INCOMPLETE RETURNS?

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Maximising investment returns – the fiduciary duty issue? New data from TaxTec reveals incomplete reclamation of withholding tax is affecting beneficiary returns.

Pension returns trends & fiduciary duty

My eye was caught by a recent piece of research from Ortec Finance among senior pension fund executives in the UK, US, the Netherlands, Canada and the Nordics whose funds collectively manage over 1.4 trillion in assets. The research tells us that 77% of pension fund executives expect the coming year to bring an elevated risk profile. All the more reason to maximise returns if the topography of risk is becoming more challenging.

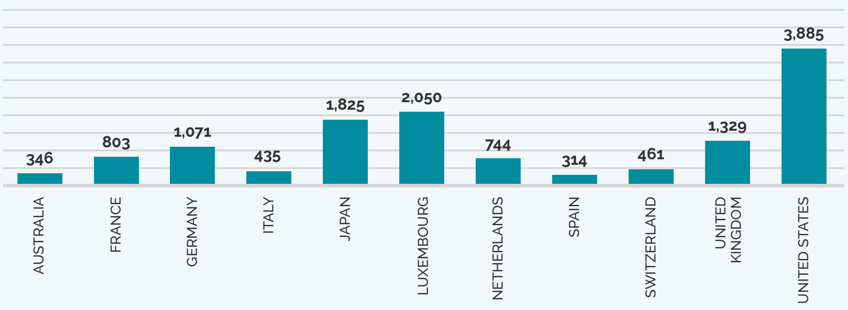
On top of this, a variety of commentators are noting issues about the affordability of retirement and the adequacy of pension plans to cover standards of retirement living.[i] And there's more. According to the Department for Work and Pensions (DWP), there are still around 5,000 Defined Benefit schemes in the UK, managing about £1.4tn in assets and relied on by over ten million people income in retirement. Their deficit has been turned to surplus, according to PwC's Low Reliance Index.[ii] That means the adequacy levels for beneficiary levels in Defined Benefit schemes seem on track to meet their future obligations. However, they are now in the minority. There are four to five times the number of enrolled members in Defined Contribution schemes compared with Defined Benefit counterparts.

Overall, according to Institute for Fiscal Studies, negative factors outweigh positive developments, resulting in the need for UK citizens to increase their savings rates to provide for their retirement.[iii] Several associations have been highlighting pension shortfalls for some years, with one research project estimating that without reform more than 50% of savers will fail to meet the retirement income targets set by the 2005 Pensions Commission.[iv] Moreover, a recent study from the Living Wage Foundation has found that the average pension pot needed to meet basic needs in retirement surged by 60% over a three-year period in the cost-of-living crisis.[v]

All of which raises a point of ethics – what more can pension schemes and their service providers do to maximise returns for their beneficiaries? And is the imperative to seek out such improvements not part of the pension fund trustee's fiduciary duty?

Unclaimed witholding tax on foreign securities

TaxTec estimates 2024 (USD million)



Securities investment trends and returns

Let's have a look at pension investment in securities.

First, some trends.

An analysis of the S&P 500 returns since 1940 shows that, over this period, dividends and dividend reinvestments accounted for 94% of the index total return.[vi] Not capital growth. Of course, it's easy to be dazzled by the massive price growth in trendy megatech stocks in recent years, especially when their capitalisation in some cases is equivalent to several percentage points of their quoted stock market.

Yet the perspective of pension funds cannot be distracted by such shooting stars. As we saw during the governmental crisis over gilts a few years back, liquidity is critically important. Securities income is clearly a massive factor for pensions funds to manage the axis between liquidity and growth.

At the same time, we see another trend in the geography of investor behaviour, including pension funds – the appetite for foreign investment. Data from the International Monetary Fund (IMF) reveals income from foreign stocks and bonds steadily growing over the last ten years.[vii]

Further analysis of this IMF data shows how foreign investment portfolio values have changed over a decade. In total, cross-border securities investment has increased by 58% over the period. If we were to take a proportionate (rather than volume) view, then total assets under management in UK institutions increased by just over a third in the last ten years; by comparison, the UK's foreign equity investments expanded by over half.[viii]

Within this picture, the United States plays a critical role. Most UK investment portfolios have a strong representation of foreign stocks, and the vast majority will tend to favour the United States – simply the result of the sheer market size and investment targets offered by the world's largest economy.

Maximising returns

One area which pension funds can check with their service providers is how effectively withholding tax is being reclaimed on dividends and bond interest payments from those foreign securities. TaxTec's analysis shows that some 20% of reclaimable withholding tax is being left on the table. And that is a meaningful chunk of investor returns/beneficiary gains left on the table.

For instance, for foreign investors into the United States markets, the statutory withholding rate is 30%. For most treaty partner countries, investors can claim back 15 of the percentage points withheld. Statutory withholding rates in most developed economies range from 15% to 30%; reclamation rates in most countries fit into the 5% to 15% range.

There would be no issue if reclaimable withholding tax were efficiently and effectively reclaimed for investors. But they are not. And that is surely a point of fiduciary reponsibility?

This issue has come under the spotlight as the global volume of dividends paid out rises, and bonds once more deliver a significant coupon. Asset owners such as pensions funds have a duty to their beneficiaries to maximise income, fund managers also have a fiduciary duty to optimise returns for investors, and custodians want to deliver the best possible service to clients.

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i For instance, https://am.gs.com/en-us/advisors/insights/article/2025/defined-contribution-trends-2025

ii https://www.pwc.co.uk/press-room/press-releases/research-commentary/2024/p340bn-pension-surplus-could-be-unlocked-for-uk-investment-as-a-.html

iii https://ifs.org.uk/publications/adequacy-future-retirement-incomes-new-evidence-private-sector-employees

iv For instance, https://www.plsa.co.uk/Policy-and-Research/Topics/Improving-pensions-adequacy

v https://www.livingwage.org.uk/news/pension-pot-needed-basic-retirement-rises-60-cent-nearly-%C2%A3110000

vi https://www.guinnessgi.com/insights/why-dividends-matter

vii https://data.imf.org/?sk=b981b4e3-4e58-467e-9b90-9de0c3367363&sid=1481568780846

viii Sources: IMF; https://www.morganstanley.com/im/en-us/individual-investor/insights/articles/is-2025-the-year-of-the-bond.html; https://www.northerntrust.com/united-states/insights-research/2024/point-of-view/yields-and-credit-quality-make-high-yield-bonds-attractive-for-2025; https://www.fca.org.uk/publication/market-studies/ms15-2-2-annex-8.pdf; et al