



## HSBC Bank (UK) Pension Scheme (the Scheme)

# Freechoice Annuity Tracker Funds Changes to the performance benchmarks

The Scheme's fund manager for the Fixed Annuity Tracker-passive Fund and the Inflation Linked Annuity Tracker-passive Fund is Legal and General Investment Management ('LGIM'). LGIM has recently reviewed these funds and has made some changes to the benchmarks used to monitor their performance.

We have set out some Questions and Answers below to provide more information about the background and reasons for these changes.

### **1. What are the main objectives of these annuity tracker funds and how do they differ?**

The Fixed Annuity Tracker-passive Fund aims to preserve the buying power of an annuity of a member's Defined Contribution (DC) pension pot invested in this fund by, in broad terms, tracking changes in fixed annuity prices (one without any, or with fixed, annual pension increases).

In a similar way, the Inflation Linked Annuity Tracker-passive Fund aims to preserve the buying power of an annuity of a member's Defined Contribution (DC) pension pot invested in this fund by, in broad terms, tracking changes in inflation-linked annuity prices (one with annual pension increases linked to inflation).

### **2. What is a performance benchmark and how is it used by LGIM and the Scheme?**

A traditional investment performance benchmark gives a direct comparison of how well a fund is doing. For example, to judge how well a fund that aims to track changes in UK equity markets is doing, an appropriate benchmark would be to compare the fund to a UK equity market index (such as FTSE All Share). In this example, the fund would invest in the shares of the companies within the FTSE All Share so it performs in line with this benchmark.

The situation is quite different for the funds which are aiming to track annuity prices. It isn't possible for LGIM to invest directly in annuities. Instead,



these funds invest in a range of assets designed to perform in line with annuity price changes. This makes it challenging to provide a suitable benchmark.

For the Fixed Annuity Tracker-passive Fund there is an independent source of fixed rate annuity prices that the fund is compared against. This is a useful comparator to show if the fund is doing what is expected. There is, however, considerably more volatility (deviation) between this fund and the benchmark comparator than we would normally expect to see in other investment benchmarks (such as our example of a FTSE All Share tracker fund above).

For the Inflation Linked Annuity Tracker-passive Fund there is no suitable source of inflation linked annuity prices available so no benchmark comparator is shown on the fund factsheet.

### **3. Why are performance benchmarks important for members and where can they find them?**

Performance benchmarks are shown on the Scheme's fund factsheet and can be useful for members to understand if their fund is meeting its objective. However, short-term deviations are likely to happen, particularly for annuity tracker funds which are not simply investing in line with their benchmark (see question 2).

For example, an equity fund manager is able to buy shares in all the companies that form the benchmark of that fund, hence tracking it very closely. By comparison, the annuity fund manager uses a benchmark that reflects the prices at which insurers are selling annuities in the market – there are no exact investments the manager can buy to replicate this market. Instead, the manager has to try and hold a combination of

similar types of investments to insurers, such as corporate and government bonds, with the aim of getting an investment return that is relatively similar to the benchmark. As a result, there will be more deviation between the annuity fund and its benchmark compared to the equity example. Where possible, using longer-term comparisons is more helpful for pension investments.

You can find all the DC fund factsheets in the information centre on the Scheme website at: <https://futurefocus.staff.hsbc.co.uk>

### **4. Why was the performance benchmark for the Fixed Annuity Tracker-passive Fund changed?**

LGIM changed the performance benchmark to better align it with the objective of the fund at the same time as making other investment improvements. It now compares the fund's performance against annuity prices (see question 6).

The fund invests in government and corporate bonds with the aim of reflecting changes in annuity prices. The previous fund benchmark was a combination of government and corporate bond indices, matching the actual investments held in the fund. This means that the fund performance was very similar to the benchmark performance, as both were holding broadly the same assets. However, using a combination of these indices as a benchmark was a less suitable representation of whether the fund is matching changes in annuity prices. This is because annuity prices change not only with changes in bond prices, but also because of other factors such as demand for annuities. These other factors were not reflected in the old benchmark. The new benchmark is an



index which measures the average change in annuity prices charged by insurers in the market. This is more appropriate for assessing if the fund manager achieved its objective.

### **5. Why was the performance benchmark for the Inflation Linked Annuity Tracker-passive Fund removed?**

LGIM made changes to improve the way that this fund accesses its underlying investments which meant that the benchmark used at that time was no longer appropriate.

Previously, the fund held corporate and government bonds via other funds – for example, by investing in a passive government bond fund. LGIM would then combine these other funds in suitable proportions in order to create what is, in its view, a suitable portfolio to match changes in annuity prices. Following the changes, LGIM now buys individual government and corporate bonds rather than buying other funds. This gives LGIM more flexibility to build a portfolio that achieves the investment objective as the manager is no longer limited to the baskets of bonds in the (smaller number of) funds, but instead can use (the much wider variety of) individual bonds to design the portfolio.

Unlike the Fixed Annuity Tracker–passive Fund, there isn't an appropriate inflation-linked equivalent index of annuity prices for the Inflation Linked Annuity Tracker-passive Fund that could be used and included on the fund factsheet. We are encouraging LGIM to continue its work to create a new performance benchmark in the future.

### **6. What is the current performance benchmark for the Fixed Annuity Tracker-passive Fund and why was it chosen?**

It's a customised index which is based on actual annuity rates in the market as calculated by FTSE (a company which creates and maintains these special indices). This index is representative of the average member who purchases an annuity which is in-line with the objective of this fund.

At the time of writing, there are no other indices available in the market that would be more suitable for measuring the performance of a fund with this type of objective. There are several versions of this annuity index representing a range of annuities that members can choose, with different features, which are linked to the different costs of buying the annuity. LGIM has selected the variant believed to broadly reflect the UK population. This means, however, the index cannot reflect the prices paid by individual members given their annuity choice and selected insurance company.

### **7. How is the Inflation Linked Annuity Tracker-passive Fund's performance tracked if there isn't a benchmark?**

The Trustee reviews this fund's performance every three months. LGIM provides detailed information that allows the Trustee to make a judgement about whether the fund is meeting its objective. We continue to work with LGIM to see if it is possible to add a benchmark to the DC fund factsheet in the future.



## 8. Why has the investment performance of these funds been so poor in 2022 and what does it mean if I want to review buying an annuity?

Since 2022, changes in the investment markets and associated increases to interest rates have meant that the price of units in the annuity tracker funds have fallen but the cost of buying an annuity has also decreased.

Over time, we expect (but cannot guarantee) that the annuity tracker funds will continue to broadly match the price of buying the annuity that each fund targets. As a reminder the aim of investing in the following funds is not to grow your pot year on year but rather to:

- Fixed Annuity Tracker – passive Fund is, in broad terms, to track the cost of buying a fixed annuity (one without any, or with fixed, annual pension increases).
- Inflation Linked Annuity Tracker-passive Fund is, in broad terms, to track the cost of buying a fixed annuity (one inflation-linked annual pension increases).

The Scheme's investment options include two strategies that use the Fixed Annuity Tracker – passive Fund to target buying a fixed annuity at retirement: the Annuity Purchase Strategy and Lifecycle 2 (this option is closed). If you have chosen to invest your DC pension pot in one of these strategies, it's important to think about the type of income you want to take in retirement and check that this still matches your plans.

If you have chosen a “hands-on” investment approach and are using the Scheme's Freechoice range to invest in one or both annuity tracker

funds, it's important to regularly check your choices continue to match your financial plans for the future.

You can find more information about the Annuity Purchase Strategy and Lifecycle 2 (and the Scheme's other targeted investment strategies) including why you might want to consider choosing them, how they work and more detail about the different types of investments and risks in the DC Investment Guide and individual fund factsheets available the information centre on the Scheme website at: <https://futurefocus.staff.hsbc.co.uk>. In the announcements section of the Scheme website you will find more explanations in “Important information for members whose DC pension pot is invested in an Annuity Purchase investment strategy or fund”.

You can choose to switch the investment of your DC pension pot to an alternative investment option if, for example, you are no longer planning to buy an annuity at retirement. We recommend that you consider speaking to a regulated financial adviser to help you with decisions about your investment and retirement income options. To find a financial adviser, visit the MoneyHelper website and go to [www.moneyhelper.org.uk/en/pensions-and-retirement/taking-your-pension/find-a-retirement-adviser](http://www.moneyhelper.org.uk/en/pensions-and-retirement/taking-your-pension/find-a-retirement-adviser).

Don't forget, the value of your DC pension pot is always linked to the price of the investment funds which make up your investment choice. This means that the value of your DC pension pot is not guaranteed and can fall as well as rise. Past investment performance is not a reliable indicator of future results.