included, and they tend to have stronger balance sheets than a lot of the companies in more conventional funds."

That potential growth, Owens argues, means Shariah-compliant funds offer Ireland a significant opportunity to act as a centre of excellence for fund administrators – in much the same way as, he believes, the IFSC should aim to attract SRI funds.

"The reality is that every such fund established at the IFSC is estimated to create one-and-a-half jobs – so this is a sector capable of providing Ireland Inc with significant employment opportunities in the immediate future and beyond."



Left to right: Alan Bigley, Denise Twomey and Munro O'Dwyer of the PwC Pension Solutions Group at the launch of the PwC Pension Survey

Fundamental rethink of pensions

As companies and employees assess the long-term survival of their pension schemes, Barry McCall looks at the obstacles they face

NOW FOR the good news. The value of Irish pension scheme assets at the end of 2008 fell by 23 per cent to €66.7 billion, from €86.6 billion the previous year, according to the Irish Association of Pension Funds' (IAPF) annual asset allocation survey. This may not sound like news but this near catastrophic drop is less than was expected by the pensions industry.

If you thought things couldn't get much worse you'd be wrong. In its most recent annual report published in June, the Pensions Board estimated 90 per cent of occupational-defined benefit schemes were failing the statutory funding standard – that is the funding level required to meet all of a scheme's obligations were it to be wound up on the day (the equivalent of the

standard used to measure a company's solvency).

This situation has arisen as a result not only of the near meltdown in the investment markets but also because of the nature of the schemes.

A defined-benefit pension does what it says on the tin – it offers members specified benefits from the outset. The standard in Ireland is usually two-thirds of a member's final salary based on them earning an entitlement of one-sixtieth of salary for each year's service subject to a maximum of 40 years.

The cost of offering such benefits has risen dramatically over the past 20 years. Back in the high-interest, high-inflation 1970s and 1980s, such schemes could be funded by contributions of around 10 per cent of annual salary. This has now effectively more than doubled and is continuing to rise due to falling returns from the markets and increased longevity.

The fact we are living longer means it is costing more to fund our pensions – and advances in medical science keep the target moving.

Many employers are now seeking to make changes to their occupational pension schemes to control costs. The 2009 PricewaterhouseCoopers Pension Survey found almost 70 per cent of the

250 companies that responded were reviewing their investment strategy and it is likely that more risk-aware strategies, reflecting perception among members of investment risk, will emerge in the future.

Some 150 employers who sponsor defined-benefit schemes responded and 5 per cent of these said they were going to wind-up their defined-benefit pension scheme, with a further 15 per cent of employers indicating this option was being considered.

Changes to legislation have been introduced which will effectively allow for retrospective reduction in benefits to both deferred and active members of schemes. Over 40 per cent of respondents said this option will be considered. The number is startlingly high, according to PricewaterhouseCoopers (PwC), given that a reduction in benefits is a serious loss for scheme members and the Pensions Board will only consent to an application to reduce benefits where it is satisfied the long-term sustainability and stability of the amended scheme can be reasonably assured.

The survey also found that members in defined-benefit pension schemes are likely to have to make higher contributions in future, while one-third of employers will or may stop their employees

earning benefits within the defined-benefit scheme – and two-thirds have already closed their scheme to new entrants.

"What we are seeing this year is a fundamental rethink of their pension schemes by many companies," says Munro Dwyer, director of PwC's pensions solutions group. "Things are so different now that a lot of companies are looking at trying to resolve the issue for once and for all through a variety of different steps."

He sees defined-contributions schemes surviving in the long-term, however: "From an economic point of view defined-benefit schemes are better than defined-contribution schemes." This is the case, he says, because individuals are not best-placed to save for their retirement over a 40-year period whereas companies are, and they can even out the ups and downs in the markets over that time.

"The problem now is that companies are not in a position to do that with many schemes," he says. "Defined benefit is fine as long as the promises are affordable and the contributions are acceptable. Companies are now looking at ways of making benefits more affordable."

In this context he says, the old 'two-thirds of final salary' model may no longer be affordable, both

from a financial and philosophical point of view.

"You have to ask if a guy on €150,000 a year needs a full two-thirds pension," he says. "It would more fit in with the philosophy of defined-benefit schemes to allow people retire on a certain basic income level and have the option to add to that themselves and be supported in that by the company."

This model might see a ceiling put on the level of income covered by a defined-benefit pension or may see the traditional two-thirds target reduced to one half, or any of a number of other possibilities.

Declan Keena is a senior actuary with pension specialist Invesco and he is also seeing fundamental changes at present.

"Nothing is off the agenda at the moment," he says. "Both companies and employees are looking at the cost of schemes and the cost of future benefits. We might see cash-balance plans, career average pen-

sions and hybrids coming in as a result."

The first two of these variants offer a different way of calculating the defined benefit while the third is a cross between the two types of scheme, where part of the salary is subject to a defined-benefit pension and the remainder is subject to the defined-contribution type, where the risk lies largely with the employee rather than the employer.

Says Keena: "Defined-benefit pension schemes are good things to have and it is a question of cutting the cloth according to the measure and making sure the schemes are affordable for the company."

"I'm seeing it everywhere. Everything is on the table."

Dwyer agrees. "It is a question of understanding what the problem is and of seeing what changes can be made to the scheme to make it sustainable and allow the company go on with its everyday business."

"There is an identity of interest between employers and employees here. Simply trying to hold onto current levels of benefits can be slightly myopic but in most cases employees are trying to do the right thing in terms of making the changes to put more sustainable and dependable pension arrangements in place."

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