

Annual Report and Accounts 2020

Statement from the Pensions Regulator, Brendan Kennedy

The Pensions Authority Annual Report and Accounts 2020 set out in detail the activities of the organisation during what was a busy and challenging year. Our goal for 2020 was to maintain oversight of occupational pensions and PRSAs while preparing for the transposition of the EU IORP II Directive. 2020 was a particular challenge given the effects of the Covid-19 pandemic, and I am happy to say that the pensions sector and the staff of the Pensions Authority adapted and coped well with the unprecedented circumstances.

One of our most important activities in 2020 was the Authority's programme of engagement with a number of master trusts and larger defined benefit (DB) and defined contribution (DC) schemes. The objective of this programme was to assess the state of preparedness for IORP II, and the results were mixed, with some areas of concern identified. It was a valuable exercise, and we have seen good progress in our follow-up engagements.

On 22 April 2021, the Minister for Social Protection signed the regulations which transposed the IORP II Directive into Irish law. There must be no misunderstanding about the significance of this event: few if any occupational pension schemes were wholly compliant at the transposition date, and for the great majority of schemes, compliance will involve very significant changes. The implementation of IORP II will also have implications for how the Authority supervises in the future with a greater emphasis on forward-looking risk-based supervision. The Authority recognises that for both the market and the Authority these changes will take time, and in April, we set out where we would focus our supervision efforts and by when we expect to see full compliance.

The purpose of these changes is to strengthen consumer protection. Retirement savings are a very significant financial commitment for contributors, and they are entitled to high standards in the management of their savings. This should encompass not just protection against fraud or error, but proper accounting, expert investment, good value for money, and good communications. Our pensions system must also be realistic about the level of knowledge and engagement that can be expected from savers.

Compared to the rest of Europe, we in Ireland are an outlier as there are over 150,000 Irish pension schemes, most of which are very small. Proper supervision and value for money will not be achieved unless there is a much smaller number of larger, more efficient schemes. Consolidation of the number of DC schemes is fundamental to improving the Irish pension system and is a goal of the Authority.

The immediate priority for all pension schemes and for the Authority is putting in place the additional structures and processes required by the transposition of IORP II: for many schemes, this will not be practical or cost efficient, and the

sponsoring employer and the trustees will be considering future provision through PRSAs or via a master trust.

Compliance with the amended legislation is not an end in itself. The purpose is to make pension schemes more efficient and accountable, and to ensure that there are trustees in place who are able and willing to address the significant responsibilities involved in overseeing and investing pension assets for up to 50 years. When this transitional phase is complete, there is both the opportunity and an obligation on trustees to address major issues, such as:

- The long term multi-generational investment of retirement savings has always been a profound and often underestimated challenge: there is no simple formula that identifies the right balance between investment return, risk, and liquidity. This challenge has become even greater in recent years, where monetary policy has contributed to high levels of negative yielding debt and where expectations of continuing economic growth will clash with the need to respond to climate change.
- The continuing replacement of DB by DC means a transfer of investment risk to individual pensions savers. However, very few savers are equipped to make investment decisions for themselves, and DC scheme trustees must recognise that they have no less investment responsibility than their DB scheme counterparts. It is likely that most scheme members will rely on the default investment options. Although there are no guarantees provided, trustees must nonetheless be clear about the objectives of these investments. Trustees must adopt a structured approach to setting and achieving their objectives and be open and objective about their performance. The investment choices offered by DC schemes must also be carefully chosen and managed by trustees in the same way.
- Low and negative yields are a particular challenge for DB schemes because of the specific benefit promises given to members. These low yields mean that the cost of providing financial certainty is higher, and this must be recognised. The transposition of IORP II does not create any new challenges for funded defined benefit schemes, but it does put the onus on trustees to address their responsibilities methodically and to make objective strategic decisions. It is especially important that trustees ensure that they have enough information and analysis to understand their scheme and in particular, the aggregate risk borne by the scheme and how it is distributed among different classes and cohorts of members. Trustees must also have an ongoing informed dialogue with the sponsoring employer to form as accurate as possible an understanding of the support that the sponsoring employer can and will continue to provide.

It is likely that for some DB schemes, a better understanding of the finances and risks of the scheme will call into question whether the scheme has any realistic chance of paying all the promised benefits to all members. Addressing these issues will in some instances involve difficult decisions for trustees.

- For both DB and DC schemes, the trustees must decide about whether to take account of environmental, social and governance (ESG) factors in making their investment decisions. Although many trustees and scheme members strongly support such an approach, any decision must take proper account of the additional work involved and the need for reliable data.
- Some DC schemes have high charges and trustees have a responsibility to address this issue. Providing additional information to members about charges may have a part to play, but such information should be comprehensible to those for whom it is intended, and we must recognise that too much complex information may overwhelm members and reduce their engagement with their savings and retirement planning. In any case, it is trustees who are best placed to address the matter. It is notable that in a number of other jurisdictions, trustees of pension schemes or their equivalents are required to justify whether their pension schemes are providing good value for money or whether their members could do better elsewhere.

Effective regulation and well managed pension schemes are a necessary part of supplementary pension provision in Ireland. But they will not in themselves increase pensions coverage, and the recent announcement by the Minister for Social Protection about the objectives for implementation of auto-enrolment are very welcome. Such a system will not only expand pensions coverage significantly, but, depending on the final design, it can function as an important benchmark and as a competitor for voluntary pensions, especially in the areas of costs, investment and member communications.

In future, the supervision of pensions by the Authority will be more intrusive, more qualitative and more demanding. It is not the Authority's job to dictate to trustees how they should run their pension schemes, but it is our job to assess how well they are doing it. Our long-term goal is that we can take for granted trustees' compliance with all their obligations, and our engagement with trustees will be a dialogue about how they intend to achieve the best outcomes for their members. Our short-term goal is to get to that position as quickly as possible.

Brendan Kennedy

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