# THE BENEFITS OF TRAVELLING TOGETHER IN PENSIONS

## BRIGHTWELL

HOW WE RUN OUR MONEY

**Wyn Francis**, CIO of Brightwell, formerly known as BT Pension Scheme Management, manager of the UK's British Telecom Pension Scheme, talks to **Carlo Svaluto Moreolo** about the new phase of development for the organisation

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The UK pension system is at an inflection point. The roughly 5,100 defined benefit (DB) private pension schemes of varying size and fortunes, with assets of around £1.4trn (€1.6trn), are maturing fast. Their main challenge – closing the funding gap amid volatile interest rates and adverse demographic trends – is not getting any easier. At the same time, the government wants them to invest more in relatively risky UK assets, including private equity and venture capital.

But there is innovation coming from the bottom up. The concept of DB ‘superfunds’ or ‘consolidators’, has become a reality, with at least two commercial operators, Clara Pensions and The Pension SuperFund, starting to onboard clients.

The latest and potentially more interesting trend relates to existing DB pension schemes offering investment and administrative resources to third parties, in a way that is reminiscent of the journey of the Dutch institutions APG and PGGM.

That is the path chosen by BT Pension Scheme Management (BTPS), the organisation managing the £37.3bn (€43.bn) DB scheme sponsored by British Telecom, the UK telecom giant – the largest UK private sector DB scheme.

The organisation rebranded as Brightwell in March this year and opened its funding, fiduciary and members services to third-party DB schemes. At the time, Brightwell also announced that its first client would be the DB section of EE Pension Scheme (EEPS), a £1bn scheme with 8,000 members. BT completed its takeover of mobile operator EE in 2016.

Wyn Francis, CIO of Brightwell, says the plan had been in discussion for at least a couple of years.

The rationale for the decision is clear. Francis says: “As a scheme, we are pretty mature, as we expect all our members to be in retirement by 2035. I have said jokingly that my team’s job is to make the journey as boring as possible, and this is not a great sell to bring in talent or even retain talent.”

The decision, therefore, is in large part about resilience. “We are proud of what we have achieved for the BT scheme and we feel we have an opportunity to help others on a similar journey. By doing that, we are building resilience into the model, because we are also integrating resources from other schemes.

“It also gives the professionals involved a different outlook and a different challenge, which is going to be more interesting in the long run,” Francis says.

The model is not for Brightwell to pool assets of other schemes, share risks with other schemes or launch investment vehicles or products, in the way outsourced CIO (OCIO) services do. This, says Francis, would equate to adopting an asset manager’s approach and is not the chosen route.

“That has been one of the key discussions that we have had with our stakeholders – the sponsor and the trustee. The phrase we used is ‘we are staying within the guardrails of what we do at the moment’. We will only provide the services we already provide to the BT scheme,” says Francis.

Instead, Brightwell proposes other schemes to join the investment platform, consisting of the design of mandates, the selection and oversight of managers, as well as the management of liabilities. Schemes that accept that proposition can retain their CIOs and executive teams.

“Most importantly, they will retain their culture, while benefiting from our scale and our existing relationships. Naturally, we look for schemes with which we share some values,” he adds.

The decision makes a lot of sense from the BT Pension Scheme Trustee’s perspective. First, retaining staff and attracting new staff is a priority. “Another benefit for the BT scheme, is that by partnering up with other schemes we will look at other ways of investing and consider a broader investment landscape, where we might find opportunities,” says Francis.

That is especially important given the BT scheme’s strategic choice to run the scheme towards self-sufficiency, instead of targeting an insurance buyout. “There are not many options out there for schemes that do not want to target a buyout in the next 10 years or so, but are facing the same challenges we are facing, in terms of access to the human resources and the technology they need to deliver on their objectives,” Francis points out.

And that is also a way to respond to the government’s call for pension fund capital to be put back into UK corporates, in the sense that a buyout represents a leakage of value to the insurance sector. “By having this managed run-off, we have also developed a mechanism with the BT scheme that releases any trapped surplus,” Francis says.

The staffing issue might seem trivial, but it is a fundamental aspect. “It is an industry-wide factor that is driving much of the discussions about outsourcing that we have heard over the last couple of years,” he says.

“As a pension scheme, we aim to be cashflow matched by 2034, and between now and then, there is a lot of heavy lifting to be done on the portfolio, but by that point, we will be maintaining a relatively light-touch portfolio, mostly consisting of credit. I would hazard a guess that it will not be the most exciting portfolio. That is the case for many schemes like ours. Furthermore, many executive teams are nearing the end of their careers. There is a real question about making that transition and being able to maintain resilience throughout the period,” adds the CIO.

Resilience is a word that comes up several times in conversation with Francis. It brings echoes of the events of late September 2022, when the UK DB pension industry was rocked by the impact of the announcement of wildly generous tax cuts by the then chancellor Kwasi Kwarteng. Following the announcement, yields on Gilts soared at an unprecedented speed and DB pension schemes holding interest-rate derivatives for liability-matching purposes exhausted their collateral buffers.

The rush to find additional collateral calls exacerbated the sell-off in Gilts, in a negative spiral that required the intervention of the Bank of England to restore stability. The crisis affected pooled liability-driven investment (LDI) funds, mostly used by small DB schemes, rather than large ones like BTPS, which manages its LDI portfolio internally.

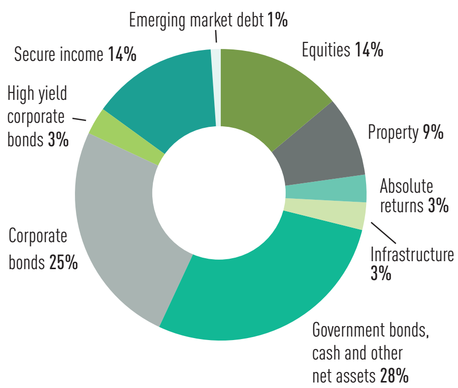
Nevertheless, it was an “uncomfortable experience”, according to Francis, which proves the need to build resilience in an institution like BTPS.

“We navigated the situation as well as we could have, meeting collateral calls each day. Since then, we have taken a good look at our liquidity management framework and introduced new tools

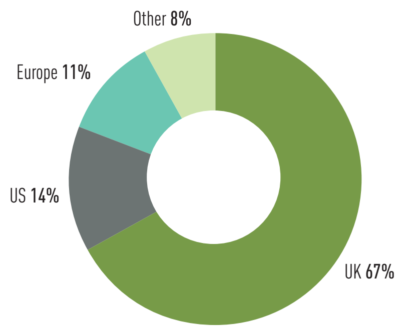
## Brightwell at a glance

- Primary service provider to the British Telecom Pension Scheme (BTPS) and fiduciary manager for the DB section of the EE Pension Scheme
- BTPS assets: £37.3bn (€43.bn) as of end June 2023
- BTPS funding ratio: 91% (2020: 88%)
- BTPS members: 263,447
- BTPS returns: -17.2% (12 months to end June 2023), -11.27% (3 year, annualised), -2.3% (6 year, annualised)
- Location: London, Bristol and Chesterfield

### BTPS asset allocation




### Geographical distribution of BTPS assets




Source: BTPS

to build as much resilience as we can into it," says Francis.

Among the new instruments introduced are corporate bond repurchase agreements (repos) and credit support annexes (CSAs), the legal documents regulating derivative transactions. The crisis might seem like a distant memory, but the Bank of England is currently running a stress test involving institutions like BTPS to gauge the preparedness of the industry for similar shocks. "The market is far better prepared for that kind of scenario than it was just over a year ago," says Francis.

The rising rates environment has allowed BTPS to accelerate its journey towards being cashflow-matched by 2034.

Francis says: "We have brought forward the switch from equity into credit and increased the cashflow coverage ratio, bringing down the volatility in the funding position. We find opportunities in credit spread space, where you can clip coupons and lock in 5% or 6% return with relatively low risk."

The CIO sees the end of the tightening cycle, but he is sceptical that rates will come down as quickly as they have gone up. "I think that rates are going to stay higher than they have been for the last 10 years for some time. Central banks seem to have got the job done in terms of controlling inflation, but we need to see what the real impact of this tightening cycle has on the broader economy. There's always a lag, and I would reserve the right to change my mind if economic numbers disappoint. If we see a deep recession, particularly in the US, which the market is not pricing in at the moment, then I could see a more rapid reversal of the cycle," he says.

That is a key consideration in the context of the asset allocation strategy over the next few years. It means that credit looks more attractive than equities on a risk-adjusted basis. But it also means that allocating assets within the credit space becomes a more nuanced exercise, especially for a sophisticated credit investor like BTPS.

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Today, Francis points out, there are good terms on offer on private credit, and private markets in general. This is partly because of higher interest rates and of the ongoing discussion within the DB pension industry on how to rebalance the exposure to illiquid assets that many schemes have built over the years, according to the CIO.

He says: "I would expect that to continue for a while. It will be interesting to see what kind of rate are on offer to refinance transactions in private markets. I imagine there were a number of companies that were funding at, say, around 3% before rates started rising. Today, funding at current rates looks less attractive for them.

"That plays into our thinking on how we build out our cash flow coverage. We find some of the opportunities in the private credit space, but it is absolutely essential to work with managers who know the fundamentals of the underlying businesses. We have longstanding relationships with a number of private credit managers. Private credit is not for everyone, but I certainly think there is a place for it if you can get the right alignment and relationships with managers, which we think we do."

**"We really pull apart our strategy and ask the fundamental questions, such as if we are on track and whether the target still makes sense. At the moment, the answer is yes to both"**

BTPS's target to be cashflow-matched by 2034 is not far off the institution's ambition to achieve net-zero carbon emissions from the portfolio. That has been set for 2035, and Francis is currently busy reviewing progress with the scheme's trustees. Every year, the investment team conducts a deep assessment of progress and challenges towards achieving that objective, and reports to the trustees.

"We really pull apart our strategy and ask the fundamental questions, such as if we are on track and whether the target still makes sense. At the moment, the answer is yes to both," says Francis.

But shifting the portfolio to net zero has been a steep learning curve, and there is more learning to be done along the way. The CIO says: "From how the measurements of carbon footprint have evolved, to questions around how we can recognise the benefit of the reduction in emissions from assets that we have subsequently sold, we have learned a lot over the past three years. At the same time, we always knew we needed things in the world to change as well for us to achieve that ambition."

The important point is that by 2035 the portfolio will be in a much better shape in terms of its carbon footprint, and that the green transition is already taking place. "We believe that there is such momentum behind the development of some of the alternative energy sources that it would be difficult to turn it back. Some aspects of the transition have started to make commercial sense, irrespective of the politics," Francis says.