An tÚdarás Pinsean
The Pensions Authority

Address by the Pensions Regulator to the Society of Actuaries in Ireland Scheme Actuaries' Forum

12 June 2020

Introduction and overview

- Thanks for the opportunity to address this forum. I will give you a short update on the Pensions Authority's current activities, followed by a briefing on the future supervision of defined benefit schemes and our expectations of trustees.

Update on transposition

- The Department of Social Protection is working with the Office of Parliamentary Counsel on the IORP II transposition regulation. This work is high priority and has continued through the Covid-19 disruption, but I do not have an expected completion date.

Current activity by the Authority

- As part of our preparation for IORP II, we have begun a programme of engagement with selected schemes. The next phase of this will include some defined benefit schemes. The objective of the work is to get an understanding of the schemes' level of preparedness for IORP II by looking in detail at their processes and governance practices.

- We have been working with the Pensions Committee of the Society on a number of defined benefit issues – these include such topics as risk assessment, transfer value bases, Covid-19 issues and practising certificates. We very much value the input from the Committee and I would like to express our appreciation to Ronan and all on the Committee for their work.

- Obviously we in the Authority have been working on our preparation for IORP II supervision, and in particular how we will implement the supervisory review process and oversee trustees' own risk assessment. Our aim is to publish as much of this as is practical, but we have to wait until all of the details of transposition are settled before we can do that.

Future oversight of DB

- What I want to do is to give you an overview of the Pensions Authority's future approach to DB supervision, what it will mean for scheme trustees, your clients, and what we will expect from them.

- The objective of a defined benefit scheme is to pay the benefits set out in the scheme rules. Therefore, the purpose and focus of our supervision of DB schemes is to ensure, as far as possible, that this objective is going to be met. Our supervision must therefore be forward looking. That means not just looking at whether the scheme is solvent today, but whether it will be solvent and in a position to pay the promised benefits, when the time comes.

- That means of course that trustees must also be forward looking in how they manage the scheme and must always have in mind the ultimate objective of good member outcomes. Our supervision will be looking at weaknesses and deficiencies in the situation and management of the scheme and whether they represent threats to the payment of member benefits. In line with the requirements of the IORP II Directive, we will take action, unless the trustees address those threats to the member benefits.

- The trustees should be just as focussed on risks to the member benefits as the Pensions Authority will be. I am sure that this is true for some schemes, but it is clearly not true for many others. There is nothing in the IORP II Directive that is surprising or left-field: there is nothing there that a well-run scheme should not be doing already. If protecting member benefits was the trustees' priority, they would already have a good risk management function, would have tight financial controls, have written contracts with their administrators and service providers, sensible KPIs, a proper investment process, clear and sensible identification and management of conflicts of interest. Of course, they need to see the finer details of the transposition to know whether they need to make some changes to their processes, but these changes should not be significant for a well-run scheme.

- But for too many schemes, this is not true. It is clear therefore that, for very many schemes, we need to change the culture of trusteeship. We need, and will expect, trustees to assess objectively the scheme's situation, to proactively identify weaknesses and shortcomings, and address them. What we must not see, but what too often happens at present, is that trustees rationalise the current situation of their scheme.

- If the trustees are fulfilling their responsibilities properly, and are well advised, they will not be especially troubled by the IORP II Directive or even by the Pensions Authority. They will already have a proper view of their responsibilities and will have a systematic approach to fulfilling them. Put another way, if the trustees' priority is merely to obey the regulations, they are unlikely to be fully discharging their obligations to safeguard the interests of members. Worst of all, if the trustees' priority is to keep the scheme in being, in the hope that something will turn up, they are falling far short of their obligations to members.

- We will divide schemes into three categories, based on our assessment of how likely they are to be able to pay benefits.

  Category 1 is those schemes who look likely to be able to meet their obligations.

  Category 3 schemes, at the other extreme, look most unlikely to be able to meet their obligations.

  Category 2 schemes are those where we judge that there is a significant risk to member benefits unless scheme practices are changed.

- We have seen very few schemes that we think are Category 1. That said, undoubtedly there are schemes that will not require significant change to achieve this categorisation. But I suspect that there are many schemes, that assume they are Category 1 ,that will be surprised.

Solvency and the funding standard

- Most of what I have said so far applies broadly to both DB and DC. I want to talk now about DB specific matters – the funding standard and related issues.

- At present, before transposition, the only measure that the Pensions Authority can use to assess the adequacy of a scheme is the funding standard. But the funding standard is of itself a poor predictor of the ability of schemes to pay benefits. If we look at the history of Irish DB over the last two decades we see too many instances of benefit reductions or schemes being wound up, when in deficit. In any case, a defined benefit scheme is too complex and dynamic an entity for its financial health to be measured by a single number, and for the supervisory response to be limited to that single number.

- In future, we will need to look not just at solvency, but at three measures: solvency, risk and sustainability. Even for each of these three, there is no single number that is definitive. In every case, the conclusion about the adequacy of the scheme will be a matter of judgement. But it has to be a matter of objective judgement, not rationalisation.

- The Pensions Authority will define a set of financial tests that we will expect schemes to undertake. But in a well-run scheme, the trustees and their advisors will probably go further and consider many potential scenarios and stresses that could have an impact on member benefit expectations. Just as the current pandemic is making many businesses re-evaluate what were previously considered to be unlikely events, trustees and their advisors should look again at the assumptions they make about the solidity of their scheme.

- The funding standard will continue to apply after transposition, and trustees will have the same legal obligations if the scheme does not meet the standard. But, in future, we will be looking at additional measures of the scheme's financial health, as well as the funding standard. By definition, this will mean that we are more likely to find additional issues that need addressing.

Conclusion

- Nothing that I have said applies directly to you: you are not trustees; you are scheme actuaries. But it is obviously important that you be aware of what is going to happen. And although we plan extensive communication with scheme trustees, it would be useful if you played your part in helping trustees to understand the changed environment. But, to finish up, I want to repeat what I said about the need for culture change. The trustees must demonstrate a clear understanding of the scheme's situation and of the threats to member benefits. Therefore, they need to have someone to give them objective assessment of the scheme's position and issues, even though it may often result in telling trustees unpleasant truths. This is the job of the scheme actuary.