A win-win

The Aviva Staff Pension Scheme recently embarked on a new journey aimed at meeting both the investment needs of its members and helping achieve the trustee's ambitious ESG goals. Pensions investment director, Steven Catchpole, tells Francesca Fabrizi about the steps it took to get to where it is today

Please give an introduction to the Aviva Staff Pension Scheme.
The £15 billion Aviva Staff Pension Scheme is one of the largest in the country and provides pensions savings for the majority of UK employees of Aviva plc. The scheme's DC section has assets of around £2 billion invested on behalf of over 45,000 members.

The trustee of the scheme recently implemented a new default lifestyle investment strategy. Can you tell us why you did this and what the new strategy entails?
The trustee has recently approved its latest responsible investment policy and set the goal of achieving net-zero carbon emissions by 2040.

To help achieve this goal, the trustee wanted to develop a new default lifestyle investment strategy which integrates ESG and climate risk management throughout, including a significant allocation to real assets focussed on the climate transition.

The new default investment strategy was also designed to deliver a 'comfortable' level of retirement income, based on the PLSA's Retirement Living Standards, for members that take full advantage of the matched contributions from Aviva throughout their career.

The key features of the new investment strategy are:
• The strategy fully integrates ESG and climate risk management throughout by investing in ESG-optimised passive equity funds and climate transition active funds across multiple asset classes, including real assets.
• The 10 per cent commitment to Aviva Investors' Climate Transition Real Assets Fund will provide an exposure to real estate, infrastructure and forestry assets that have previously been hard to access for DC schemes and are expected to enhance the risk-adjusted returns for the portfolio.
• The overall scheme design and asset allocation life-styling has been constructed with reference to the PLSA's Retirement Living Standards.
• Aviva Investors was selected as a single fund manager for the strategy, which provides the trustee with several advantages, including:
  • Clear accountability for delivery of the strategy's investment and ESG objectives
  • Speed of decision making and implementation
  • A consistent approach to ESG, climate risk and stewardship across the whole strategy, including combined reporting.

What are the aims of the strategy and how does it hope to achieve those aims?
The starting point for the trustee was to determine the return objectives required to achieve a 'comfortable' level of retirement income using the PLSA's Retirement Living Standards, based on a member taking advantage of the matched contributions from Aviva during a full career with the company. Working with their investment adviser, the trustee developed a lifestyle investment strategy that switches between three multi-asset funds targeting different levels of risk and return to be used at different points in the member's working lifetime.

Based on analysis of the scheme's membership and the choices they are making at retirement, the default strategy has been designed on the basis that members will move to a drawdown investment strategy at retirement. As a result, it was agreed that the strategy should deliver a portfolio targeting CPI+2 per cent at retirement i.e. recognising that a typical member will still be a long-term investor at the point of retirement so retaining some market exposure can help to deliver better outcomes in retirement.

The output from this exercise was a set of return targets and risk tolerances for three multi-asset funds that Aviva Investors could use to construct portfolios to deliver these objectives based on their long-term asset return and risk assumptions.

The trustee's other primary objective when developing the strategy was to fully integrate ESG and climate risk management. The trustee was keen to implement a strategy that could meet its goal of net-zero emissions by 2040, an ambitious target that is 10 years earlier than the UK government's target.

The trustee also wanted to ensure that ESG risks were being considered as part of all investment decision-making and that its stewardship and engagement policies were being implemented. Furthermore, the trustee wanted to include an allocation to illiquid real assets that have been a core part of the defined benefit section's investment strategy for many years, delivering excellent risk-adjusted return for the benefit of members.

The outcome from all this work was three new multi-asset portfolios: Growth, Diversified and Consolidated, which target returns of 4 per cent, 2.5 per cent and 1 per cent above inflation respectively over the long term. The ESG objectives are achieved by investing in funds that have ESG and climate objectives at their core including ESG enhanced passive indices and active strategies focused on the climate transition in equities, credit and real assets.

Why did you opt for a single manager approach as opposed to multiple managers?
Before appointing Aviva Investors as a single manager for the strategy, the trustee considered the alternative approach of appointing multiple managers to run the various components of the trustee's desired asset allocation.

The trustee concluded that single-manager approach:

- Improved governance by making a single entity accountable for the delivery of the performance objectives, with the trustee focused on getting the objectives right.
- Enabled quicker and easier implementation of strategic and tactical asset allocation decisions.
- Reduced costs for members.
- Ensured a consistent approach to ESG decision-making, engagement and stewardship across the portfolio.
- Simplified reporting, including consistent reporting of climate metrics to help the trustee meet its obligations under TCFD.

What, if any, were your challenges and how were these overcome?
This was a significant project involving multiple stakeholders in an unusual situation where the sponsoring employer of the pension scheme is a large financial services firm that provides workplace pensions and asset management services for its clients. This created a good alignment of interests and everyone worked together towards creating an investment strategy that we could all feel proud of.

One of the main challenges was creating the legal structure and operational framework to enable the trustee to make a commitment to the Climate Transition Real Assets fund and manage the operational risk of meeting capital drawdown notifications from the fund and rebalancing the asset allocations as capital is drawn down. With all parties working together and the support of the trustee's legal advisers, we were able to develop a structure and framework that dealt with these issues to everyone's satisfaction.

What have been the results to date?
The strategy has been in place for less than nine months and, in that time, we've seen some material moves in investment markets. In fact, 2022 has seen one of the worst starts to a year across most asset classes globally in decades. Everyone will appreciate that's not a great period over which to judge overall investment performance. However, we have been pleased that the Diversified and Consolidated portfolio has offered some protection to the downside risk in markets as a result of their allocation to absolute return strategies.

As ever, it's important for us all to remember that pensions are long term investments and we remain excited about the difference the new default lifestyle strategy will be able to make by delivering its return objectives and meeting the trustee's ESG and climate objectives.

Written by Francesca Fabrizi