Northern Trust and True Partner Capital have worked together on a white paper to help pension funds navigate investment risks into the transition. The white paper explains:

- **What is changing** in the WTP transition;
- **How portfolios are expected to change**, and why;
- **Investment risks in the transition**, with practical examples based on a hypothetical pension fund. We show how liabilities, assets and funding ratios could be impacted and how moves affect different age cohorts. The impact of tail scenarios can be very significant and can have materially different effects on different age cohorts.
- **How risks can be mitigated** and considerations for transitioning underlying portfolios.

### What are the key investment risks in the transition? Why focus on this now?

- **Under the current system**, fund participants build up entitlements. In the new system, entitlements will be converted into individual capital accounts. Going forward, individuals will accrue personal pension capital, not entitlements.
- **The changes create a ‘pin risk’ around the date of contract transition**, which occurs whether a fund chooses the solidarity or flexible contract. This is because existing entitlements will be valued and converted into the new system based on a snapshot of the current value of liabilities (which is very sensitive to market interest rates) and the market value of assets on that date. History teaches us that tail events can happen quickly, and our analysis suggests that many funds would see significant losses and even not be able to transition in some scenarios.
- **The reforms are also likely to drive significant changes in underlying portfolios.** Pension funds are likely to move younger participants (broadly speaking, those under 50) to have a (significantly) higher allocation to growth / risk assets such as equities (as seen in other DC pension systems globally). At the system-wide level, this is likely to mean a reduction in long-dated interest rate hedges and an increase in equity allocations.
- **This creates important investment action items:**
  - Mitigating investment risks into the transition date and around the transition of underlying portfolios – we believe that many pension funds would benefit from hedging downside risks.
  - Transitioning the underlying investment portfolio – we believe that many pension funds would benefit from transition management services to effect this change, as the shifts could be large.
- **These action items are interrelated.** The management of the portfolio transition and the hedges around the transition will require coordination between the parties involved as they involve interrelated adjustments to exposures.

### We believe that many pension funds would benefit from the expertise of external partners to manage these challenges

Pension funds will need trusted partners to help them navigate the transition: we believe we have the thought leadership and capabilities to help them achieve the best outcome for their participants.

**Why are we bringing this paper together?** Northern Trust and True Partner Capital have complimentary areas of expertise and can work together to help pension funds navigate the transition, providing a bespoke, solutions-oriented approach to help funds evaluate and mitigate their risks. Senior experts from both firms have come together to work on the white paper.

- True Partner Capital are experienced derivatives experts and have done extensive work on the pension transition. Using their proprietary toolkit they can model a pension fund’s liabilities, assets and the relative shares of individual age cohorts in the transition valuation, simulate the effects of historical or custom market shocks on funding ratios, portfolio values and individual age cohorts, and design and manage hedges to mitigate these risks.
- Northern Trust has a leading position with pension funds in the Netherlands and globally and is in active dialogue with many funds on their transition plans. There are opportunities to work with clients as a strategic partner as they seek to transition portfolios, adapt their pension fund administration and processes to the new contract, and to add value through additional services such as brokerage and other capital markets offerings that may be beneficial to clients.

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