A UNIVERSAL PENSION FOR IRELAND
WELCOME ADDRESS

DEAR ATTENDEE,

On behalf of Insurance Ireland and its member companies, I want to welcome you to our seventh and final event considering the development of a Universal Pension for Ireland.

Given our demographics and current contribution rates, a long-term strategy on retirement income is a recognised public policy objective in Ireland. The complexity of the issue necessitates a full examination of the options available as well as insights from countries that have implemented policies in response to similar challenges.

It is our belief that Irish consumers will benefit from a coherent, sustainable and reformed pension model that takes account of ageing and changing socio-economic patterns.

To this end, Insurance Ireland has conducted extensive research over the past 18 months involving international experts to examine the framework for a Universal Pension for Ireland. Our involvement has been motivated by our members’ considerable experience in pension provision and the international expertise we can draw on to inform this important debate.

This programme has been marked by constructive engagement from all stakeholders. The consideration given to the topics by attendees bodes well for our final event and for informing future policy formation.

We are very pleased to have facilitated this open dialogue and would like to thank all the attendees for their contributions, our member companies for their continued support, TOR Financial Consulting for their excellent report and finally, the Insurance Ireland Pensions Policy Working Group led by Gerry Hassett, for their outstanding work throughout the series.

I look forward to what will be another productive event and to engaging with stakeholders on the insights from this report.

Yours sincerely,

Kevin Thompson
CEO Insurance Ireland
September 2016
ABOUT THIS REPORT

The Government-commissioned OECD Review of the Irish Pension System (2013) recommended the establishment of a universal defined-contribution pension model for Ireland that would ultimately cover all Irish workers. This generated significant discussion among policymakers and key stakeholders as to which potential design best meets Irish needs.

Insurance Ireland is in a unique position to contribute to this debate. As the voice of Insurance in Ireland its members manage €82bn in pension assets on behalf of over 1m Irish workers. Ireland already enjoys the benefits of a leading-edge DC infrastructure.

Over the past 18 months, Insurance Ireland has worked with its strategic partner Tor Financial (who assisted the OECD in preparing its review) in outlining the policy options and technical challenges involved, in order to stimulate informed debate and dialogue with policymakers and key stakeholders. This has involved:

- A series of technical workshops on the key building blocks of a Universal Pensions model – Governance, Design, Investment, Retirement/Decumulation, Administration and Simplification. These typically involved international speakers sharing their experience and best practice with Irish stakeholders
- Assessment of international exemplars from countries who are further along the path to a Universal Pensions model such as New Zealand, Australia, UK, United States, Netherlands and Chile to identify which aspects of each can be deployed to meet Irish policy requirements
- Identifying the key objectives and design principles for a Universal Pensions model for Ireland, outlining the choices available to guide policymakers through this technical arena

This paper is the culmination of this work, and forms the basis of a major policy workshop in Dublin involving thought-leaders from around the world interacting with Irish policymakers and stakeholders. Our objective is to provide an overview of the design and implementation issues involved to allow Government create the best Universal Pension model for Ireland.

The development of a Universal Pension for Ireland will challenge all of the stakeholders involved to deliver. Insurance Ireland stands ready to meet the challenges required to deploy its infrastructure to deliver the best long-term solution for Ireland.

We would welcome the opportunity to discuss any aspect of this report with policymakers and key stakeholders.

Gerry Hassett
Chair – Insurance Ireland Pensions Policy Working Group
September 2016
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INTRODUCTION

The purpose of this section is to set out core principles and best practice on some of the detailed aspects of a potential Universal Pension for Ireland (referred to here as MySaver).

This is based on an extensive research and consultation process undertaken by Insurance Ireland over the past 18 months. We were assisted in our deliberations by experts from the UK, the USA, Australia and New Zealand. Their insights into the implementation and outcomes of universal workplace pensions (voluntary, auto-enrolled and mandated) have helped to crystallise our views on how a universal pension can work for Ireland.

This blueprint is not intended to be prescriptive – there is clearly more discussion and consultation required before a final solution can be agreed. However, it does provide an overview of the various governance, design and implementation issues involved to stimulate informed debate among policymakers and key stakeholders to deliver the best solution for Ireland.

GOVERNANCE

Governance of MySaver is particularly important given the semi-compulsory nature of auto-enrolment.

- Governance must build and maintain trust with stakeholders and the public. It cannot be developed in isolation and should evolve through consultation between policymakers and key stakeholder groups.

- Governance requirements should be set in such a way that innovation is not stifled and compliance costs do not adversely affect the objective of providing reasonable return on investment and adequate sustainable retirement income. We think it will be cost effective to maintain existing occupational/trust-based arrangements and it will be important that it is consistent across the whole of pension provision. In this regard, we welcome the recent consultation process by the Pensions Authority to streamline and simplify these arrangements.

- A trust-based scheme is not the only option to achieve good governance. An alternative model could be adopted where the product provider is the first line of defence supervised by the Regulator. In addition, independent oversight could be given through a Governance Oversight Board with international experts in the roles of Guardians. Consideration must be given to the right balance between regulation of providers and the trustee role. Failure to get this balance right will involve more complexity and ultimately higher costs to members.

- From a practical perspective, consideration should also be given to how the existing legislative framework might be re-used and recycled before developing a new legislative model. For example, PRSAs have developed strong governance standards which have protected employers and employees/consumers.

- Governance will be a key mechanism for building trust in MySaver and for this reason investment should be at arm’s-length, on a purely commercial basis and in line with international best practice. The Government should resist the temptation to become ‘the investor’ because of the recent negative experience of both the National Pension Reserve Fund and the Pensions Levy.

- Codes of practice must be clear, concise and fit for purpose. This is vital to ensure those contributing to My Saver trust the product, provider and crucially the concept.
PRODUCT DESIGN

1. Longevity gains, the decline of Defined Benefit (DB) schemes and relatively low take up of voluntary defined contribution (DC) schemes, raises the risk of inadequate financial security for the majority of workers when they retire¹. Both the Mandatory and Auto-Enrolment models are viable solutions. From a purely design perspective, a mandated retirement savings system, as recommended by the OECD, would be preferable. However, from a consensus and buy-in perspective automatic enrolment into a universal pension is more likely to generate the consensus required among the social partners. For the purposes of this paper, we assume the auto-enrolment model is the more likely final choice of policymakers, but most of the principles apply equally under both models.

2. MySaver should target low to medium earners who do not have retirement savings. Existing DB and DC arrangements should be preserved: it makes no sense to damage the existing infrastructure if it provides benefits at least as good as MySaver. In addition, there is an urgent need now to build confidence in the social welfare system and trust in future pension provision.

3. Workers should be allowed to opt out within three months of being auto-enrolled but re-enrolled every two or three years at the beginning of the tax year.

4. The opportunity should be taken to reduce complexity in the pension system by delivering an automated and portable defined contribution pension that is high volume and low cost. The existing template of Personal Retirement Savings Accounts (PRSAs) could be developed, with minor changes, to simplify implementation, keep costs down and shorten the time to launch. Reference by the PRSA provider to the Governance Oversight Board - and tax simplification - would assist with PRSA suitability.

5. The aim should be to achieve at least 50% of income replacement at the state pension age from the state pension and MySaver contributions should ideally get to 10% of gross salary by phased increases over the first five to seven years:

6. Employees to contribute 1% of gross annual salary and increase this by 1% each year until 5% is reached.

7. Employers to start at 1% and increase every year until 5% is reached. With tax relief at the marginal rate this effectively makes the employee contribution 4% net.

8. Costs need to be kept as low as possible, and industry will rightly be challenged to benchmark prospective fees against international comparisons. Keeping the design of MySaver as simple as possible is critical to delivering best value for consumers.

9. Eligibility rules should be compatible with current pension provision: minimum age 22 and 55 maximum for auto-enrolment and the income eligibility band could potentially be linked to the standard income tax band. It is essential to keep the eligibility rules simple to avoid unnecessary cost.

¹ According to the OECD, private pension plan coverage in Ireland was 41.3% in 2009-10 OECD (2014), OECD Reviews of Pensions Systems: Ireland, OECD Publishing. http://dx.doi.org/10.1787/9789264208834-en
INVESTMENT

1. International experience indicates that retirement savers are not confident about making decisions about investment and an overload of investment choice should be avoided. The majority of savers are likely to be in default investment funds for most if not all of the accumulation period. These funds can bring benefits if they are designed to reflect the needs of plan members and they should not be seen as a poor relation of active choice.

2. Default investment funds associated with MySaver should be designed as long term investments able to deliver reasonable returns, protect accumulated funds and be capable of achieving individual retirement aims. The investment objective should be clearly defined by policymakers.

3. Existing DC Pension savers in Ireland already enjoy the full range of dynamic investment solutions offered by leading international players, with life styling and auto rebalancing the norm. Many of these solutions can be recycled to meet the needs of MySaver customers.

4. A partnership between government agencies and industry is needed to deliver investment education programmes to members of MySaver. Financial advice, guidance and information can be harnessed to encourage more active participation.

5. We think it important to bear in mind when considering fees and charges for MySaver that the outcome is sustainable: excessive pressure on fees and charges may work against the long-term objective of the universal pension to build adequate savings. Similarly, the complexity of the system may incur unnecessary costs. Efforts should be made to simplify MySaver to achieve cost containment.

RETIREMENT INCOME

1. Decumulation must be built into the design of MySaver. A universal pension will need clear objectives for growing savings and maintaining retirement incomes consistent with longevity gains.

2. Financial advice and guidance is most important when individuals are making choices about decumulation of retirement savings; we believe access to advice is essential if unrestricted access to savings is allowed. It will be vital that the quality of advice offered to those making financial decisions is the best available.

3. Our view is that annuities have a place in decumulation strategies despite a fall in popularity in the countries we have examined. Retirees should be persuaded of the benefit of reinvesting their lump sums into deferred annuities.

We suggest a four-fold approach to retirement income:
4. Given that MySaver members may have relatively small pension pots because of relatively low contributions, consideration should be given to encouraging the development of ‘master’ retirement funds to pool investment and risk and new products in general that may offer a guaranteed monthly pay-out.

5. Barriers to innovation of new retirement products should be removed where these products can create benefits for the scheme.

**ADMINISTRATION**

We define pension administration as: the arrangements and tasks needed to operate a pension scheme that delivers good member outcomes.

1. There are two options to be considered for the administration of MySaver: Build a system from scratch or leverage existing architecture. We think the UK experience with NEST suggests that a new system could be expensive. The current DC administrative infrastructure in Ireland already meets the pensions saving needs of over 1m workers and most of the functionality required to administer MySaver is already in place.

2. A key consideration is the number of additional savers being brought into the DC environment through auto-enrolment; these will be largely workers who do not have experience of saving for retirement. According to the OECD, if the entry earning level were to correspond with the income tax threshold, the system would target approximately 840,000 households.

3. We understand the importance of designing and running MySaver as a low cost scheme and ‘low cost’ needs to be defined in the fullest sense by including investment costs and particularly costs associated with investment default funds.

4. A single Administration Hub (potentially sponsored by industry) could connect to this infrastructure and employers’ systems to enable ‘pot follows member’ to new employers, delivery of standardised information and guidance, collection of contributions by small employers and a New Zealand-type carousel of providers - with default status - would allocate MySaver members who do not make their own choice to suitable providers.

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1 National Employment Savings Trust – the UK’s auto-enrolled DC workplace pension
2 OECD: Review of the Irish Pension System - Preliminary version, 22 April 2013, Department of Social Protection, Dublin Ireland, p. 127
5. ‘Kitemark Status’ granted by the Government to approved providers of MySaver (subject to licensing and governance requirements) would give certainty of member growth and minimise marketing costs for those firms.

6. Customer-focused online communications should deliver standardised information and guidance to ease the decision-making burden for MySaver members. With ‘pot follows member’ customers will be able to access all of their funds in one place which is an important requirement.

7. The PPSN should provide a single reference number for MySaver. This we believe, would be a critical success factor for MySaver to avoid lost accounts, avoid the cost of creating another unique identifier and enable ‘pot follows member’ which, we believe, would be the pragmatic approach to workplace pension provision.

INTERNATIONAL SUMMARY

INTRODUCTION

We were very clear when we set out to examine the case for a Universal Pension for Ireland that we should consider how other countries had increased coverage for workplace pensions. Our aim was to learn from best practice and to assess whether we could adopt or adapt new ideas and approaches. We were also open to expert advice on what had not worked as expected. The following summary captures some of the key information we believe to be important for our deliberations.

After 18 months of research, Insurance Ireland has built up an extensive database of how Universal Pensions operate in different legislative environments. The attached summary is a useful starting point, but we are willing to share further detailed insights with interested parties as required.

GOVERNANCE

In 2001, the New Zealand Superannuation Fund was created for the first pillar to maximize returns on surplus assets and for future financial demands by retirees. Guardians of the fund were appointed – with some coming from outside New Zealand - to further enhance the pension governance credentials of the Fund and minimise opportunities for conflicts of interest. This approach seems to be effective: high investment returns have been maintained and common operational and investment risks have been mitigated. With Kiwisaver, governance programmes have focused on the effectiveness of administration, the Inland Revenue’s role in collection and payments and investment requirements related to default solutions. Legislation has incentivised fund managers to act in the best interests of investors by making them primarily responsible for the accuracy of their prospectus, investment statement, and advertisements; trustees are responsible for supervision of scheme managers. The Commission for Financial Literacy and Retirement Income increases financial knowledge and offers guidance to KiwiSavers through its free and independent financial information Sorted website and online tools.

In the UK, measures to enhance pension governance have tended to become more prescriptive and regulation-supported and this has added significantly to the cost of running a pension fund. The UK’s state-sponsored master trust, NEST, is run as a corporation which is the Trustee. Governance is provided by a chair and 14 other members known as Trustee Members appointed by the Secretary of State for Work and Pensions. They set the strategic direction and objectives for NEST and have legal duties which include making sure that the scheme is run in the interests of its members.

required by legislation, NEST also has an Employers’ Panel and a Members’ Panel. The UK’s focus on pension governance has been The Pension Regulator’s Code of Practice\(^5\) which has attempted to address issues of investment, administration and member communications. Other documents that have embraced elements of pension governance include the Department for Work and Pensions (DWP) guidance for auto-enrolment default funds, charge levels, investment strategy around default, the performance of individual fund components and whether such performance was consistent with the overall default.

A planned government review in 2017 of overall pension policy has already flagged a need for simplification, especially for small employers trying to comply with regulatory oversight.

Deficits in the UK’s defined benefit schemes have increased sharply with recent uncertainties in stock markets. Parliamentary Inquiries into the collapse of BHS stores and its impact on pensions have highlighted the performance of the workplace scheme, governance by trustees and the supervisory capabilities of the Pensions Regulator. The net effect has been that governance and product design of occupational schemes and legacy solutions will now be monitored more closely. Additionally, the future of steel production in the UK may be shaped by how unfunded liabilities and related benefits are treated by industry, government and regulators. Both BHS and the future of the TATA steel pension scheme raise real issues for trustees in how existing schemes operate and the potential transition to a purely DC retirement framework buttressed by soft compulsion in the form of auto-enrolment.

In Australia in 2009, the Minister for Superannuation and Corporate Law, the Hon. Nick Sherry, announced a review into the governance, efficiency, structure and operation of its superannuation system. Its chairman was Jeremy Cooper, the former deputy chairman of ASIC\(^6\). The review proposed MySuper, a low cost default investment solution. Now trustees who offer MySuper must formulate a single diversified investment strategy and seek to maximise opportunities for scale in terms of asset management and administrative costs.

The Australian Government announced in 2013 that a Council of Superannuation Custodians would ensure that changes to the system would be consistent with its Charter of Superannuation Adequacy and Sustainability. APRA\(^7\) (the regulator) now requires a strategic plan from each fund and fund returns, costs, fees and charges must be published. Australia has progressively moved away from employer-sponsored governance structures to a more defined institutional model whereby the product and individual trustees are licensed.

The United States has had a checkered history with regard to governance. The Employee Retirement Income Security Act (1974) enshrined highly detailed regulatory standards for pension fund operation but the collapse of Enron in 2001 also caused a collapse in trust. The Sarbanes-Oxley Act attempted to bolster pension governance through enhanced audit and reporting functions. But it was not until the Pension Protection Act 2006 that governance was further enhanced by the recognition of target date fund default strategies. At the same time ‘safe harbour’ protections were provided to employers who provided minimum levels of member communication and education about their pension plans.

**PRODUCT DESIGN**

- Australia was the first country to introduce radical pension reform to increase workplace coverage and supplement its old age pension. It chose to make retirement saving compulsory for both employers and employees and mitigated the impact by using an annual pay increase as the first contribution to the scheme. The UK and New

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\(^5\) The Pensions Regulator (November 2013), ‘Governance and administration of occupational defined contribution trust-based pension schemes’, Code of Practice No.13, p.6

\(^6\) Australian Securities and Investment Commission

\(^7\) Australian Prudential Regulatory Authority
Zealand chose instead the softer option of automatic enrolment (with voluntary opt-out and automatic re-enrolment) into workplace DC schemes. The USA also has auto-enrolment but it remains the choice of employers who are not mandated to provide pensions. One of the significant features of the reforms in each country has been the effort to explain the change to workers through television and newspaper advertising, workplace information campaigns and online access to information and guidance. Electronic communication with scheme members is now widely accepted as the way forward; the UK’s NEST scheme is fully electronic, for instance, and members have online accounts only.

- Minimum contribution levels into the new schemes have varied between countries but the UK, Australia and New Zealand have all had gradual increases in contribution levels (for employees and employers). Low income thresholds for eligibility have enabled part-time and seasonal workers and the self-employed to be included. New Zealand also gives employees the choice of three default rates (3%, 4% or 8%) to be deducted from earnings.

- In the UK, gradual introduction of the auto-enrolment scheme started with large employers and is ending with small businesses. Overall contributions in the UK remain relatively low compared to other international models. Net employer and employee contributions will progressively increase to eight percent over time, although some argue that this needs to be higher to develop a more sustained retirement income policy. Some critics argue that more workers need to be included under the AE system through regulatory amendments.

- New Zealand’s auto-enrolment product, KiwiSaver, is essentially a series of mastertrusts operated by 26 private providers regulated by the Financial Markets Authority. Nine form a carousel of default providers chosen at random by the Inland Revenue if a worker fails to choose a provider. The UK is one of the few places in Europe where it is mandatory for auto-enrolment schemes to provide a default investment fund and the NEST scheme uses a target retirement date approach.

- New Zealand’s KiwiSaver accounts allow individuals to withdraw funds for a first time housing deposit and American workers can take loans from their 401(k) accounts but the general rule is to allow early access only for hardship and terminal illness.

- Tax concessions have been used to encourage retirement saving but the general trend is to limit the annual contribution total that attracts tax relief.

- Downward pressure on fees and charges has been a feature of the auto-enrolment schemes, and a late consideration for the Australian scheme, where recent reforms of the system have introduced a new simple, low cost default super product called MySuper.

- The lack of a unique identifier for members of the Australian superannuation scheme resulted in thousands of lost accounts, a problem which has been rectified by using an individual’s tax file number. Tax Office runs the SuperSeeker site which tracks down lost accounts and picks up enquiries if an employer fails to pay contributions.

- Over the past 12 months, the Australian superannuation system has encountered two major changes:
  - a non-concessional lifetime contribution cap (after tax contribution) of A$500,000 or €340,000 introdced on 3 May 2016 which was aimed at ensuring a reasonable income in retirement; and;
  - a A$1.6 million transfer balance cap on the total amount of accumulated superannuation an individual can transfer into the retirement phase (across all pension accounts an individual may hold) from 1 July 2017 although earnings on these balances will not be restricted.
The Australian government is estimated to save A$2 billion over three years from these tax changes, although political support within the ruling Coalition Government appears to be declining. Budget papers suggested that a new Low Income Superannuation Tax Offset (LISTO) would be introduced to reduce tax on superannuation contributions for low income earners. LISTO will provide a non-refundable tax offset to superannuation funds based on the tax paid on concessional contributions made on behalf of low income earners, up to a cap of A$500.

The United States is debating future coverage of workplace savings solutions and related product innovations on an individual state level. State Retirement Savings Plans and the myRA initiatives at a Federal government level are attempting to broaden the coverage. The argument for promoting such products centres on the fact that many small employers – fewer than 500 life plans - hold little interest for existing financial services providers who argue that scale in administration and investments is critical. Nevertheless, Illinois, California and Washington are eager to facilitate retirement savings for smaller employers to bolster economic prosperity on an individual employee level.

The role of investment advice has been closely examined by the Department of Labor and pronouncements suggest that retirement income advice and products need primarily to meet the needs of the consumer. The Obama Administration has been seeking to address the challenges of retirement income but this has many legislative gates to go through.

**INVESTMENT**

International experience shows that heavy regulatory oversight of investment strategies can add to complexity and cost. The trend is towards reducing choice of funds and improving default investment funds – because most savers will not make a choice - and target (retirement) date funds to add a measure of individuality to the default.

NEST’s default option has 50 NEST Retirement Date Funds each named according to the date at which each member expects to retire. Individuals can change their preferred retirement date and the funds are switched free of charge. The pooled funds are provided by global fund management companies. Savers in the default option go through three phases aimed at preserving capital (foundation phase), growth and consolidation which moves the portfolio to annuity-tracking assets and cash-like investments but continues to grow the portfolio in real terms where possible.

KiwiSaver schemes offer funds ranging from conservative to higher-risk growth funds. Members have the option to invest in one or more of the funds and some schemes allow individuals to set their own investment strategy. The Government negotiates fees for default funds and these are prescribed for each scheme. The KiwiSaver Act prevents the charging of ‘unreasonable’ fees and the Financial Markets Authority is responsible for determining what constitutes ‘unreasonable fees’ and the ongoing monitoring of fees.

Australian Super funds offering a lifecycle product have two approaches: member switching (favoured by industry funds) which shifts members from growth to conservative funds as they get older and cohort funds (favoured by retail funds) managed in line with what is deemed appropriate for members of similar age: these can be target date funds but are increasingly ‘birth date’ funds.

In the US, target date funds have been the most prominent trend. The demand for large numbers of investment options and self-managed account/brokerage windows has declined in the last five years.

NEST produces key documents to explain its investment arrangements and it has a rolling programme of communications research to assist with member communication. In New Zealand providers are required to offer investor education to members and before signing up they receive an investment statement that includes fees. Trustees of regulated
Australian superannuation funds with at least five members must publish a standardised product dashboard for each MySuper product, and each lifecycle product that is a MySuper product to allow consumers to compare products.

Enhanced disclosure standards have been introduced in the US to highlight fees and charges in investments but there is continuing debate about disclosure overload from the documentation issued by DC plans. Safe-harbouring for plan sponsors has been a regulatory benefit of the Pension Protection Act 2006 (PPA), in connection with investments. Employers who endeavour to comply with the PPA in connection with investment design and fee disclosure are provided with some legal relief. This has helped in allowing employers to be ‘paternally’ connected with the sponsorship of DC plans.

**RETIREMENT INCOME**

There is a common view, held by international experts, that retirement income has not received the depth of review necessary to turn growth of retirement savings into healthy post-work income. This is being remedied in a number of ways but the overall lesson is that failing to integrate decumulation design at the outset significantly dilutes the benefits of a Universal Pension model.

The UK has given retirees free access to their pension savings from age 55 and they have taken the opportunity to cash in small pots, seek drawdown arrangements and move away from annuities. One of the results has been an increase in the risks associated with inexperienced individuals making decisions in a highly complex area, often without advice. In contrast, Chilean financial advisers play an integral role in the at-retirement choice and are mandated to meet retirees to discuss retirement options.

Australia has vast pension assets accumulated over nearly 20 years of compulsory superannuation, but at least 94 per cent of them are in account-based pensions which lack risk management features and may not deliver high levels of income. Australia has no significant market for products with longevity risk protection. The government agreed in 2015 to develop legislation to allow trustees of funds to provide preselected retirement income products, increase consumer choice and provide better protection against longevity and other risks. It also promised to continue work to remove impediments to product development and has announced that it will remove tax barriers to the development of new retirement income products from 1 July 2017. This will be achieved by extending the tax exemption on earnings in the retirement phase to products such as deferred lifetime annuities and group self-annuitisation products which do not currently qualify for exemption. The Government will also clarify how the new retirement income products will be treated under the Age Pension means test ahead of 1 July 2017.

The development of new products could provide more flexibility and choice for Australian retirees, and help them to boost living standards and better manage consumption and risk in retirement. TOR anticipates innovation and new product designs coming to market in 2017 as the sale of annuities and retirement income products continues to grow.

The New Zealand annuity market has collapsed because retirees can depend on a relatively high state pension and the government has not incentivised annuitisation. Retirees are expected to self-manage pension savings and baby boomers are increasingly using buy-to-let property to generate income but this is creating intergenerational tension around property prices; younger workers are increasingly borrowing from their KiwiSaver pension pots to buy homes. Small product initiatives in this area, though positive, has not made much difference to the use of rental property as a ‘proxy’ for generating retirement income and capital growth. A ‘contained’ review of the New Zealand Retirement System is being conducted by the Commissioner for Financial Capability this year but the Minister for Finance, Bill English, suggested in 2015 that the country does not have an ageing population even though some academics disagree. Issues such as replacement rates,
ageing and contributions will come into focus in the years ahead and a national Re-
Enrolment Day to get employees back into KiwiSaver may need to be initiated.

Self-managed investment solutions are also the norm in the USA. Individual Retirement
Accounts (IRAs) and Target Income Funds are providing fixed incomes and one-off
withdrawals but many Americans in their twentieth year of retirement are running out of
funds. Regulators\(^8\) have created a Qualified Default Investment Alternative (QDIA) which
specifies target date or diversified funds as an investment default and have incentivised
plan sponsors to use it.

South Africa is unusual though in using annuities as a default mechanism: when savers do
not make an active decision about how to take their retirement pot they are automatically
placed into a traditional annuity solution.

**ADMINISTRATION**

Re-using and recycling existing infrastructure has been a feature of the ‘universal’
systems introduced in Australia, the UK and New Zealand. The New Zealand
government’s approach to KiwiSaver contribution collection was to use the Inland
Revenue Department’s tax collection arrangements to build a hub for registered Kiwisaver
providers to receive contributions from employees and employers. In addition, the hub
provides a large number of forms, guidance and KiwiSaver member information.

The response of the Australian financial services industry to lost accounts was to generate
common protocols on transferability but the Federal Government passed legislation
to force aggregation of accounts through data matching. Super funds are now obliged
to send them to the Australian Tax Office. The AUSfund holds unclaimed super funds
and there are online services such as ‘Find My Super’ to assist in the consolidation of
Super accounts. Australia’s DC administration framework has become more simplified
as corporate entities outsource their mandated superannuation solutions to third party
mastertrust providers who have proprietary software.

The introduction of auto enrolment in the UK generated a high degree of administrative
complexity and a non-departmental public body, the National Employment Savings Trust
(NEST). The cost of NEST has been considerable and the UK’s National Audit Office (NAO)
- reported that at 31 March 2015 NEST owed the Department of Work and Pensions the
near equivalent of €487.6million. For the 12 months ending 31 March 2015, it had an
income of €23.3million and had incurred expenditure of €123.5million. Otherwise, the
UK’s DC pension administration is shared among life insurance companies, in-house
employer solutions, specialist administration service providers and mastertrust providers.
Some administration systems are derivations of old defined benefit systems upgraded
for the demands of new regulations and legislation. Practical challenges remain in terms
of lost accounts and tracking and tracing accounts. Solutions offered have been ‘pot
follows member’ and an aggregation approach advocated principally by the Centre for
Policy Studies. As there is no hub, tracking and tracing can be lengthy and cumbersome
although common IT protocols and processes have gone some way to help.

Record keeping and administration offered by some US 401(k) providers have suffered
from inadequate economies of scale. As employers and employees seek bespoke
offerings from their plan providers, so administrative complexity and costs grow. Lost
accounts and tracking and tracing services have not been aided by the current approach
of using social security numbers and zip codes. Broadly speaking DC administrative
solutions have been developed in-house and are proprietary to individual financial service
firms. Many providers had accepted that they need a good record keeping business in
order to win new schemes and retain existing plan assets but this was disrupted in 2014
when J.P. Morgan Asset Management sold its 401(k) record keeping business to Great-
West Life Co. Inc. because recordkeeping for workers’ retirement accounts had become
unprofitable.

\(^8\) The Department of Labor’s (DOL) regulation regarding Qualified Default Investment Alternatives (QDIAs), effective December 24, 2007
A UNIVERSAL PENSION
FOR IRELAND:
GOVERNANCE /
PRODUCT DESIGN

AN INSURANCE IRELAND WORKING PAPER
INTRODUCTION

In response to the OECD’s Review of the Irish Pension System (published on 22nd April, 2013) Insurance Ireland’s report, A Universal Pension for Ireland (published 30th September 2014), emphasised the need for action on Ireland’s looming pension crisis. In particular we underlined both the importance of individual citizen ownership of pension accounts and the dangers of a state-only solution.

In late 2013 and throughout 2014 Insurance Ireland hosted discussions between policy-makers, employers, trades unions, public servants and economists with a view to facilitating an informed consensus about the best way to introduce a universal pension into Ireland. In early 2015 the Government established the Universal Retirement Savings Group (URSG) to consider its future policy on universal pensions. During 2015 we are continuing to provide a platform that allows stakeholders and experts to engage with each other by facilitating a series of workshops and the development of associated working papers that will both inform our engagement with the URSG and lead, later this year, to concrete proposals for a private-sector managed universal pension system for Ireland.

Today’s workshop concerning governance is the first of a series. Future workshops during 2015, will focus on the Design, Investment Strategy and Decumulation aspects of a universal pension system.

GOVERNANCE / PRODUCT DESIGN

PURPOSE OF PAPER

This paper is one of a series intended to provide policymakers with an expert perspective on pensions as they begin to develop a new pension system for Ireland. It will focus specifically on the design and operational elements of an auto-enrolled Universal Pension (here referred to as MySaver) aimed at low-to-medium income workers. Ireland already has a well-established DC infrastructure and industry players have exceptional experience in the design and delivery of private and company pensions for the Irish workforce; it is this expertise which informs this paper.

Governance of defined contribution pensions is of particular interest, we believe, because soft coercion (in the form of auto-enrolment) increases the Government’s responsibility to protect savers – many of whom are unlikely to actively participate in investment decisions - and avoid misselling criticism in the future. A good governance structure should also provide credibility and acceptance for the scheme.

DEFINITION OF GOVERNANCE

Governance is essentially about trust. This does not mean that a scheme must have a formal trustee structure but it does mean that defined contribution, however delivered, must be trustworthy. For this reason we argue that ‘governance’ is about what builds and maintains trust.

Applying the question of ‘trust’ enables us to challenge design and operational proposals that may not meet the need to build and maintain trust.

When it comes to building and maintaining trust among stakeholders (members, employers and the regulator), we have to consider:

- What improvement and alignment of existing Governance structures will build and maintain trust in MySaver?
- What new initiatives will build and maintain trust in MySaver?

The OECD seems to be in broad agreement with this approach:

The governance of private pension plans and funds involves the managerial control of the organizations and how they are regulated, including the accountability of management and how they are supervised. The basic goal of pension fund governance regulation is to minimize the potential agency problems, or conflicts of interest, that can arise between the
fund members and those responsible for the fund’s management, and which can adversely affect the security of pension savings and promises. Good governance goes beyond this basic goal and aims at delivering high pension fund performance while keeping costs low for all stakeholders. Good governance can have many positive side effects such as creating trust amongst all stakeholders, reducing the need for prescriptive regulation, and facilitating supervision. Good pension fund governance can also be conducive to more effective corporate governance of the companies that they invest in, as well-managed pension funds are more likely to seek value for their investments via a more active stakeholder policy. Good governance also needs to be ‘risk-based’. For example, the more sophisticated the investment strategy the pension fund adopts, the stricter the governance oversight required; or the more complex the administrative arrangements of the plan, the tighter operational oversight needs to be.\(^9\)

It will be essential to gain public trust in MySaver. The level of subsequent retirement incomes will be critical to this. Some comfort will need to be engendered in terms of expectations and their fulfilment. As Professor Gordon L. Clark and Roger Urwin note “increasing attention is being paid to the performance of institutional funds; whether public or private, large or small, well-governed or not, these institutions have come to play crucial roles in underwriting the welfare of many citizens of developed and developing countries.”\(^10\)

It should be noted that good pension governance cannot be developed in isolation but should evolve through consultation between government and key stakeholder groups. The definition of good pension governance needs to have both legal and regulatory backing. It is worth noting that defined benefit (DB) schemes have a well-established position and function for governance and trustees but with defined contribution plans these roles and functions are still evolving.

GOOD GOVERNANCE

A number of Codes have been adopted to achieve good governance. The first question for Government is: what, in terms of trust, must be built into a system through legislation? Thereafter, the deliberation should be whether a Code of Conduct should be mandatory or voluntary and the means for its supervision and enforcement. Insurance Ireland’s view is that governance requirements should be set by Government in such a way that innovation is not stifled and compliance costs do not adversely affect the purpose of MySaver which is to provide reasonable return on investment and adequate sustainable retirement income. When considering the governance structure for MySaver we think it will be cost effective to maintain existing occupational/trust-based arrangements.

If the aim of governance is to build and maintain trust then we must look at what this means for the following constituencies:

INVESTORS/MEMBERS

We should not lose sight of the Member perspective when designing governance for MySaver. Members will want to be able to check their savings and make sure that they are being protected. Investment needs to be at arms-length and based solely on ensuring the best returns. It will be important to be seen to be fair: MySaver will be a ‘universal’ pension and governance also has to be seen to be ‘universal’ and consistent across provision.

How the interests of MySaver investors could be protected by governance:

- A recognised protector or protectors, for example, in the form of a trustee committee or a Governance Panel
- Representation on the Governance Panel (to include training)
- Regular and tailored communications (where decisions by individuals are required) aimed at informing and educating
- Independent and expert oversight of governance decision making
- Applied and appropriate sanctions for non-compliance and unlawful activity
- Investment best practice applied to well-designed default strategies
- Problem-free collection, investment and payment plus the ability to get problems solved quickly


Adequate and smart risk-management.

Good stewardship: investment for long-term not short-term gains and consideration of international best practice to help shape options for MySaver investors.

EMPLOYERS

In a similar way, we should consider the perspective of employers when designing governance for MySaver. For most employers, this will simply be a matter of compliance. They will be required to offer the scheme to their workforces, set up internal processes for information and payroll changes and pay towards the scheme. Our experience with employers is that whilst they will comply with the rules laid down, they do not want the additional burden of a role in the governance process; we suggest that any governance structure should also provide some protection for employers as sponsors of MySaver. This protection could allow for:

- Open and transparent processes which can be challenged at any time
- Representation on the Governance Panel if required
- Identification of and solution for conflicts of interest
- Problem-free collection, investment and payment plus the ability to get problems solved quickly
- Fit and proper persons running governance (prudent person test)
- Clear definition of roles and responsibilities
- A ‘go-to’ person/organisation to report problems with governance
- Adequate and smart risk-management
- Operational efficiencies (such as electronic transfer, straight through processing using ISO standards and portal/applications technologies) which will improve all-round experience of MySaver and provide cost efficiencies for what must be a cost effective scheme.

PRODUCT PROVIDERS OR TRUSTEES

- Ensure contributions are received
- Design appropriate investment strategies
- Invest funds
- Make arrangements for paying benefits
- Ensure that records are kept
- Ensure that a registered administrator is appointed

REGULATORS

- How the Regulator can protect the interests of MySaver members:
  - Legal backing for supervision and enforcement
  - Making resources available for supervision, enforcement and reform as necessary
  - Development and dissemination of best practice solutions centred on: risk-management, investment, minimalisation of conflicts of interest, suitable quality of administration and communication
  - Provide a ‘go-to’ facility for employers, trustees and providers to deal with problems
  - Training for key people concerned with governance
  - Communications to providers and employers that inform and educate
SUMMARY

1. The current governance for existing DC schemes is working well and should be maintained. Any new model should apply to MySaver only. From a practical perspective, consideration should be given to how the existing legislative framework might be re-used and recycled before developing any new legislative model.

2. MySaver gives us the opportunity to learn from both trustee and provider models of governance. We note from the New Zealand experience that collection, payments and investment are the key areas for applying good, pragmatic governance.

3. Governance could be undertaken by providers. We should not get locked into the mind-set that a trust-based scheme is the only option to achieve good governance. A ‘three lines of defence model’, for instance, would see the product provider as the first line of ‘defence’ followed by the Regulator and finally oversight via independent experts. Consideration must be given to the right balance between regulation of providers and the trustee role. Failure to get this balance right will involve more complexity and ultimately higher costs to members. Appropriately regulated schemes should highlight good governance for the benefit of consumers. The governance model for PRSAs has focused on key issues such as investment options, regular member communications and clarity on charges. This model has success fully protected employers and employees/consumers. Such lessons should not be ignored when it comes to MySaver.

4. We suggest that governance is a key mechanism for building trust in MySaver and because of the experience of the National Pension Reserve Fund and the Pensions Levy, the Government should resist acting as investor for MySaver contributions. Investment should be at arms-length and in line with international best practice.

5. It is important that all stakeholders work together to develop a sustainable and effective governance framework. Developing simple and efficient solutions should be the aim.

6. We see in the PRSA regulatory framework potential elements that could be used as a basis for future governance structures related to MySaver.

7. MySaver should be widely accessible and should integrate with the simplification agenda so as to align regulatory rules and legislative oversight.

SPECIFICS TO CONSIDER:

1. Are Governance Panels necessary and how should they be organised?
2. Who provides training for governance representatives/trustees - should it be the Pensions Authority?
3. What specific communication and education should be provided in the remit of governance?
4. Who should provide independent and expert oversight of Governance Panels? The Regulator?
5. What would mandated/voluntary risk-management include?
6. What would a Code of Conduct look like?
7. What must be covered by legislation?

INTERNATIONAL EXPERIENCES

NEW ZEALAND

Two areas of pension scheme governance are worth highlighting:

In 2001 the New Zealand Superannuation and Retirement Income Act 2001 created the New Zealand Superannuation Fund – first pillar to maximise returns on surplus assets and then for future financial demands by retirees. Guardians of the fund were appointed to ensure that good governance and management was maintained at all times. Some of these Guardians came from outside New Zealand to further enhance the pension governance credentials of the Fund and minimise opportunities for conflicts of interest. This approach seems to be effective: high investment returns have been maintained and common operational and investment risks have been mitigated.
In terms of Kiwisaver, which was established in 2007, the New Zealand government attempted to ‘recycle and reuse’ existing securities, superannuation and managed fund legislation. Most Kiwisaver superannuation schemes are run in an identical manner to managed funds products.

Regulation of schemes is split between several agencies including:

- The Registrar of Companies which registers scheme prospectuses
- The Government Actuary / Financial Markets Authority which registers schemes and has a prudential role in overseeing the financial management of schemes and
- The Securities Commission which supervises market conduct.

There are six KiwiSaver funds and members are randomly allocated to a fund if they do not select one. The default funds are required to have one of the trustee corporations as a trustee, while non-default KiwiSaver schemes are required to have an ‘independent’ trustee.

Most governance programmes have focused on the effectiveness of administrative quality linked with the Inland Revenue and related default structures. As such, many of the governance responsibilities of KiwiSaver products are tied to government agency performance (collection and payments) and investment requirements related to default solutions. The New Zealand Government is required to maintain high standards of administration quality through the collection and payment of contributions. While no charge caps are in place, fee disclosure by the Financial Markets Authority occurs with KiwiSaver. Fees and charges need to be ‘reasonable’ with regard to these products.

In addition, the KiwiSaver Amendment Act 2011 made changes which:

- incentivised fund managers to act in the best interests of investors by making them primarily responsible for the accuracy of their prospectus, investment statement, and advertisements; and
- required trustees to be responsible for supervision of scheme managers and for making sure that they complied with trust deeds and other responsibilities.

UNITED KINGDOM

As a result of auto-enrolment the number of people in DC arrangements is projected to increase from just over 4 million in 2012 to almost 14 million by the 2020s. Enhancement of governance has made specific reference to investment and default structures. Since automatic enrolment (AE) – mainly into DC pension schemes – was first introduced in 2012 there has been an increasing focus on the investment governance of DC pension schemes, and in particular default funds that the majority of DC savers will be invested in.

The Department of Work and Pensions and the Pensions Regulator (TPR) are central to regulation and pension governance. The UK’s state-sponsored master trust, the National Employment Savings Trust – NEST – is run as a corporation which, in turn, has a separate Trustee Board arrangement. Governance is provided by a chair and 14 other members known as Trustee Members appointed by the Secretary of State for Work and Pensions. The Chair and Trustee Members set the strategic direction and objectives for NEST and have legal duties which include making sure that the scheme is run in the interests of its members. As required by legislation NEST also has an Employers’ Panel and a Members’ Panel. Both are consulted when decisions are being made in specific areas such as changing NEST rules.

For individual pension accounts or contract-based arrangements like Stakeholder and Personal Pensions, an institution manages the account and is seen as the governing body of the fund. The Financial Conduct Authority, HM Treasury and TPR partly regulate these products and dictate pension governance procedures. Note that divergence in approaches to pension governance can occur if pension products are regulated in a different format. This was highlighted by the OECD when they identified that the central figure in pension fund governance is the governing body that is the person, group of persons, or legal entity responsible for the management and safeguarding of the pension fund. Where the pension fund is established as a pension entity, such entity’s governing body will normally also be responsible for the management of the fund. Where the fund consists of a separate account, the financial institution that manages the account is the governing body of the fund.

The UK’s focus on pension governance has been the Pensions Regulator’s (TPR) Code of Practice no. 13 Governance and administration of occupational defined contribution trust-based pension schemes which has attempted to address issues of investment, administration and member communications. The document itself blends DC quality features and requirements. It has shaped other regulatory approaches embraced by regulators and professional standards and guidelines espoused by professions such as accountants and actuaries. This DC code is underpinned by a number of defined contribution (DC) quality features that describe those activities, behaviours and
control processes that are more likely to deliver good member outcomes. The DC quality features are set in the context of their legal requirements and represent the standards we expect trustees to attain. They will help trustees to demonstrate they are complying with legal requirements.14

Another element of pension guidance in the UK is focused on the ‘Stewardship Code’ issued by the Financial Reporting Council (FRC) in July 2010. The code was designed as the FRC suggested to “…enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders”. Other documents that have embraced elements of pension governance include the Department for Work and Pensions (DWP) Guidance for auto-enrolment default funds which considered the on-going suitability of the default option, charge levels, investment strategy around default, the performance of individual fund components and whether such performance was consistent with the overall default. The DWP’s intention is also to legislate around the trustees’ responsibilities to ensure that the default strategy remains appropriate for the members of the scheme and that the underlying performance of the investment funds meets the aim of the strategy.

The Financial Conduct Authority (FCA) which regulates contract-based products is seeking, through governance, ways to develop high quality schemes that offer value for money. New governance standards, a charge cap on default funds, the banning of certain charging practices and enhanced disclosure are being advocated by the FCA.

Measures to enhance pension governance have tended to become more prescriptive and regulation-supported and this has added significantly to the cost of running a pension fund.

AUSTRALIA

Australia’s superannuation (pension) governance approach is based on English trustee law. Prudent person and fit and proper person tests provide the necessary ‘underpins’ for the Superannuation Industry (Supervision) Act 1993 when it addresses appropriate investment approaches and the background and conduct of trustees. In recent years the Cooper Review highlighted the need to have more developed or enhanced default strategies that best served the financial needs of members.

While employer and employee nominated members have formed the bulk of Australia’s trustees serving on superannuation boards, the recent Federal Government Financial Services Inquiry argued that: “Government should amend the Superannuation Industry (Supervision) Act 1993 to mandate that public offer APRA-regulated superannuation funds have a majority of independent directors on their trustee boards. The chair should also be independent. An arm’s length definition of independence should apply.”15

It was argued that Australia was lagging behind the rest of the world in having pension fund governance that stressed international best practice and independent directors. This point is salient for Ireland in terms of the number of trustees who are currently equipped to deliver such governance oversight. We see also in Australia a progressive move away from employer-sponsored governance structures to a more defined institutional model whereby the product and individual trustees are licensed. This is a reflection of the diminishing elements of paternalism by the employer for providing pensions to their workers through a ‘hard’ compulsory system.

UNITED STATES

The United States has had a checkered history with regard to pension scheme governance. The Employee Retirement Income Security Act (1974) enshrined highly detailed regulatory standards for pension fund operation but the collapse of Enron in 2001 also caused a collapse in trust: employees who had invested heavily in inflated company stock were exposed to the risk of losing their jobs and their retirement savings. The Sabannes Oxley Act that resulted from the collapse attempted to bolster pension governance through enhanced audit and reporting functions. But it wasn’t until the Pension Protection Act 2006 that governance was further enhanced by the recognition of target date fund default strategies. At the same time ‘safe harbour’ protections were provided to employers who provided minimum levels of member communication and education about their pension plans.

The growth in 401(k) plans and default strategies since the Global Financial Crisis (GFC) suggests that active investment selection may not be the answer for most members. The demand for large numbers of investment options and self-managed account/brokerage windows has declined in the last five years. There is now an active behavioural economics approach in the US that accepts that individuals are unlikely to make good investment decisions (even with education) and that default strategies are the best option: after auto-enrolment and auto-escalation we have auto-investment. In other words the fund manager tends to have more control.

14 The Pensions Regulator (November 2013), ‘Governance and administration of occupational defined contribution trust-based pension schemes’, Code of Practice No.13, p.6
PRODUCT DESIGN: UNIVERSAL PENSION FOR IRELAND
1. This paper presents some of the questions and possible answers to the design of a universal pension for Ireland (working title: MySaver). Our working assumption is that it will be an auto-enrolled, workplace solution with contributions from employees and employers. The aim of the paper is to prompt discussion about:

- a design fit to fulfil Ireland’s future pension needs and relevant in terms of economic realities and the nation’s employment profile; and
- pension simplification to assist reform

2. We start by outlining the outcomes required of a universal pension and then explain how these can be achieved through design. These suggestions reflect our experience of similar universal pensions introduced in the UK, Australia and New Zealand. One major feature should be to reduce complexity in the system and design a universal pension that is simple to deliver and simple to understand.

3. It is important to note that the Universal Retirement Savings Group’s (URSG) objectives and international experiences correctly focus on workplace savings solutions rather than retail-based products. This observation is important to note in respect of product design elements such as charges, governance and investment aspects.

4. While a mandatory system like Australia has not been ruled out by the Irish government or the URSG, we anticipate that an auto-enrolled solution, as seen in New Zealand or the United Kingdom will be the most likely politically in order to achieve political and economic consensus. The design outlined here can, however, be made applicable to a mandatory regime if required in the future.

**STRATEGIC OBJECTIVES**

5. Outcomes required of a Universal Pension for Ireland:

   a. Simplicity: the adoption of auto-enrolment and a universal pension offers the opportunity to reduce complexity in our workplace pensions system and deliver a defined contribution offering that is simple to deliver and simple to understand for members, employers and administrators. Simple rules around eligibility and account identification are essential for successful implementation.

   b. It should significantly increase pension coverage in the Irish workforce to 90% within seven years.

   c. It should achieve pension adequacy based on the assumption that average life expectancy in Ireland will continue to increase.

   d. Cost effectiveness: charges and returns have to deliver pension adequacy so a realistic approach has to be made to designing MySaver as a large scale offering to leverage efficiencies.

   e. Auto-enrolment should encourage open competition among existing and new providers.

   f. Preserve existing DB and DC arrangements: it makes no sense to damage existing infrastructure if it provides benefits at least as good as MySaver.

   g. Public confidence will be critical for capturing and retaining members and it should be a shared responsibility between all major stakeholders.

   h. There should be encouragement for voluntary ‘top ups’: employees should be so convinced of the economic sense of pension saving that they are willing to boost contributions (as they do in Australia) and there should be no disincentives to that outcome.

One option for policymakers may be to use the existing template of Personal Retirement Savings Accounts (PRSA’s). This design could be developed (with minor changes) to simplify implementation, keep costs down and shorten the time to launch. An Independent governance committee overseeing providers and tax harmonisation would assist with PRSA suitability.
DESIGN FEATURES

6. Membership of MySaver

To preserve existing arrangements MySaver should be aimed at those who have no current pension coverage but also made available on a voluntary basis to those who switch employer. Individuals would have to opt out within 3 months of being auto-enrolled. Experience in the UK and New Zealand suggests that the compliance costs associated with opt-out have been unnecessarily high due to complexity. Senior economists in both countries suggest that a fixed annual or tri-annual opt-out re-enrolment process would have been more ideal in hindsight.

A key lesson from the UK experience is to keep the eligibility rules as simple as possible. We suggest that the income eligibility band should be linked to the standard income tax band as:

- those who are not paying income tax are unlikely to be earning enough to contribute to a pension (to make the ultimate pot worthwhile or ensure that they have adequate income to cover basic outgoings) – this would exclude part-time/casual workers
- linking it to the standard tax rate would ensure that it remains flexible and pinned to affordability over time and would, by default, automatically enrol workers as they reach a certain wage level
- the PPSN should provide a single reference number for MySaver which is essential to streamline administration and avoid lost accounts
- it would accommodate the self-employed

Consideration should also be given to templates currently used by existing payroll software providers to ensure eligibility rules can be easily administered.

The minimum age should be set at 22 to give new employees the chance to build voluntary savings for property ownership, training etc. We think that, in any case, they are unlikely to be employed at wage levels that will make contributions affordable or necessary (in terms of pension adequacy).

A decision has to be made at the inception of MySaver of a maximum age point for auto-enrolment. We suggest this should be 55 to ensure that an ultimate pension pot will have sufficient value to make contributions worthwhile.

If 90% of coverage of the Irish workforce cannot be achieved within seven years of the introduction of a universal pension model then mandation should be re-considered. We also suggest that workers who opt out of membership should be re-enrolled every 3 years on a specific date (we suggest at the beginning of the tax year) to coincide with an information campaign about the benefits of retirement saving. This approach was flagged as being back on the political agenda by New Zealand by Finance Minister, Bill English on May 29th 2015, with the announcement of the scrapping of the NZ$1000 kickstart government subsidy for Kiwisaver accounts. ^16

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UK APPROACH

Employers must enrol eligible workers between 22 and state pension age and contributions are payable on ‘qualifying earnings’ which include: salary, wages, commission, bonuses, overtime, statutory sick pay, statutory maternity, paternity and adoption pay.

The threshold for qualifying earnings is reviewed annually: in 2015/16 it is £10,000 (the threshold for paying income tax).

Re-enrolment of ‘opt-outs’ happen every three years and opt-outs are accepted back into the scheme once in every 12 months.

In terms of hardship provisions, funds can be returned back to the individual prematurely if terminal illness can be proven for the trustees. No consideration was given towards partial withdrawals being used for housing deposits.

AUSTRALIAN APPROACH

Workers earning AUS$450 gross per month and above are required to pay 9.5% into an individual superannuation retirement account. This low threshold means many temporary workers such as university students and temporary foreign entrants are ‘conscripted’ into the superannuation system. It also caused the initial proliferation of multiple accounts for every worker that has exaggerated the number of lost accounts and assets.

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^16http://www.radionz.co.nz/news/political/274900/govt-considers-‘mass-auto-enrolment’
NEW ZEALAND APPROACH

Employers must enrol workers over 18 and under 64 within the income band. Workers can opt out within 2 to 8 weeks of enrolment via an online request to their employer or the Inland Revenue.

A ‘sweetener’ of NZ$1000 to workers enrolling in KiwiSaver for the first time has been abandoned by the New Zealand Government. Opposition politicians argue that a re-enrolment day is the likely outcome from removing this government subsidy. Proposed tax relief for employer contributions was abandoned.

Depending on how long the Kiwisaver account is held, an individual can withdraw funds for a first time housing deposit. Considerations for withdrawal of Kiwisaver balances include terminal illness and departing permanently from New Zealand.

7. Contributions to MySaver

The aim should be to achieve 50% of income replacement at the state pension age from the state pension and MySaver.

We suggest that contributions to MySaver should ultimately get to 10% of gross salary but this should be achieved by steady increases:

- Employees to contribute 1% of gross annual salary and increase this by 1% each year until 5% is reached.
- Employers to start at 1% and increase every year until 5% is reached. With tax relief at the marginal rate this effectively makes the employee contribution 4% net.

The rate of employee contributions should be gradual and small in order to satisfy concerns about affordability but also build confidence as the pension pot increases. It will be important to ensure that members can see their savings growing year by year.

The relatively quick increase to 10% in five years would have this advantage and encourage voluntary ‘top ups’. Contributors should be encouraged to make additional contributions, and these should receive full tax relief up to the limits already in place for PRSAs and Personal Pensions.

Implementation of MySaver should also be phased to take account of the impact on Ireland’s many small and medium-sized employers (SMEs). The Government may want to consider a longer phasing in period for employers of fewer than 20 employees. Consideration will need to be given to state incentives for SMEs to ensure affordability and compliance: failure to make MySaver available to all eligible employees could attract a financial penalty for instance.

Consideration should be given to early access of a portion of the pot (e.g., 5% over 10 years) as a means of promoting MySaver. We suggest contribution holidays for hardship could be offered to members up to a limit of 2 years but the ‘hardship’ criteria would have to be clearly defined. Early access to the entire pot should be allowed in the event of terminal illness and early access to a percentage of the pot in the event of life-shortening illness and non-EU emigration. Any allowance for early access should be available on existing forms of pension provision and treatment of the fund on death should be consistent with current rules for all personal pension structures (AVCs, PPPs, PRSAs). Provision should be made for the full value of a MySaver account to be paid to an individual's estate on death.

UK APPROACH

A minimum percentage of ‘qualifying earnings’ must be paid into a workplace pension: 0.8% rising to 4% by the employee, 1% rising to 3% by the employer and 0.2% rising to 1% by the state. Workers can pay less than the legal minimum if their employer makes up the shortfall.

AUSTRALIAN APPROACH

Contributions to Australia’s mandated superannuation accounts are known as employer contributions. They have risen steadily each year from 3% in 1992/93 to 9.25% in 2014/15. The aim is to reach 12%. Extra can be contributed via salary sacrifice, spouse contribution or voluntary savings. The self-employed get a tax deduction for Super contributions but any above AU$25000

17 Experience in Chile and Australia suggests this level broadly meets the expectations of replacement rate in retirement
can incur extra tax. Tax savings are allowed for people over 55 setting up a transition-to-retirement account, for voluntary contributions and for self-managed superannuation funds. A high level of compliance is achieved because employer contributions are tax deductible.

There are caps on the amount a worker can contribute each financial year that are taxed at lower rates, if workers contribute more than these caps they may have to pay more tax.

There are minimum and maximum withdrawals from the fund when preservation age (retirement age when superannuation can be accessed) is reached, the worker retires or turns 65. Early access is possible for specific medical conditions and severe financial hardship.

NEW ZEALAND APPROACH

KiwiSaver introduced in 2007 and other qualifying workplace schemes use auto-enrolment but in a different way to that seen in the UK. Employee contributions are deducted from pay at a default rate of 3%, 4% or 8% as the individual chooses. Employers contribute 3% of an employee’s gross salary or wage into a complying fund. A contribution is not required if an employee has an existing qualifying superannuation account of at least 5 years standing or if they are under 18 or over 65.

Access to a retirement fund is restricted to age 65 when all savings can be withdrawn as a lump sum. Withdrawals are tax free. Early access may be allowed for first home purchase, emigration, financial hardship and serious illness.

8. Defaults by Design

A low-cost universal pension for low to medium earners suggests that few, if any, features will be bespoke. The aim should be for simplicity of design and regulation to minimise costs and charges. This objective has been adopted by other nations when introducing mandation and auto-enrolment and has led to increased automation of administration and greater use of defaults. Again, pension simplification needs to be considered so that all retirement savings solutions are suitable for consumers.

Automatic enrolment is the default joining mechanism. We suggest that there is also the opportunity to establish a default communications approach using technology to deliver standardised information and guidance that reduces the personal decision-making burden on MySaver members. We know that decisions around investment choices are not being made by members: the experience of DC providers in the US, UK, Australia and New Zealand is that even when given choice of funds, more than 80% of members will rely on a default investment fund chosen by their sponsor/employer or the scheme’s trustees. The MySaver approach to default investment structures will be discussed in a future paper on investment.

UK APPROACH

The UK is one of the few places in Europe where it is mandatory for auto-enrolment schemes to provide a default investment fund. The NEST default uses a target retirement date approach.

NEST is fully electronic. It does not provide paper statements: members have online accounts.

AUSTRALIAN APPROACH

Recent reforms of the system have introduced a new simple, low cost default super product called MySuper delivered though administration called SuperStream.

NEW ZEALAND APPROACH

KiwiSaver is essentially a series of master trusts operated by 26 private providers (2014) regulated by the Financial Markets Authority. Nine form a carousel of default providers chosen at random by the IR if a worker fails to choose a provider. Default investment is largely around lifestyleing, cash and domestic equities.
9. Retirement options

The most important decision made by retirement savers – after joining a scheme – is what to do at retirement: should a pension pot be converted to an annuity, drawn down over time or cashed in and re-invested elsewhere?

We know there is evidence of a reluctance to buy annuities and governments have devised rules to require them to be bought in certain circumstances to avoid ultimate reliance on a state pension. The UK has recently torn up the rule book on annuities and given savers over 55 free choice of what to do with their savings. As expected, the Exchequer has benefitted from increased taxes as savers have cashed in their pensions. The Chancellor of the Exchequer announced this month (June 2015) that 60,000 pension pots had been accessed since April 2015 and £1bn of savings had been removed.

In Ireland, a flexible range of retirement options is already available on existing pension provision. These options strike a good balance between flexibility, protection for the individual and access. We suggest that the existing regime is fit for purpose and can be easily applied to MySaver, although the current regime can be simplified (see 13). Individuals have different needs and plans at retirement and it is important the state encourages retirees to seek financial advice when making these decisions. We will refer to this topic in a later paper.

AUSTRALIAN APPROACH

There is a small but growing annuity market after recognition by the federal governments that retirement income policies should be developed. Depending on the size of the pot, Australian workers tend to cash in and use the savings for immediate domestic purposes and cash deposits. Allocated pensions using mutual fund products provide an income stream within certain withdrawal limits and related earnings for tax purposes. A growing segment of the market focuses on traditional and innovative annuities.

NEW ZEALAND APPROACH

No annuity products are sold due to unfavourable taxation and an ambiguity in government policy for such products. Traditional allocated pension products are available but an increasing number of retirees are using buy-to-let property as a mechanism for retirement income. New Zealand does not have an effective retirement income framework that is coherent with KiwiSaver.

10. Administration Features

Any reform model should stress the need for automation in terms of collections and payments. Ideally, employers should remunerate funds electronically and payments and employee enquiries should be dealt with purely online. This will require industry and Government to develop alignment in how an automated system similar to that of the UK’s NEST can be achieved. Switching of investments, for example, will also have to be done online and potentially restricted in terms of the number of switches available in any one calendar year. The critical consideration will be to achieve cost containment for a high volume, low margin solution delivered without advice.

The following recommendations are based on international experience:

a. Contribution collection through employer payroll systems into a central hub is the simplest means of collection.

b. A single tax number such as the PPSN number should be used to identify individuals in MySaver to avoid the problem of lost accounts.

c. Software interfaces, provided by payroll providers, for collection into a centralised hub managed by providers will be the most cost effective and efficient means of ensuring distribution of contributions to the right investment funds. This hub could provide for a centralised administration system to manage not just payments, but lost accounts and transfers through use of the PPSN. New Zealand agonised about the use of a hub administered by their tax office but the cost of this has proved to be ill defined and not transparent. We argue that insurance industry associations are best placed to unify IT, payroll and administrative standards so as to recycle and re-use existing DC solutions. Any hub development should stress online capability for members.
d. Common protocols will be needed for administration and data management between providers, sponsors and the tax office. Providers should be responsible for record keeping and paying benefits. Concentration of responsibility for key features of the scheme will be important to minimise risk associated with data sharing. Payroll providers should be engaged early in the process to ensure that they develop standards and operating procedures that do not impact on the implementation process as experienced in the UK.

e. It will be important to ensure the portability of MySaver from employer to employer within Ireland and the EU because cross-border working will increase. Pot following member will remove the problem of workers owning multiple pension pots at unnecessary cost and inconvenience. Should the Annual Management Charge of MySaver be capped? There is a good ‘public good’ argument for doing this given that the state is auto-enrolling workers into a financial product but there is also the risk that an arbitrary cap would become the norm for MySaver schemes.

f. Competition and transparency are the best way to reduce charges; any arbitrary cap will either be too high or too low (in which case MySaver contributors will receive inadequate service and administration compared to other pension savers). It should be noted that charges are not capped in either Australia or New Zealand.

g. We suggest that charges should be simple and transparent (based on the PRSA model), and that every provider should be obliged to publish its charges every year so that comparisons can be made by sponsors and trustees. It seems to us that a market for MySaver should be allowed to emerge but only with the safeguard of true transparency.

h. Eligibility rules need to be carefully considered to ensure they do not conflict with existing pension arrangements.

11. Specific issues

Eligibility rules need to be sensible, simple and as far as possible they should not conflict with existing arrangements.

The temptation to set up a new pension system entirely for MySaver – at taxpayers’ expense – should be resisted. Ireland has a well-established and efficient workplace pensions industry very capable of delivering MySaver using existing infrastructure.

In terms of governance, we suggest that consideration be given to a semi-permanent panel of Irish and international experts to maintain oversight of the model in the initial years. When auto-enrolment is implemented it will be tempting to believe that the pension problem is resolved. International examples advocate this is not the case: New Zealand has changed aspects of KiwiSaver, Australia has undertaken re-evaluations and reforms since mandation and the UK has kept its pension policy under review since auto-enrolment. We propose that an Independent (of government and industry) Oversight Council or Guardians should be appointed to review MySaver on a 5-yearly cycle to ensure that it takes account of changing circumstances and economic realities.

UK APPROACH

The National Association of Pension Funds (NAPF) has suggested that a permanent national retirement commission be established but no decision has been made to that effect.

AUSTRALIAN APPROACH

The Government announced in 2013 that a Council of Superannuation Custodians would ensure that changes to the system will be consistent with its Charter of Superannuation Adequacy and Sustainability.

APRA

(the regulator) now requires a strategic plan from each fund. Fund returns, costs fees and charges must be published.

The Australian Tax Office runs the SuperSeeker site which tracks down lost accounts and picks up
enquiries if an employer fails to pay contributions. The Small Business Superannuation Clearing House is a free online payments service that helps businesses with fewer than 19 employees meet their Super Guarantee obligations.

NEW ZEALAND APPROACH

The first pillar of the retirement framework is New Zealand Superannuation. There are Guardians for the New Zealand Superannuation Fund and these are drawn from national and non-national sources. The guardians are responsible for the governance, investment policies and broad framework of the operation of the fund.

12. Communication and Information

Any suggestion that the state pension will eventually become a means-tested benefit because of workplace pension provision is likely to act as a disincentive for remaining opted into MySaver. A publicly funded information campaign on the merits of retirement saving is critical to the success of auto-enrolment; the inertia that brings workers into pension saving through auto-enrolment can quickly become action (to opt out) if surrounding publicity is unhelpful.

Ideally, communication should be in electronic format delivered to an email address specified by the employee. A broad framework of communication tools and templates should be developed by the regulator and industry to provide standardised and transparent information when comparing MySaver solutions.

As seen in New Zealand, the regulator publishes regularly data on fees and charges associated with KiwiSaver, this approach should be considered for Ireland. At the same time the ability for the employer or trustee to communicate with their employees about MySaver should not be hindered but encouraged. Financial services entities should ideally support this endeavour through existing communication and education infrastructure. Financial guidance programmes in the US workplace are worth considering especially around 401(k) providers who help employees at or near retirement.

13. Simplicity and alignment with existing pension rules

One of the fundamental barriers to pension coverage is that individuals do not understand pensions and therefore it is critical that simplification of the current regime is considered and implemented in tandem with any universal solution.

Specifically we point to:

- Harmonisation of retirement rules – irrespective of the source of the retirement fund (mandatory, private provision or occupational) the retirement options should be consistent.
- Harmonisation of contribution regime – individuals need to be afforded the same ability to accumulate pension assets irrespective of their source of earnings ie the current disparity between self-employed and employed needs to be addressed and synchronised. The current array of wrappers needs to be culled – if contribution rules and retirement rules are harmonised this would eliminate the need to differentiate between wrappers – eg Buy Out Bonds / RACs could be replaced by PRSAs thus making the landscape less complex and more understandable

A simple, clear and transparent regime is more likely to gain the confidence and understanding among Irish workers and drive down charges. In addition, eliminating and removing anomalies simplifies administration and eliminates the arbitrage which currently exists between existing structures.
Simplifying the regime in advance of the introduction of a mandatory solution affords the opportunity for employers to structure their existing schemes in a manner that future-proofs their integration with a universal regime: a simplified regime makes it easier for existing structures to satisfy whatever criteria are imposed under the universal solution.

14. Questions

a. What would be the industry’s response to a NEST-type proposal from the Government?
b. Would the contribution rates proposed here provide pension adequacy?
c. Is adequacy sufficient at 50% replacement of income for this group of workers?
d. Should there be separate phases of introduction for large, firms of fewer than 50 workers and very small employers of ten or fewer workers?
e. Tax relief for employers, is this feasible and at what rate?
f. A relatively steep contribution curve is suggested here: what would the macro economic consequences be?
g. A comprehensive public education campaign will be needed: who should be responsible for this in terms of co-ordination and at what cost?
h. What should be the qualifying criteria for existing DC schemes related to auto-enrolment?
SAVING RETIREMENT INCOME DECUMULATION BY DESIGN
OVERVIEW

We asked the question: If the Irish workforce is automatically enrolled into a workplace defined contribution (DC) pension, how can we ensure these retirement savings translate into a retirement income worth the sacrifice of salary?

This question is now being asked by governments across the developed world but it has taken rather a long time to come to the surface. The focus has been to persuade or coerce people to save for retirement, not on what they do with the savings at the end of their working lives; pension reforms have set the train rolling but the destination has not always met expectations. A recent US study\(^\text{18}\) found that by the twentieth year of retirement more than 81% of Americans with incomes up to $27,000 were short of money.

The UK is a good example of where one single answer – annuities – has not provided the panacea for retirement income and it is now undergoing a radical change of direction. The UK’s new policy of pension freedom has removed the requirement to buy annuities, is allowing free access to pension pots and is allowing existing annuities to be traded in. The clear message is that annuities aren’t necessarily the best option for retirement income and that individuals are the best judge of what to do with their savings. It is worth noting, however, that pension experts in the OECD, New Zealand and the US have expressed the view that annuities do have a place in smart decumulation strategies but individual savers have still to be convinced of this. The annuity market is collapsing in the UK, has collapsed in New Zealand and is growing very slowly in the US. This is not the case in South Africa and Chile where annuitisation has the explicit backing of government.

So what is the answer for countries where huge pension assets have been accumulated but are not currently plugging the gap between state benefit and a financially comfortable retirement?

There are a number of reasons for the gap including insufficient contributions to DC plans but a significant reason is that the emphasis on accumulation has not been applied to decumulation. Public policy to encourage preservation of funds has been missing or messy. DC members are guided and prodded through the growth phase but when they have accumulated wealth they are left to decide for themselves how to spend it, preserve it or place an annuity bet on living long enough to outperform their savings. The prompt response to this is that all retirees should seek professional help from advisers. In reality relatively few do unless they have significant wealth or have to deal with the complexities of a benefits system: Australian retirees tend to seek advice because their state pension is means tested. Surveys have shown that only 46 per cent of Australian retirees have used a financial adviser\(^\text{19}\) and only 23 per cent of Americans\(^\text{20}\). The latest trend for Robo-advice\(^\text{21}\) has still to prove itself. Nevertheless this aspect of decumulation is receiving more attention from governments and regulators. In the UK for instance, a free and impartial government service – Pension Wise - has been set up in tandem with pension freedom to give advice/guidance to retirees.

The DIY approach to decumulation may change as pension wealth increases and automated guidance (online and telephone) becomes more popular, but overseas experience is indicating that more than the freedom to choose is required to meet the needs of retirees. New strategies for decumulation and new products are likely to be required of the market as governments seek to protect economic and financial interests.

A successful retirement regime will need solutions to a problem which is growing in complexity as it takes into account longevity gains, longer productive working lives, changing employment patterns, the long-term rise in the cost of living and consumer expectations (including property ownership). Depending on age and circumstances these will be shifting influences on individual savers. Property is a dominant component of wealth for many people and this is likely to continue (although the UK has found a way to discourage buy-to-let for retirement income\(^\text{22}\)).

There are issues to resolve about sustainability of funds, informed decision making and how and how far governments intervene in the decumulation process. One positive finding is that given the freedom to manage their own savings, retirees are not blowing the lot on frivolities. A study\(^\text{23}\) by The International Longevity Centre of official UK data reveals that people in the sixties and seventies are saving nearly twice as much as thirty and forty year olds. Spending reduces significantly between the ages of 70 and 74 as people slowly reduce consumption on non-essential goods and services such as holidays, leisure activities and eating out.


\(^{19}\) National Seniors Australia (2015).

\(^{20}\) National Seniors Australia (2015).
The best a government can achieve is probably a robust but flexible framework of regulation that protects consumers while encouraging the market to provide solutions and transparency.

Ireland, compared to many other OECD countries, does have the building blocks to sustain and nurture decumulation but the model needs to be applied more consistently and be better aligned to retiree needs. Its well developed ARF, annuity and lump sum markets allow individuals to design their own decumulation from a range of solutions and advice - but will this be an appropriate strategy when thousands more workers on low and medium incomes are auto-enrolled into a workplace DC pension (referred to here as MySaver)?

See International Trends section for detail on overseas decumulation experiences.

THE IRISH APPROACH

A number of questions need to be answered when considering decumulation of an auto-enrolled MySaver pension:

- What financial objectives for the saver is the DC plan intended to achieve?
- What can be realistically expected of relatively small pension pots at retirement?
- Has annuitisation any place in the system? Should the state continue to insist on annuitisation or allow individual savers the freedom to decide what to do with their accumulated wealth?
- What new products should be considered to meet the needs of MySaver members at retirement?
- What information is available or needed to determine those needs?
- Should any regulation/prescription be applied to all savers (i.e. those with MySaver funds and other defined contribution funds)?
- What tax treatment is needed?
- What kind of advice/guidance will be necessary to ensure appropriate decision making and who should provide that and at what cost?
- Should the government intervene to regulate charges related to drawdown?

First pillar – State pension

The State pension will continue to be the foundation for most workers’ retirement incomes. MySaver should aim to provide a supplementary income over and above this state benefit. In addition, the pension could assist healthcare costs which are likely to rise as individuals age. Calculation of an ideal retirement income from MySaver will, we suggest, require research into typical income needs at age points from the state pension age to average life expectancy. It will take some years to reach a pension fund sufficient to meet these needs, however, and for this reason expectation of MySaver will have to be managed. Early retirees from MySaver will have relatively small pension pots and, realistically, should expect to use these for immediate needs such as paying off mortgages. Thus the first pillar of the Irish retirement framework needs to be reinforced to offset any likelihood that its sustainability falters in the future. The Irish Society of Consulting Actuaries has expressed concern over the long term sustainability of such pensions for retirees. In order to maintain public confidence in overall retirement income approaches, future Irish governments will need to ensure that first pillar pension promises are maintained and bolstered. Critically the first pillar pension provides the ‘bedrock or guarantees’ for retirees in planning their short and long term needs.

We suggest a four-fold approach to retirement income which starts with a guaranteed basic level of income for individuals through the state pension. MySaver would then provide supplementary income taken as: a tax-free lump sum for immediate expenses such as paying of a mortgage or other debt or as a reward for saving; an annuity to provide a regular supplementary income on top of the state benefit; and a discretionary element which uses some of the pot for a long-term investment fund to meet additional care or health expenses in old age.

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21 Robo-advice: automated, online, algorithm-based portfolio management advice
22 A punitive stamp duty on properties that are not the owner’s main residence and removal of tax relief on mortgage payments for buy-to-let property.
23 Understanding Retirement Journeys, the International Longevity Centre - UK (ILC-UK) and Prudential, December 2015
Hierarchy of needs in retirement

Annuities

The international trend seems to be away from annuities for workplace DC plans when individuals are allowed to choose their decumulation route. Perceived poor value and the failure to shop around are two reasons for this, but it is also the case that people tend to underestimate their life expectancy and are aware that an early death will lose their ‘bet’ with the annuity provider. In summary, savers see annuities as a potentially poor investment rather than insurance. That said, we do not believe that annuities should be written off. There is an argument for encouraging retirees to buy an annuity to ensure a guaranteed income to supplement the state pension or a deferred annuity to provide a supplementary income from age 80 when health and care costs are likely to be greater. A deferred annuity could be accessed at an earlier age if ill health is already being experienced at retirement. The cost of the annuity could be re-imbursted, at least in part, in the event of death before it is activated. Annuities would then have a better chance of being perceived as ‘insurance’ and would leave savers free to drawdown or cash in their pensions pots as needed.

Employers and decumulation

The efforts of employers to provide some future financial security for employees can be undermined at retirement when poor choices are made about decumulation. Given that MySaver members may have relatively small pension pots because of relatively low contributions (MySaver is likely to be aimed at low to medium earners), we suggest that pooling pots at retirement could provide an enhanced investment return and lower charges. Employers are best placed to offer this kind of master retirement fund through existing investment structures or, potentially, an industry association. A pooled structure would enable more complex investments to improve performance of the fund and provide volume to generate cost efficiencies. A further enhancement would be to incorporate annuities that offer a guaranteed monthly payout in retirement. In the US, United Technologies has adopted a 401(k) plan which uses target-date mutual funds that roll into a guaranteed annuity. Any employee who does not self-select an option is automatically enrolled into the programme. The difference between this income strategy and more traditional 401(k) options is that in mid-career an employee’s savings are gradually moved into variable annuities that guarantee a minimum level of income for life. By the time an employee turns 60 all of their pension pot has been moved into a secure income funds with a portfolio of stocks and bonds. The level of guaranteed income is recalculated each year and when new money is added to the fund.

Freedom v prescription

Workers already contributing to the state pension system may well feel that any additional saving for retirement via MySaver should come with the freedom to use the money to match individual circumstances. International experience shows that, in general, small pots are cashed in and larger ones are re-invested or annuitised. There may be more willingness to preserve funds if a low charge and secure lifetime income fund is available through the workplace. Tax incentives should be considered to encourage longevity protection but the market should also be prompted to find decumulation solutions that will enhance the sustainability of retirement incomes. In particular, retirees should be persuaded of the benefit of re-investing their lump sums into deferred annuities.

Advice and guidance

Should the government set up a UK-type Pension Wise service for Ireland? We suggest the size of the workforce likely to be automatically enrolled will not justify the expense of a new service.
The industry has the capacity and capability to provide at-retirement guidance and to escalate the adoption of robo-advice as a low cost means to continue engagement with scheme members after retirement.

Charges

The volume of savers in an auto-enrolled system should produce cost efficiencies and lower charges. We suggest that the role of government should be to encourage transparency of charges and enable comparisons to be made between products and providers.

Investment

Out of the global financial crisis has come retirement income solutions that are more internationally diversified in terms of investments and are more attuned with consumer needs such as target date retirement and smart default solutions. Ireland needs to bridge the gap of making financial guidance more accessible in the workplace for future retirees and also accessing alternative investments such as infrastructure solutions to generate higher rates of return whilst minimising investment risk. Cost consideration for retirement income products is an aspect that industry is continuing to strive for through smart and automated retirement solutions. Ireland is well placed to catch the ‘wave of innovation’ in retirement income solutions through industry and regulatory co-operation.

CONCLUSION

The decumulation trends in the UK, Australia, the US and New Zealand are worth noting in terms of building a decumulation strategy into pension reform. Getting people to save is a challenge but ensuring that those savings deliver the intended outcome of a financially secure retirement is the next challenge. Without timely consideration, decumulation policies – or lack of them – can undermine the great achievement of pension coverage for the mass of workers. If Ireland is to successfully install pension reform – either by mandation or auto enrolment, - it must consider the flexibility and simplification of retirement income solutions for new DC workplace members. A balance will need to be struck between generating sufficient investment returns and accommodating longevity risk for retirees. We see retirement income product innovations taking place in most OECD countries and Ireland would do well to examine closely some of these innovations and see if they can be applied to local market conditions – pre and post anticipated pension reform initiatives.

INTERNATIONAL TRENDS

UNITED KINGDOM

The Problem

For many years the UK annuity market has been accused of poor deals for consumers but exhortations from government and regulators for people to ‘shop around’ for best rate annuities have not made significant headway.

The Strategy

The UK is continuing the phased installation of auto-enrolling most workers into DC workplace plans and has turned its attention to decumulation in a radical way. This year obstacles to free access to pensions pots were removed; from age 55 employees can cash in their pension savings, buy an annuity, opt for drawdown or mix all three approaches. The reasons for the new policy include: continuing failure of consumers to seek advice or shop around for annuities in the largest annuity market; falling annuity values; Conservative belief in self-management of free choice in a free market; and the tax gains to the Exchequer of allowing retirees to cash in their pension savings.

Since these at-retirement reforms were implemented £1.38bn had been invested in flexible drawdown products via single premiums and transfers. Self-invested inflows in the first 9 months of 2015 were £12.29bn compared with £9.41bn for the same period in 2014 – a growth of 31 percent. There has also been an increase in regulators’ interest in the decumulation market and the risks associated with making decisions in a highly complex area.

The UK’s Financial Conduct Authority is investigating the level of charges associated with decumulation products and advice and the mix of investments. Some observers are suggesting that price regulation may be the result of the inquiry. To the problem of retirees not shopping around for the best annuity has been added the potential failure to shop around for the best drawdown deal.

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25 Equifax Touchstone data
The pension freedoms were introduced with a new information campaign to persuade retirees and annuitants to seek free and impartial telephone guidance from the government service Pension Wise. This is provided by The Pensions Advisory Service (TPAS) in partnership with Citizens Advice (England and Wales), Citizens Advice Scotland and Northern Ireland Association of Citizens Advice Bureaux. The government went further and made illegal any imitation of Pension Wise by firms seeking to cash in on the new freedoms. It has also committed to making it a requirement for individuals with higher value annuities to seek advice before cashing them in – and for advisers to check that they have received appropriate advice - though it has already influenced the outcome by indicating that the tax take on the cashed-in sum will be reduced from the current 55-70 percent to the the marginal rate of income tax. The changes have prompted warnings of poor deals for the sellers and a debate about the difference between advice and guidance. At the same time the Treasury and the Financial Conduct Authority have launched a Financial Advice Market Review.

The Products

It is hard not to conclude that the UK government favours drawdown over annuitisation: inheritance tax has been removed from drawdown funds remaining after the death of the owner.

AUSTRALIA

The Problem

Australia has vast pension assets accumulated over nearly 20 years of compulsory superannuation. But a government-commissioned 2014 inquiry\textsuperscript{26} reported that at least 94 per cent of pension assets are in account-based pensions which lack risk management features and may not deliver high levels of income. Those who do want to convert their asset into income have the choice of an account-based pension or an annuity as Australia has no significant market for products with longevity risk protection. The inquiry noted that: “A well-functioning market would be expected to provide a wider range of products that meet different needs and preferences. This would allow people to combine products to achieve their desired levels of income, risk management and flexibility. However, there are tax, regulatory and other impediments to developing innovative retirement income products.”

The Strategy

The inquiry\textsuperscript{27} recommended that superannuation funds be required to pre-select a ‘comprehensive income product for retirement’ (CIPR). At retirement an individual would give permission to start the pre-selected option or elect to take their savings in another way. The CIPR would have minimum features determined by Government which would include: a regular and stable income stream; longevity risk management; and flexibility. The inquiry stated that CIPRs should be low-cost and include a ‘cooling off’ period and that their design could vary to suit an individual’s circumstances such as the size of their pot and health expectations. The government responded in 2015 with a pledge to develop legislation to allow trustees of funds to provide pre-selected retirement income products, increase consumer choice and provide better protection against longevity and other risks. It also promised to continue work to remove impediments to product development.

The Products

The inquiry’s view was that a combination of products would be needed for CIPRs and gave as an example an account-based pension paired with a pooled product that provides longevity risk protection. It suggested that mandatory use of pooled longevity risk could disadvantage those with lower life expectancies if pricing of products and a portfolio approach did not reflect an individual consumer’s characteristics.

To make some traditional annuity and drawdown solutions more attractive one investment management firm, Challenger\textsuperscript{28}, has placed underlying investments into domestic and international infrastructure, hedging solutions and commercial property such as shopping centres. Investing in infrastructure is becoming more common for large superannuation funds too in the expectation that this will provide a better match of assets and liabilities. Additional benefits are generally higher rates of return for plan members than if invested in cash instruments and a strategic stake in assets of national interest such as ports and airports. Some industry superannuation funds such as Host Plus are allowing for smaller superannuation funds to buy units in infrastructure investments. Infrastructure investment can be on a direct investment/strategic stake basis rather than offering units in a specially designated investment fund. Enhanced governance may be needed for such product innovations to become more mainstream.

\textsuperscript{26} The Financial System Inquiry Final Report published December 2014
\textsuperscript{27} The Financial System Inquiry Final Report published December 2014
\textsuperscript{28} Challenger Limited is an ASX-listed investment management firm managing more than $56.1 billion in assets
NEW ZEALAND

The Problem

In New Zealand ageing baby boomers are increasingly using buy-to-let property as a mechanism for generating retirement income streams due in part to the absence of a traditional annuity market. This has led to some inter-generational tension with younger workers who are eager to get on a property ladder where prices are continuing to accelerate. Younger workers are increasingly borrowing from their KiwiSaver\(^{29}\) pension pots to buy homes.

Annuity growth tends to happen when it has government support or prescription. In New Zealand the market has collapsed because retirees can depend on a high income replacement rate from the state superannuation programme and the government has not incentivised annuitisation.

The Strategy

New Zealand has put its effort into the accumulation phase – the world’s first auto-enrolment system – and has not made significant moves to design decumulation. Retirees may take a tax-free lump sum from KiwiSaver but then they are expected to self-manage their pension savings. In the past retirees from DC schemes were required to buy an annuity but there is now no life annuities market partly because of a punitive tax regime and market failure.

The Products

There is an expectation that ‘synthetic annuities’ or a basic retirement income stream product will be created using buy-to-let properties. Drawdown arrangements, whereby members can leave their funds with the same provider and same portfolio allocation, are becoming more popular.

UNITED STATES

The Problem

Self-managed investment solutions are the norm in the United States. The US annuities market has seen some increase over the past few years but in general it is not the decumulation route of choice for 401(k)\(^{30}\) members. Individual Retirement Accounts (IRAs) and Target Income Funds are providing fixed incomes and one-off withdrawals. As noted previously, many Americans in their twentieth year of retirement are running out of funds.

The Strategy

Regulators\(^ {31}\) have created a Qualified Default Investment Alternative (QDIA) which specifies target date or diversified funds as an alternative default to stable value funds or employer stock. In doing so it also incentivised plan sponsors to use the default; the QDIA regulation states that plan participants have exercised their control over the assets in their retirement accounts if, in the absence of a worker’s instructions, the plan sponsor invests those assets in a QDIA. Control on charges for retirement investments is non-existent in the US but a fiduciary must act in the best interests of the employee through legal precedent and regulatory interpretation.

The responsibility for financial guidance and information tends to fall to employers in the US where large data sets are used to design intuitive member and retiree communications. Large pension providers, such as T.Rowe Price and Principal Financial Group have expanded their businesses by offering advice to retirees and in so doing have retained them as clients throughout retirement.

The Products

The Department of Labor defines a QDIA as a model portfolio or investment fund that aims for long-term appreciation and capital preservation through a mix of equity and fixed income investments. Investments that qualify as QDIA include lifecycle or target date retirement funds, balanced funds or managed accounts. Management of investments must be based on an employee’s age or target retirement date or on the overall age of a plan’s employees.

\(^{29}\) The auto-enrolled DC workplace solution
\(^{30}\) The tax-qualified DC workplace pension
\(^{31}\) The Department of Labor’s (DOL) regulation regarding Qualified Default Investment Alternatives (QDIAs), effective December 24, 2007
**SOUTH AFRICA**

**The Problem**

A small state pension is provided for people aged 60 plus and so the government has promoted DC workplace pensions. Elements of compulsion in the accumulation and decumulation phases have encouraged retirement saving but savers can make early withdrawals and they do. When changing jobs, they can opt to take all of their retirement savings. Only 6 per cent of South Africans are able to maintain their lifestyle and replace their income in retirement.

**The Strategy**

A government attempt in 2014 to encourage new employees to preserve their money in their own funds met with only modest access. South Africa is unusual though in using annuities as a default mechanism: when savers do not make an active decision about how to take their retirement pot they are automatically placed into a traditional annuity solution.

**The Products**

Annuity rates are better than those seen in the UK as longevity assumptions are more aggressive. There is an expectation that investment solutions adopted by annuity providers will include hedging commercial property. Flexible annuities are being developed that combine mutual fund solutions with traditional annuity products to offer guaranteed income streams and higher rates of return and partial returns of capital. With-profits annuities remain popular as a hedge against inflation.

**CHILE**

**The Problem**

Chile has almost nothing in terms of a state pension and workers are required to contribute 10 per cent of earnings to funds know as AFPs. Compulsion has prompted a degree of government protection for savers in terms of retirement income.

**The Strategy**

Advisers play an integral role in the at-retirement choice of what to do with pension assets. They are mandated to meet retirees to discuss retirement options. The majority of retirees buy annuities which are, in effect, index-linked. Unusually, the government explicitly supports insurance company payments up to certain levels. It also provides retirees with information on the best annuity rate to suit their circumstances.

**The Products**

Annuity companies are separate from AFPs and offer two types of annuity: Renta Vitalicia Inmediata – Immediate Annuities and Renta Vitalicia Diferido con Renta Temporal- Deferred Annuities with temporary withdrawals. Chile’s workers also have the right to choose SWiPs (systematic withdrawal plans), drawdown- type solutions.

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INVESTMENT SOLUTIONS
POTENTIAL DESIGN
FEATURES AND
INTERNATIONAL BEST PRACTICE
This paper is one of a series which considers potential features of a universal pension for Ireland (here referred to as MySaver) into which the bulk of the workforce could be automatically enrolled by employers. It is published by Insurance Ireland to stimulate debate about the investment solutions suitable for a defined contribution (DC) pension which is proposed to be low cost and targeted at low to medium earners. The paper notes some of the challenges this presents and solutions adopted for similar workplace pensions in the UK, Australia, New Zealand and the United States.

OVERVIEW

The global financial crisis knocked public confidence in financial services and it continues to affect the way savers think about investments; for many it will have made them more cautious and led them to question whether ‘spend now’ is the right approach to their earnings or whether property is the only ‘sure’ investment. This matters for any government considering automatic enrolment of the workforce into a pension. The challenge will be to keep workers opted in and making contributions when they are experiencing heavy pressure on low to medium incomes. In addition, how does a government explain that something more than cautious investing will be needed to reach retirement income security?

Despite the losses experienced during the financial crisis American pension savers did not respond by switching their assets into cash. In fact more workers were enrolled into defined contribution plans. This was not the case, however, for consumers in Ireland, Australia and the UK where many did switch into cash or fixed deposits and have still to return to equities. A 2013 IAPF\textsuperscript{35} survey suggested that DC funds’ portfolios had seen an increase in aggregate allocation to cash from 12.5% at the end of 2009 to 17.3%.

A balance needs to be struck between risk and reward at various points in an individual’s pension savings’ timeframe. This is too complex a problem for most savers to attempt even with guidance. We should accept that default investment funds will be the norm for the majority in MySaver and use our industry’s well-evidenced expertise to make default fit for MySaver purpose. Default strategies should be regarded less as ‘hands free’ and more as ‘in the safe hands of experts’. These strategies are already commonplace in Ireland and the complex infrastructure built for them is an excellent starting point for MySaver. Investment managers have to fulfil the role already assigned to them by consumers as guardians of retirement income. Regulators have the same view and are increasing their expectations of fund managers, trustees and providers: “As an immediate response to the crisis, pension regulatory and supervisory authorities have increased the monitoring and supervisory activities of pension funds around the world.”\textsuperscript{36}

Much thought and application has gone into communication and education programmes for workplace pensions in the past ten years and especially where pension reform has taken place. US companies in particular have examined this issue and have come to the conclusion that regular and simple personalised communication can be effective. We suggest that costs in MySaver could be kept reasonable if communications were standardised and delivered at point of need via online portals. The onus around effective communication for employees is that it has to lack bias, be informative and tailored towards individual needs. MySaver should require very little decision making from members other than:

- whether to stay in the scheme;
- whether to voluntarily save more than the required minimum contribution;
- whether to voluntarily choose investment funds (from a limited risk-based set of options);
- choosing a retirement income process (annuity or drawdown).

International experience suggests that government, regulatory agencies or specific retirement bodies are best placed to devise standards and the industry is best placed to deliver information and guidance. A partnership is needed with industry to maximise the outcomes in the way pension investment is approached, undertaken and explained to consumers. For the latter, the lessons from elsewhere are that savers have to be involved: nothing compares to talking to a broad cross-section of consumers about their experience with financial services and then testing new ideas with them. Similarly, plan sponsors and trustees should be actively consulted about investment strategies for MySaver.

The impact of reform on pension fund investment can be complex and the burden of regulation can increase – as seen in international examples. Excessive prescription may cause market innovation to be stifled or halted in its tracks especially in the online environment; it is also the case that regulation can have a positive impact on default investment design. Safe harbouring\textsuperscript{37}, which protects American sponsors from some liabilities if they adopt enhanced compliance is something
to consider. Complicated, prescriptive regulatory structures should be avoided and simplicity of the whole pensions system should be pursued. We suggest that a review of any new universal system should be conducted every three years by an advisory panel of domestic and international experts.

**BASIS FOR DEBATE**

A number of ‘truths’ should form the basis for debate on a suitable investment strategy for MySaver. We suggest these include:

- Fees and charges for the investment element will need to fit a balanced risk and reward strategy which will give confidence to new pension savers and make the most of their relatively modest pension pots.
- The well-documented tendency for the majority of pension savers to make no decisions about where their money is invested and instead rely on default options.
- Savers’ reluctance to engage with even basic financial education offered by employers and pension providers.
- Good investment management will be the key requirement that determines the success of MySaver for improving the financial security of retired Irish workers.
- Investment strategies will need to fit with savers’ expectations of retirement income, how they wish to take it and the tax relief regime for MySaver.

**DESIGN FEATURES**

Experience in other countries (see the International Section pages 4-8) suggests the following should be considered when designing an investment strategy for MySaver

- Consumer-centric design: forget what the ‘ideal’ investor should be doing because it rarely happens and, instead, design investment strategies that take account of the way the target constituency thinks and acts.
- There should be clear standards for publishing performance and risk/reward information and plain-style information should be an essential feature of MySaver (using simple assessment tools such as dashboards, online information and calculators) and focus on a few metrics that will enable savers’ to judge their financial position.
- There should be clear communication of the level of risk within each fund option to ensure that savers are not surprised by good or bad investment performance when it arises.
- Investment choice, for those willing to engage with it, should be simple and limited.
- Investment strategies for MySaver should have a clear aim such as achieving an appropriate asset mix at retirement for a typical investor.
- Default investment funds in particular should be designed to make reasonable returns, protect accumulated funds and be aligned with needs at retirement age; that will mean using lifestyling strategies or target date funds. The Irish pensions industry is already well positioned in this regard, having introduced lifestyling in advance of many other countries and developed new strategies as customers’ needs have changed.
- There should be regulation of default fund options. We suggest this should be based on existing regulation in place for PRSAs or the Pension Authority guidance for defined contribution investment options.
- We should avoid the assumption that any reference to MySaver being a ‘low cost’ scheme means entirely passive fund management - passive or active can be used for optimal investment and performance for different age cohorts
- The investment rules for MySaver should not be so restrictive as to limit innovation in fund offerings. We have seen considerable innovation in this area but it is not possible to define the best solution for 20-30 years’ time and the ability to innovate will be important.
- Avoid the temptation to pour MySaver assets into domestic investments; internationally diverse strategies are needed to protect against volatility in the long term and avoid positive and negative upswings in return. The history of National Pension Reserve Fund and the Pension Levy will mean that any suggestion of state interference in assets will severely damage acceptance of auto-enrolment and public confidence.
- Ring-fencing individuals’ asset accumulation from access by third parties.

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38 The Small Job Protection Act 1996 provided 401(k) plans with alternative, simplified methods of meeting the prescribed contribution requirements; if plans adopt enhanced compliance they are protected from litigation and breach of regulations.

39 It should be possible to define ‘reasonable’
UNITED STATES

Investment strategy

The Pension Protection Act of 2006 (PPA) kick-started the debate in the US over the value of investment by plan members and the need to improve default solutions. The PPA encourages employers to include a qualified default investment alternative (QDIA) where contributions are defaulted into a diversified portfolio that includes exposure to both equity and fixed income markets. The trend is a steady decline in the number of investment options offered through 401(k) plans and the progressive enhancement of target date funds. The success and prominence of target date funds in the last decade is the most prominent trend to highlight. Many providers and employers are suggesting that ‘the set and forget’ strategy of a good default along with automatic enrolment is ideal for employers and plan members. Challenges remain in the communication of risk and return that the consumer can understand.

Guidance and Reportage

The US has creatively embraced behavioural economics to improve consumer education and guidance where it can work and discard it where it has been proved ineffective. The general rule is that investment decisions are too complex for savers who cannot make rational economic decisions. Evidence for this approach has come from cognitive psychology literature, and has been applied in a financial context. Enhanced disclosure standards have been introduced in the last five years to highlight fees and charges on investments. Debate still surrounds whether consumers experience disclosure overload from the documentation issued by DC plans.

Regulation and Governance

Safe-harbouring for plan sponsors has been a regulatory benefit of the Pension Protection Act 2006, in connection with investments. Employers who endeavour to comply with the PPA in connection with investment design and fee disclosure are provided with some legal relief. This has helped in allowing employers to be ‘paternally’ connected with the sponsorship of DC plans.

UNITED KINGDOM

Investment strategy

The National Employment Savings Trust (NEST) was designed for an auto-enrolled universal pension in the UK. The trust set out to: “build a pension savings vehicle that’s easy for members to understand but at the same time gives them access to the latest technology and thinking on portfolio management”. The strategy is based on low-cost target date funds and on each member not making decisions about investments: “one of the best things a saver with NEST can do after they’re enrolled is nothing”. NEST concentrated on creating a default option it believed would be right for most people but also offers fund choice for those who want to make investment decisions. NEST applies the same low charge across all funds. Its investment objective is to deliver above-inflation growth and it has set a benchmark of 3% above inflation after all charges over an economic cycle. Risk budgets have been set to take sufficient but not excessive risk.

NEST’s default option has fifty NEST Retirement Date Funds each named according to the date at which each member expects to retire eg the NEST 2040 Retirement Fund. Individuals can change their preferred retirement date and the funds are switched free of charge. The pooled funds are provided by global fund management companies. In addition NEST offers: an Ethical Fund, Sharia Fund, Higher Risk Fund, Lower Growth Fund (for the very cautious) and Pre-retirement Fund for those due to retire in 2018 or earlier and who want to buy an income with some or all of their savings.

Savers in NEST’s default option go through three phases with different objectives:

Foundation phase objectives are to preserve capital and target a long-term volatility average of 7% (joiners in their 20s will typically spend one to five years in this phase)

Growth phase objectives include returns greater than inflation plus 3% and all scheme charges, a long-term volatility average of 10-12% and to maximise diversification.

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Consolidation phase objectives include moving the portfolio to annuity-tracking assets and cash-like investments but continuing to grow the portfolio in real terms where possible. This phase typically starts 10 years before retirement.

Guidance and Reportage

NEST produces key documents to explain its investment arrangements. These are:
- a Statement of Investment Principles that guides investment decisions by trustees;
- an Investment Implementation document which describes day-to-day management of funds; and
- fund factsheets that track performance.

It has a rolling programme of communications research and has developed information “using plain language and real-world examples”. Funds have been named to explain their function as in NEST Higher Risk Fund instead of ‘higher growth fund’.

Regulation and Governance

NEST is a signatory to the UN-backed Principles for Responsible Investment (PRI) and the UK’s Stewardship Code which aims to enhance long-term returns and strengthen corporate governance. Its investment committee meets quarterly to review fund performance, operations and investment decisions such as risk budgets, strategic asset allocations, fund manager selection and investment costs. NEST also has a Members’ Panel and Employers’ Panel to provide feedback. Other mastertrust providers such as The People’s Pension and NOW Pensions also have developed enhanced governance and compliance standards to demonstrate efficient operation and ideal investment solutions.

NEW ZEALAND

Investment strategy

The aim was to provide stable returns, build confidence in KiwiSaver and enable members to actively decide how their money was invested. Savers have a wide choice of funds but KiwiSaver providers are obliged to take a conservative investment approach because the Government believes this is appropriate. The conservative option has no less than 15% and no more than 25% of members’ money in growth assets. Most KiwiSaver funds are PIEs (portfolio investment entities) which means returns are taxed at lower than normal rates. A PIE that invests in New Zealand shares and/or in most large Australian listed shares is not taxed on capital gains.

KiwiSaver schemes offer funds ranging from conservative to higher-risk growth funds. Members have the option to invest in one or more of the funds and some schemes allow individuals to set their own investment strategy. The Government negotiates fees and these are prescribed for each scheme. The KiwiSaver Act prevents the charging of ‘unreasonable’ fees and the Financial Markets Authority is responsible for determining what constitutes ‘unreasonable fees’ and the ongoing monitoring of fees.

Guidance and Reportage

The Commission for Financial Literacy and Retirement Income increases financial knowledge and offers guidance to KiwiSavers through its free and independent financial information Sorted website and online tools. Providers are required to offer investor education to default members and before they sign up they receive an investment statement that includes:
- specific rules, fees, terms and conditions of the scheme
- how money will be invested;
- who is responsible for managing the money;
- what returns can be expected;
- the approach to responsible investing (this includes their environmental and social considerations).

Regulation and Governance

All KiwiSaver schemes are regulated by the Financial Markets Authority in a similar way to other registered superannuation schemes. The KiwiSaver Amendment Act 2011 made a number of changes to governance to:

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41 Looking after members’ money, NEST’s investment approach
42 ibid
44 http://fundfinder.sorted.org.nz/must-knows-of-kiwisaver/
– incentivise fund managers to act in the best interests of investors by making them primarily responsible for the accuracy of their prospectus, investment statement, and advertisements;
– require trustees to be responsible for supervising managers and making sure they comply with trust deeds and their other responsibilities.

The balance between regulation and governance of investments and the need to nurture retirement savings has helped to achieve the original policy objectives. “Many KiwiSaver accounts are broadly diversified portfolios of domestic and foreign assets, with the level of foreign assets (and expected long run returns) increasing as a portfolio’s risk profile is increased given the greater exposure to international equities. As such, KiwiSaver is a mechanism to reduce the financing risk and achieve the benefits of portfolio diversification (a higher return per unit of risk). As KiwiSaver portfolio balances grow with time, this benefit will also rise.”

AUSTRALIA

Investment strategy

Australia’s mandated superannuation has undergone a shift from a static strategic asset allocation to a strategy more aligned with members’ individual needs. Debate has arisen about what personal circumstances should be taken into account when designing default options but age is the predominant one. The Cooper Review resulted in new policy – Stronger Super – which stated that the universal, low cost pension, MySuper, would have a single diversified investment strategy. If members make no decision on investments their money is put into a standard mix of investments and the risk-reward approach stays the same for the life of the pension. Trustees are allowed to use an age-based lifecycle investment option as the single investment strategy. MySuper trustees are required to state the targeted rate of return (over a rolling ten year period) and level of risk that they have decided is appropriate for members. Super funds offering a lifecycle product have two approaches:

– member switching (favoured by industry funds) which shifts members from growth to conservative funds as they get older - funds use different strategies for de-risking generally based on age;
– cohort funds (favoured by retail funds) managed in line with what is deemed appropriate for members of similar age: these can be target (retirement) date funds but are increasingly ‘birth date’ funds - cohorts may include individuals within a 3, 5 or 10 year age band and may take into account superannuation pot size.

The Government has allowed four fee levels for MySuper but according to Mercer most cohort offerings charge a single fee. Investment options are:

– growth investing around 85% in shares or property and members may be able to invest in a ‘high growth’ option with 100% in shares and property;
– balanced investing around 70% in shares or property and the rest in fixed interest and cash but savers may be able to invest in a ‘moderate’ option with around 50% in shares and property;
– conservative investing around 30% in shares and property with the majority in fixed interest and cash;
– cash investing 100% in deposits with Australian deposit-taking institutions or in a ‘capital guaranteed’ life insurance policy.

Australian lifecycle funds are the most dominant form of default solution but tend not to continue into the post-retirement phase. The funds rebalance automatically towards a target asset mix. This asset mix does not remain constant but changes and becomes more conservative as an employee ages. A target date is reached in terms of the intended retirement of the employee but the downside is that often this target date needs to be fluid and move with an employee’s retirement intentions. It should be noted that Australia has witnessed a sharp growth in infrastructure investment as a result of mandatory pension savings. The investments have been on a sound commercial basis and supported by corresponding regulations but while such investments have benefited Australia directly and indirectly, industry has continually resisted any attempts to make them on a purely ‘good for national society’ level.
Guidance and Reportage

The trustee of a regulated superannuation fund that has at least five members must publish a product dashboard for each MySuper product and each lifecycle product that is a MySuper product. This must be publicly available at all times on the fund’s website. The dashboard must be presented in a standardised manner to allow consumers to easily compare products and make informed choices. Key information covers:

- returns for previous financial years;
- comparison between the return target and the returns for previous financial years;
- level of investment risk;
- a statement of fees and other costs.

Regulation and Governance

The most recent reforms empower APRA (the regulator) to require a strategic plan from each fund and to publish fund returns as well as detailed fund costs, fees and charges. Trustees will also be required to use the same approach for calculating and presenting this information in the new product dashboard. APRA develops guidance for trustees on issues related to the way in which they develop and maintain a lifecycle investment approach for a MySuper product.

QUESTIONS TO RAISE

- To what degree – or not – should Government intercede in investment strategies for a universal pension?
- Should Government and industry design investment solutions or should market forces prevail?
- What investment design principals are best served for the development of default investment funds?
- What elements of international experience can we integrate into sustainable investment solutions in Ireland?
- How can negative investment returns be minimised?
- Is the emphasis on risk profiling helping or hindering achievement of optimal investment strategies?
- How can providers ensure – through communication – that savers understand the linkages between: risk, return, level of contribution and final benefit?
- What is currently lacking in report-back requirements for fund managers?
A UNIVERSAL PENSION FOR IRELAND: 
THE BENEFITS OF AN ADMINISTRATION HUB
The purpose of this paper is to consider aspects of the administration required for the successful implementation of a Universal Pension for Ireland (referred to here as MySaver) into which the nation’s workforce would be automatically enrolled with an option to ‘opt out’.

We are defining pension administration as: the arrangements and tasks needed to operate a pension scheme that delivers good member outcomes.

The process to achieve this consists of a plethora of moving parts including:

- enrolment (in the case of MySaver auto-enrolment)
- accurate record keeping, data cleansing and keeping member information up-to-date
- efficient contribution collection from employers and employees
- distribution of contributions into investment funds
- governance and controls
- identifying and evaluating risk
- member information and education using hard copy and online media
- custodial services
- internet functionality for both employers and employees
- benefit payments.

Administration will be the key to the success of auto-enrolment. Examples of pension reform in Australia and New Zealand make the case for including it in MySaver design from the beginning rather than retro-fitting solutions to avoid problems such as lost accounts.

Irish pension providers have over many years invested in and built infrastructure to administer defined contribution (DC) workplace schemes. Nevertheless, if MySaver is adopted, it will pose a new challenge to bring all employers into pension provision. Many of these will be small companies with few employees and almost no experience of pensions. The relatively small contributions that will be expected of auto-enrolled employees earning low to medium incomes, will also present a challenge in terms of providing low cost administration. In addition, the entry of thousands of new savers into new MySaver accounts will eventually risk the problem of lost accounts. Employees switch employers and should expect to take their savings with them – a significant number being enrolled into MySaver are likely to have small pots of pension savings with previous employers. Some means has to be established early on to ensure that MySaver members remain attached to their money.

In general, we see the priorities of MySaver administration as:

- making it integral to the design of MySaver
- keeping it simple and helping to support the general policy direction of pension simplification
- using existing infrastructure with enhancements to meet the special needs of an auto-enrolment system and MySaver’s target market of all employers and relatively low to medium earners
- cost effective and affordable overall
- ease of use for employers and employees.

Having reviewed international best practice, TOR believes the following model merits serious consideration for Ireland:

Use what you have in terms of existing industry infrastructure for MySaver administration. New Zealand decided against this when KiwiSaver was introduced, as did the UK government when it set up the National Employment Savings Trust (Nest). In both cases extra cost was incurred which has either to be borne by the taxpayer, the saver or the industry. An entirely new system developed and run by a non-industry supplier would also carry political risk.
Enhance it, potentially, by using a MySaver Hub to bring together some aspects of administration for the purposes of efficiency, cost and control. The Hub could provide linkages between providers’ existing administration systems and employers to ensure that when switching jobs MySaver members’ take their pension pot with them (‘pot follows member’). The Hub could also be used by small employers who do not have a pension provider to collect contributions and transmit them to an investment fund chosen by an employee – or allocated by ‘Carousel’ method (see below).

Using existing industry infrastructure would minimise cost and the implementation risk to Government but it does represent a serious challenge for the insurance industry in Ireland. During the current MySaver debate it will be important that the industry indicates whether it is willing to take on the challenge of MySaver administration and engage in meaningful dialogue to develop the model for consideration by policymakers.

WHAT HAPPENED ELSEWHERE

NEW ZEALAND

The government’s approach to KiwiSaver contribution collection was to use the Inland Revenue Department’s existing tax collection system to build a Hub for registered Kiwisaver providers to receive contributions from employees and employers. By aggregating collection and payments, the risk of lost accounts could be minimised. KiwiSaver account holders are able to track and trace their savings on-line. In addition to collecting and transferring data the Hub provides a large number of forms, guidance and KiwiSaver member information. The Inland Revenue’s main responsibilities are to:

- receive member and employer contributions
- transfer contributions to the right KiwiSaver scheme provider for investment
- give employers information packs to pass on to employees
- allocate people who don’t make a choice to default schemes via a ‘Carousel’ system
- administer requests for opt-outs and contributions holidays
- provide information to savers which includes a calculator to enable employers and employees to calculate any required KiwiSaver employee deductions.

An important part of the Inland Revenue’s (IR) involvement in KiwiSaver has been engaging with scheme providers who continue to have the primary relationship with members. Early research indicated that providers were particularly keen on the introduction of relationship managers to act as a point of contact with the Inland Revenue and forums to enable providers to meet and discuss KiwiSaver with others in the industry.

The model has been effective but its cost is less clear as it seems to have been absorbed into the IR’s general running costs. But, in discussions with the IR department during September 2014 it was revealed that large costs are anticipated over a 25-year period to continue to enhance the existing systems and provide for future updates. This was partly because initial planning had been limited due to the rapid introduction of KiwiSaver.

AUSTRALIA

Australia’s adoption of a compulsory superannuation system was relatively rapid and that meant recycling and re-using existing administration systems. The problem of lost accounts – six million recorded in 2014 – finally forced the Australian authorities to confront the issue. The response of the financial services industry to lost accounts was to generate common protocols on transferability but the Federal Government passed legislation to force aggregation of accounts through data matching. Super funds are now obliged to transfer lost accounts to the Australian Tax Office (ATO) and an individual’s Tax File Number (TFN) is now used as a Unique Identifier for employees joining superannuation schemes. Search engines, combining Tax File Numbers fields, date of birth and the full name of the individual now assist in tracing and tracking lost accounts. The AUSfund holds unclaimed super funds and there are online services such as ‘Find My Super’ to assist in the consolidation of super accounts.

48 Inland Revenue October 2007, KiwiSaver Communications and Awareness Evaluation Research Report:1.1
49 Accounts are deemed ‘lost’ if a Super fund has not been able to contact a member, they have not received any contributions or rollover amounts the past five years, the account has been transferred from another fund as a lost member account and no new address has been found.
Late on, some of the Australian industry funds tried, through an administration company Superpartners, to forge common administration protocols and processes but the project to create a unified IT platform reportedly went over budget by $180 million and took four years longer than planned without delivering. Superpartners was taken over by Link, a specialist in superannuation administration. This case study highlights the ‘devilishly’ complex nature of pension administration and the need to address lost accounts and trace and tracking services.

Australia’s DC administration framework has become more simplified as corporate entities outsource their mandated superannuation solutions to third party mastertrust providers who have proprietary software. These mastertrusts are continuing to expand and generate economies of scale for administration and investment functionality. The average administrative cost per member is declining as large and small employers combine to share the efficiency dividend.

UNITED KINGDOM

The introduction of auto enrolment generated a high degree of administrative complexity. Some observers suggest HMRC’s concerns about data protection and potential data losses scuppered the possibility of a clearing house. In its place came a non-departmental public body, the National Employment Savings Trust (NEST), a workplace DC pension for small-to-medium sized employers. NEST’s IT administrative function was aided by long term contract with the Indian IT firm TATA after a bidding process which included ATP and IBM. The cost of NEST has been considerable and according to the UK’s National Audit Office (NAO) it will need to grow funds under management significantly before it can be self-supporting. The NAO reported that at 31 March 2015, NEST owed the Department of Work and Pensions the near equivalent of €487.6 million and for the 12 months ending 31 March 2015, it had an income of €23.3 million and incurred expenditure of €123.5 million.

Otherwise, the UK’s DC pension administration is shared among life insurance companies, in-house employer solutions, specialist administration service providers and mastertrust providers. Some administration systems are derivations of old defined benefit systems upgraded for the demands of new regulations and legislation.

Practical challenges remain in terms of lost accounts and tracking and tracing accounts. Solutions offered have been ‘pot follows member’ and an aggregation approach advocated principally by the Centre for Policy Studies. As there is no Hub, tracking and tracing can be lengthy and cumbersome although common IT protocols and processes have gone some way to help. That said, the UK still has not found a solution for aggregating or allowing pots to follow members. In both mandated and auto enrolled systems, the lack of a central Hub can mean a multiplicity of small accounts charging proportionally higher fees.

USA

Record keeping and administration offered by some 401(k) providers have suffered from inadequate economies of scale. Industry experts suggest privately that an industry Hub or better thought-through solutions should have been intrinsic to the 401(k) product launch in the mid-1980s.

As employers and employees seek bespoke offerings from their plan providers, so administrative complexity and costs grow. Lost accounts and tracking and tracing services have not been aided by the current approach of using social security numbers and zip codes. Broadly speaking, DC administrative solutions have been developed in-house and are proprietary to individual financial service firms. Many providers had accepted that they need a good record keeping business in order to win new schemes and retain existing plan assets but this was disrupted in 2014 when J.P. Morgan Asset Management sold its 401(k) record keeping business to Great-West Life Co. Inc. because recordkeeping for workers’ retirement accounts had become unprofitable.

The cost of administration is seen as a hygiene factor in winning new business and deriving revenues from investible assets and cross-selling opportunities. An industry clearing house or DC Hub would have provided the industry with combined efficiency for regulatory and member reporting.

A MYSACER HUB

As suggested, an enhancement to the existing Irish DC infrastructure could be a Hub to gather industry-wide data, information and education and act as conduit to and from employers, employees, the Inland Revenue and pension administrators. The Irish insurance industry already has a motor insurance Hub (see the Annex) which pools information about policyholders.
The Hub could have several stages of development depending on the complexity needed to service MySaver as it grows and to what degree existing industry systems can provide what is necessary. For instance, Stage 1 could provide:

- employer access to MySaver administration forms and guidance;
- employers with an easy means to register new entrants to the scheme;
- members with a Unique Identifier (this would probably have to be the PPSN\(^5\) but this is likely to involve resolving data protection issues);
- a ‘Carousel’ function for those members of MySaver who do not make a choice about pension provider;
- member information, guidance and education;
- transmission of relevant information to the Revenue Commissioners and the Regulator;
- collection of employee and employer contributions and distribution of those contributions to investment funds where an employer does not have a pension provider;
- a ‘pot follows member’ function

As with New Zealand’s KiwiSaver scheme, if a MySaver member does not choose a plan the Hub would automatically allocate the individual to the next provider on a ‘Carousel’ of providers.

Diagram 2 – ‘Carousel’ for savers who do not make a choice

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\(^5\) PPSN – Personal Public Service Number
Stage 2 of the Hub development could be a Track and Trace function to ensure that MySaver contributions can be tracked and accounts traced. Australia had a particular problem with lost accounts and tracing accounts for individuals is a function of the KiwiSaver Hub. Tracking accounts is straightforward if a Unique Identifier is used, but tracing and combining different accounts as people move jobs will be more of a challenge. It would also require the co-operation of pension plan providers who may not wish to offer a MySaver scheme.

IN SUMMARY

TOR’s view is that the KiwiSaver Hub has proved useful in disseminating information about the new workplace pension and smoothing potential problems such as lost accounts and making a provider choice for workers who do not make a choice for themselves. It has also helped to bring providers and employers together to discuss aspects of the scheme and solve problems. New Zealand looked at the experience of a compulsory mass enrolment of workers in Australia and decided to do something better: provide a data and information Hub to connect all the partners in the endeavour.

But, we do not believe it will be useful to establish a Hub simply to shift information. To be worthwhile, the Hub must make a significant difference to good member outcomes above and beyond what is possible from a disaggregated system. It will be important that MySaver engenders confidence in savers and sponsors from the beginning given that contributions from low earnings have considerably more impact on disposable incomes than they would for higher earners.

Administration plays the ‘front of house’ role in pensions and problems will be magnified in the kind of mass market envisaged for MySaver. A good member experience is, we suggest, a priority for policymakers and providers.

What is clear from the international perspective is that the administration elements of an entirely new DC workplace system should be an essential feature of its design from the beginning: technology is improving efficiency and reducing costs but it can also raise new challenges in terms of connections and sharing data.

The Irish industry has to decide whether its current infrastructure can be ‘knitted’ into a MySaver seamless experience for employers, savers and future retirees without some form of aggregation. We think a Hub would provide the right enhancement for what exists already but if the industry agrees, it needs to say so and step forward to become part of the administration solution for MySaver.

ANNEX

Insurance Ireland’s Insurance Hub

Insurance Ireland currently runs data hubs for its members like ANPR (Automatic Number Plate Recognition) system, InsuranceLink System, IIDS (Integrated Information Data Service) System and Market Intelligence Portal. The ANPR system is built to track uninsured driving by Gardaí using automatic registration plate recognition from road cameras. Details of motor insurance claims are also collected by the Hub under the Insurance Link system and made available to participating members on request to enable them to check suspected fraudulent claims. IIDS system works for no claims discount data and also provides a mechanism by which participating insurers can check penalty point information. The system collects no-claim discount information from all participating members so that an individual insurer can verify no-claims discount data provided by its customers. The front-end of the Hub has different query mechanisms for different users.

Penalty Point system is available for participating insurers through the IIDS Hub and it takes a data feed from the Department of Transport. The issue of data protection does not arise because the system acts as a conduit for the information, the Hub does not hold any penalty point information. Insurance Ireland has recently launched a new service of aggregated industry statistics via market intelligence portal that enable members to compare where they are in the market against their competitors in terms of premiums and claims. The Hub is paid for through member contributions.