Pensions Authority Code of Practice

IAPF Governance Conference

1 December 2021

Introduction

- I would like to thank the IAPF for the opportunity to speak during this Governance week. This annual event has grown in importance and relevance since the IAPF launched it a number of years ago.

- As you are probably aware, the Pensions Authority has published a number of information and guidance documents in recent weeks. Most of what I say this morning will focus on two of those recent publications: the Code of Practice and the defined benefit risk measure. But I think that it is important to say that I am making no further announcements here today: all you need to know is in the Pensions Act and in what the Pensions Authority has published since April.

- I will be happy to take questions at the end. I will also make the text of this presentation available in a few days.

Pension scheme governance

- First I would like to talk generally about governance and the transposition of IORP II.

- The IORP II Directive, as transposed into Irish law last April, imposes a significant number of new obligations on the trustees of pension schemes. What it does not do in any way is lessen the responsibilities or undermine the discretion of trustees in relation to their basic obligations. The fact that there are additional tasks to be undertaken by trustees must not be understood as narrowing the scope of the trustee role. Responsibility for running the scheme and looking after the interests of the members rests unambiguously with the trustees, as it always has.

- The objective of pension scheme governance is to ensure that a scheme is well managed and to provide evidence of that management. Governance comprises the processes that trustees put in place to ensure that their management of the scheme is consistent, reasonable and well informed. Good governance will not mechanically answer the difficult decisions that trustees are often faced with. What it should do is identify those decisions, ensure that trustees have the information and advice that they need and ensure that they set about those decisions in a systematic and balanced way. But a difficult decision is still a difficult decision.

Code of Practice

- Let me turn to our new Code of Practice. I am not going to go through the Code. What I want to do is to set out the context, identify the objective of the Code, and draw your attention to a number of particularly important issues. Much of what I say will be familiar to many of you, or at least I hope it will.

- The context of the Code – the reason that we decided that it is necessary – is twofold:

  (a) firstly, there are a number of areas where the new legislation prescribes obligations but does not give much detail about what is required to meet them – the Pensions Act is legislation, not an instruction booklet. The Code sets out what the Pensions Authority expects as a minimum in these areas

  (b) the second reason is forward looking risk-based supervision: the amended Pensions Act obliges the Pensions Authority to implement forward looking risk-based supervision but says very little further: the Code sets out for trustees what this will look like in terms of our expectations of them.

- Forward looking risk-based supervision means that our supervision is focussed on risks to the interest of members and beneficiaries, not just on past instances of strict non-compliance. It is not for the Pensions Authority to identify these risks to member interests. Nor is it for us to propose the responses: these are the responsibility of trustees. The Authority will be looking at how well trustees do this. We will only look to intervene in two circumstances – if the way that trustees set about their tasks seems inadequate or if the decisions they make appear to be outside the set of reasonable decisions.

- In order to achieve the best outcomes for members, trustees need, firstly, qualifications/knowledge and, secondly, processes – decision process and control process. This is in essence what the code addresses – standards for trustees and key function holders, and the governance processes of the scheme. What the code is certainly not doing is forcing trustees to make particular decisions. Rather it is intended to make sure that they address the important issues in an informed and structured way.

- Forward looking risk-based supervision means that we look at risks to member and beneficiary interests, and we expect trustees to have this same focus. It therefore follows that the trustees' own risk assessment – the ORA – is or ought to be central to the work of the trustees. An ORA must not be seen as a form-filling exercise or as an effort to find the right boiler plate text that will keep the scheme below the Authority's radar. Trustees should recognise that a thorough ORA is an important and useful process that they should be doing even if it were not a legal requirement.

- An ORA will fall short or fail if not done objectively. There are two potential threats to an objective ORA – the first and most obvious one is conflict of interest: it is vital that this be avoided where possible and managed closely otherwise. But just as important is objective assessment. An ORA must be unbiased and history free – it must not be justifying a particular course of action or favouring a particular point of view. Trustees must be aware of the possibility of unconscious bias, because we are all only human, and this again underlines the importance of process and governance.

- The ORA must also be proactive. Clearly, trustees must be active in identifying risks to members interests. But the ORA is not intended to be just an exercise in drawing up a risk register: the purpose is not just to identify risks but as far as possible to address them. This is going to be the most challenging aspect of trustee responsibilities, but it is undoubtedly the most important.

- In summary, what we expect, and what scheme members are entitled to expect, are trustees who are informed, systematic, proactive and objective. This is the trustee culture we will be looking for, and the Code of Practice is intended to underpin it.

Defined benefit risk

- We also recently published our defined benefit risk measure. I want to take some time to put this into context.

- Every defined benefit trustee is familiar with the funding standard, and the obligations that arise if the scheme does not meet the standard. However the funding standard is not intended to be the basis on which trustees decide on the funding of their scheme. Rather the trustees should make their funding decision after examining a range of measures of solvency, risk and sustainability. Only if the funding standard requirement is higher than the result of those considerations should it determine the funding of the scheme.

- It is useful to think of scheme funding in the context of the own risk assessment. The lower a scheme's funding is, the greater the risk is that there won't be enough to pay all benefits. Funding decisions should not be made without explicitly considering risk and as far as possible measuring it and seeing if it is acceptable.

- But measuring DB risk is not straightforward. The main financial risks for DB schemes are investment risk, longevity risk and interest rate risk, and these can and should be modelled. However, for most Irish defined benefit schemes, this financial risk is offset by the possibility that the sponsoring employer will make additional financial contributions to the scheme in the event that these risks come to pass.

- But in most cases it is not possible to measure this employer support. Future support depends on both the ability and willingness of the employer, and it is simply not possible to put a number on employer willingness. Therefore the 'net' financial risk – total financial risk less potential employer support – is a matter of judgement rather than of calculation, even though significant components of it can be calculated.

- What the Authority expects is that DB schemes will put a value on their financial risk. They should then use the outcome of these risk calculations as the basis for engagement with the sponsoring employer, so that the employer understands the likelihood and extent of any support that may be sought, and the trustees can make a more informed assessment of the possibility of such support.

- It has been a constant theme of Pensions Authority statements about defined benefit that no single measure of solvency, risk and sustainability gives an adequate understanding of the scheme's condition: defined benefit schemes are simply too complicated. Nonetheless, we have published a standard risk measure which we expect trustees to include in their financial assessment.

- There are a number of reasons for this:

  - We recognise that many trustees and their advisers would like to have specific guidance from the Authority of what degree and methodology of risk assessment we expect:

  - As well as being interested in the absolute level of DB risk, we believe that it is important to assess how schemes compare to each other and how wide the range is. Obviously a standardised measure is useful for this.

- I want to be clear that there is no legal obligation on trustees to take any specific steps in response to the results of their risk measurement – the risk measure is not comparable to the funding standard in this sense. Rather the results of the risk measure and the resulting discussions with the sponsoring employer form part of the trustees' ORA, and should inform their decision about whether the scheme's risk is acceptable. Our responsibility is to oversee that process, and to decide whether the trustees have adopted a reasonable process, gathered the necessary information, and reached a reasonable conclusion.

Next

- In the coming weeks, we will be publishing an employer's guide to master trusts. We will also be publishing the results of our 2021 scheme engagement programme. But we plan no further guidance in the short term: trustees and their advisers must now get on with the task of becoming compliant with the amended Pensions Act.