THE IRISH ASSOCIATION OF PENSION FUNDS

SUBMISSION TO THE PENSIONS BOARD

CONSULTATION PAPER ON PENSIONS SIMPLIFICATION

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iapf
the voice of Irish pensions

INTRODUCTION

The Irish Association of Pension Funds (IAPF) was established in 1973 and is the leading Irish body providing representation and other services for those involved in operating, investing and advising on all aspects of pensions and other retirement provision.

IAPF members provide retirement security to over 200,000 employees, pay pensions to nearly 70,000 people who have already retired and are responsible for some €74 billion (end 2011 figure) in retirement savings. Therefore, we are well placed to comment on the subject of simplification and have for the last four years had a dedicated committee looking at specific issues which impact on Defined Contribution (DC) pension provisions.

The IAPF recognizes the huge growth of DC pension provision and to this end launched a Pensions Quality Standard (the "PQS") which seeks to improve overall standards and recognizes those schemes that achieve a certain standard in the area of communications, investment offering and governance. To date a number of schemes have attained this standard and to this end we are experiencing a growing interest in trustees and employers enquiring about the PQS. Further details may be found using the following link: http://www.iapf.ie/PQS/default.aspx

We believe that the key issues which face DC members centre around engaging all citizens to understand the need to save for their future and to support individuals to adequately provide for their retirement.

The IAPF believes that we need to structure a system which can cater for all the different pension structures which will make it easier for people to get a greater understanding of their overall pension position through education and engagement and by using all media to ensure the delivery of different messages to different cohorts. Clearly, the government has a role to play and should lead the way in advising what employers and providers can and should do to communicate with participants whilst noting that communication is key, and not just a disclosure requirement. These may be summarized as short, medium and long term goals as follows:

Goal	Issue	Priority
Short Term	Promoting the understanding and need for adequate pension provision	High
Short Term	What are employers bound to offer?	High
Short Term	Simplification of pensions communication and disclosure requirements	High
Medium Term	Provide for the portability of pension benefits, including for workers coming to and leaving Ireland	Medium
Short Term	Making the operating costs of pension arrangements more transparent using a single system e.g. Total Expense Ratio (TER)	High
Medium Term	Providing a single pension framework in which all types of pension arrangements can be held	Medium
Long Term	Early drawdown of pension funds	Medium

***Short Term (1 to 2 years); Medium Term (2 to 3 Years); Long Term (3 to 5 Years)**

In order to ensure these goals are achieved we suggest that a strategic roadmap for DC is developed which identifies the essential building blocks and points of reference, along with timelines and a national stated "mission statement" that by the year 20XX, we will have achieved certain goals which are stretching but achievable.

SCOPE OF IAPF RESPONSE

In December 2011, the Pensions Board (PB) issued a consultation paper on pensions simplification.

While we will comment on DC provision in particular as requested in the consultation document, it is considered that we should also detail a number of wider practical provisions which could be adopted to support the simplification agenda as the shift from pension provision moves from Defined Benefit (DB) to DC. The IAPF is very conscious that this period of transition will offer its own complexities.

We welcome the focus on DC arrangements as this is now the main form of provision for the majority of private sector workers.

We are of the view that many of the efforts and requirements designed to ensure adequate policing of pension benefit structures do not achieve their primary purpose and a different approach is required.

Specifically, we are of the view that a basic understanding of providing for one's future is of vital importance to everyone and should be supported at second level schooling and we would welcome an initiative in schools to support this.

We also believe that we need a framework to support a fresh approach which explains pension benefits, both at State welfare level and private level to consumers. Much of the current focus is on disclosure requirements. We are not convinced that these sufficiently achieve their intended purpose. The focus needs to be on communication with pension savers; with the primary purpose of informing and empowering savers. Too much of the current focus is just on complying with the regulatory requirements.

The IAPF supports easier understanding of total retirement provision which highlights the value of what employers offer, what the State provides and what individuals can contribute. It is suggested this can be achieved in a number of ways including using the media available (IT, TV, newpapers, social media) which:

(i) supports easy access to information which is provided in clear and simple language without the use of jargon
(ii) allows consumers to be more questioning of their entitlements/benefits
(iii) supports the value proposition of offerings; and
(iv) encourages individuals and beneficiaries to take responsibility for and know their entitlements/rights.

It is suggested that this can achieved in a number of ways and always under three headings which identify the responsibilities and requirements of employers, trustees and individuals:

- Identify thought provoking issues for pension savers based on segmenting groups by age cohorts e.g. "twenty somethings", and develop and publish information through appropriate channels and media (such as the PB website, social media channels, etc) which identifies relevant information for that age group
- Clarify what employers are required "to offer" in simple terms for employees and how individuals may obtain more information from the PB or other sources
- Simplification of communications, whether by document or all collateral material (including electronic) which are designed to inform individuals of the different means of providing for their retirement. Provide for the portability of pension benefits between products for self-employed and employer sponsored pension arrangements especially where this stems from or supports European and international movement. Provide a more transparent platform for displaying charging structures on all types of pension arrangements which must be adhered to by the pensions industry. Streamline the various types of pension structures and the various ages at which one can drawdown pension benefits so that there is uniformity on the rules surrounding pension benefits
- Consider early drawdown of pension benefits.

AWARENESS AND EDUCATION

One of the biggest challenges faced is to move retirement planning significantly up the individual's agenda, whilst making retirement relevant and compelling to different age cohorts; what appeals to a 49 year-old is likely to be completely different to a 25 year-old employee.

Current one-size fits all

The current one-size fits all awareness campaigns (whilst successful) may potentially be sub-optimal through being viewed as irrelevant to some age cohorts and frightening to other age cohorts;

Shift emphasis to age segmentation in tandem with identification of WIFMs (What's in it for me?) by age cohort

Member interests vary widely by cohort, e.g. a 25-year old versus a 45-year old.

Accordingly, we would recommend that all campaigns, collateral material, sections on websites are organised and delivered based on age cohorts which are aligned with that age cohorts core WIFMs:

Age cohort 25–34 year-olds – we would recommend that there is a shift in focus from "retirement planning" to building your future capital and work related savings – which may have a greater resonance with this cohort. In addition, the medium or touchpoint through which groups are reached will differ based on the age cohort, e.g. sporting events, concerts, Facebook, etc;

Age cohort 35-49 year-olds – we would recommend that there is a continued emphasis on building capital and work related savings but also building on retirement planning;

Age cohort 50-60 year-olds – this is the intensive planning and accumulation phase which requires limited effort in terms of getting interest.

Early stage financial literacy - In addition, we are also of the view that development of Financial literacy/ planning skills and an understanding of the criticality of savings needs to be delivered at a much earlier age. This should be integrated into early stages of the secondary school curriculum.

Building a long term vision and roadmap of where DC needs to be

One of the essential elements to building a successful DC strategy is to build a long term vision and roadmap with regard to where DC needs to be in (say) 15 years times. This needs to contain the following components:

- A clear definition of where DC needs to be in 2030 (say);
- A definition of the essential building blocks to arriving at the end point of the roadmap set-out, in terms of stakeholders such as Trustees, employers and individuals.

We would suggest that some of the essential building blocks may include issues such as Education, Charges, Taxation, Portability and Access and clarity on what each of the stakeholders are responsible and accountable for. We suggest that it might be useful to look at the success of other campaigns, such as the Road Safety Authority, as a template for building a DC roadmap. Fundamental success is the development of a long-term vision, coupled with the formulation of key building block areas which would help arrive at an envisioned end-point.

COMMUNICATION

The IAPF would welcome communications with retirement savers to be more simplistic in their presentation and their language. Whilst taking account of the various existing regulatory requirements, it is suggested that:

- A key features summary page of an individual's retirement benefits would be welcome. This should include personal details, current total value of fund and current total amount of funds paid in. Current disclosure requirements support projected values of funds assuming one remains in employment and, subject to certain assumptions and current fund choice, noting what this choice reflects on an attitude to risk basis. We suggest it would be better to move away from prescribing information but illustrating it in "today's" terms. The simple metric of monies paid in to valuation and the pension that would provide should help to focus the minds of the individual
- All communication as required by disclosure requirements should be reviewed to satisfy simplified presentation embracing plain language principles. This review should focus on the overall intention to communicate with the member in a way that makes information understandable and helps them to make choices that will improve their outcomes
- Explanatory information should be updated every two years in an effort to ensure they reflect the governing documentation and current legislation. There should be flexibility about how information is made available with the use of electronic means where appropriate
- The provision of online benefit statements and other information should be an acceptable means of communicating with members without the requirement to provide paper copies (e.g. currently, annual benefit statements must be sent via paper unless members consent in writing to be communicated with by other means). Obviously, different companies have varying degrees of workforce (e.g. factory based employees may not have access to email) but it should be up to sponsoring employer or trustees to decide the most efficient method of communicating with members, provided they do so in accordance with disclosure requirements
- Multi-media communication channels should be encouraged to educate individuals. FAQ style documents should also be encouraged for pension arrangements which turn the features of the arrangement into questions and answers e.g. what do I get on retirement?
- A simplified table which adds up all types of pension benefit/funds should be produced with rule of thumb guidelines e.g. if the value of your pension fund is €X, this could provide a pension (i.e. a payment for the rest of your life from age 68 of €Y (using an appropriate factor). A new initiative supported by the Government should be launched aimed at getting pension savers more up to speed with their pension arrangements (e.g. "Know your pension scheme" document as well as "Know your Social Welfare Entitlements on Retirement")
- The IAPF suggests that the PB should introduce a more comprehensive online retirement calculator. While the current calculator serves a very useful purpose, it lacks sophistication as it does not take account of lifetime limits, the variety of tax reliefs, at retirement taxation, and post retirement taxation. In particular, such a calculator should be updated regularly to incorporate market and legislative changes
- A link to various government sponsored agencies should be included e.g. itsyourmoney.ie. The National Consumer Agency and these agencies should reciprocate with appropriate advertising to encourage pension savers to ask questions about their pension provision and keep asking until such time as they are satisfied
- Carry out a national survey which is supported by TV, newspapers etc to ascertain the level of (a) engagement (b) knowledge (c) current barriers as suggested by consumers as to why they do not invest anything/as little as possible in pensions
- In addition, the requirements for trustees to report to both the Revenue and Pension Board in respect of amendments and scheme approvals should be harmonized to eliminate costs and a compliance burden for trustees.

PORTABILITY

The IAPF would welcome an easier environment for the portability of pension benefits between products for self-employed and company sponsored pension arrangements, and between contract-based and trust based arrangements. For example, the requirements to produce a certificate of comparison of benefits when transferring from a DC scheme to a PRSA appear to have been designed to cover DB to PRSA transfers but are also required for DC to PRSA transfers. This does not make sense and over complicates what should be a straight-forward transfer in a DC environment.

The transferability of pensions from Ireland to other countries and vice-versa is extremely complicated for a variety of taxation reasons which cannot be readily addressed due to the variety of different taxation models around the world. However, this is an area where a body such as the PB could assist members and advisors. A central database of transfer rules and regulations could be developed and maintained (updated) on an ongoing basis by the PB and this could be the reference point for all concerned parties.

Also, in the case of international transfers (assuming permanent change in tax residency), refunds of contributions up to a certain limit (subject to a refund tax) should be considered.

More broadly, the IAPF would like the PB to consider the establishment of a National Pensions Default Fund (or other name as appropriate) to enable individuals to save for their retirement without the need for investment decision making and have the ability to move funds from existing schemes into this fund upon leaving their place of work. The fund would be established along the lines of best practice internationally and would be protected within constitutional law from governmental raiding at times of crisis. This issue could be considered in accordance with the introduction of auto-enrolment.

Advantages

- Individuals can transfer assets into one place
- Offers ease of assessment for evaluating future pension value
- Reduces management costs
- National effort, so national understanding of value and of the benefits accrued
- Supernormal monitoring of fund due to size and critical value to the country
- Easier to educate populace on one fund than the values of many
- Offers opportunity at some future point to be a receptacle for the transfer of unsustainable DB funds
- Offers a useful scheme for companies to contribute to on behalf of individuals without any management headaches
- With retirement planning complexity surrounding a mobile European Workforce, the Default Fund offers a destination where disparate funds of this mobile workforce can be positioned in a single place with a view to offering a managed drawdown upon retirement to the individual.
- Institute a central member tracing service to be run by the PB
- Put in place a register of schemes linked to registered administrators to be publically available on the PB website.

Disadvantages

- Will be complex to guarantee integrity within law.

CHARGES

The IAPF note that the study being by the Department of Social Protection with the Pensions Board and the Central Bank on the level of pension charges and expenses associated with different forms of private pension arrangements is ongoing at the time of writing. We welcome this study and hope that one of the main outcomes of it is to bring about a clearer understanding by all stakeholders of the effect of charges on members' retirement outcomes. Furthermore, we hope that any changes brought about from the study will help simplify the charging structures which will give greater confidence to individuals to make retirement savings. Clearly, the variety of complex charging structures currently in place for DC arrangements is a hindrance to individuals when making decisions regarding their retirement savings.

We note from the Minister's announcement of the study that there would be a focus on those charges or expenses that have the effect of reducing members' or employers' contributions or investment returns. Therefore, although the study will cover both DB and DC pension structures, it should always be remembered that only members of DC arrangements need to be personally mindful of the effect of charges on their retirement savings. In effect, any charges levied on DB plans are usually met either directly or indirectly by the sponsoring employers but this is not the case in respect of DC schemes. Recent years have seen many employers move from DB to DC models primarily due to the cost of funding the DB benefits. However, changing system from DB to DC hides the fact that the cost of running those schemes are also being passed from employers to members. Therefore, the IAPF believes that the PB should be mindful that perhaps there is a balance in how charges should be applied between both employers and members of schemes.

There are a range of charges that pension scheme members must be mindful of and a sample of these are as follows:

- Initial charges on joining the scheme or on contributions being made
- Contribution charges ("bid offer" spreads)
- Ongoing investment management (and/or custodian) charges
- Charges for switching from one type of fund to another
- Monthly/quarterly fixed policy fees
- Annual Pensions Board fees
- Charges for exiting on retirement or transfer to another pension arrangement

In addition to the above, it shouldn't be forgotten that sponsoring employers also have charges for professional services (e.g. registration, administration, audit and trusteeship).

The IAPF would note that any regulation imposed upon trustees and pension providers results in costs to members. We would therefore not wish to see further regulations that would either be costly for members or make work unprofitable for providers.

We would strongly support improved simplification and standardisation in respect of displaying understandable charging structures on all types of pension arrangements as this will instill improved confidence for members and help promote increased saving for retirement.

Legislation currently provides that PRSA holders cannot be charged for:

- Transfers to or from another pension arrangement
- Setting up or closing the PRSA
- Changing contributions (subject to some conditions)
- Stopping contributions

It should be considered whether such restrictions should also be provided for occupational pension schemes to align the different structures.

Rather than enforce more (potentially costly) regulation on the sector in relation to improved fee disclosures, the PB could set out the principles that industry providers would be expected to achieve in respect of how fees are applied to individuals. Providers could then use this qualification standard in the marketing and promotion of the pension and fund arrangements. In this regard, lessons could be learnt from the United Nations Principles of Responsible Investment which is a set of aspirational and voluntary guidelines for investment entities wishing to address environmental, social and corporate governance issues. Most international fund managers have signed up to these principles and, in turn, they have used this in the marketing and promotion of themselves with buyers that raise concerns regarding social responsibility. The IAPF would be happy to work with the PB in the development of such principles.

Other proposed measures:

- Most charging structures are designed in a way that allows commissions to be paid to brokers. This in turn provides that the charging structures can be difficult to understand for members. A higher ongoing fee may be more understandable than a higher initial fee to pay for such commissions. In the absence of that, commissions should be disclosed in such a way that the fund loss due to the commission should be shown in monetary terms

- Consideration should also be given to disclosing total expense ratios only rather than annual management fees to avoid the non-disclosure of hidden charges

- Managers should be promoted to disclose to members that some fund offerings are lower because they are invested on a passive basis rather than take credit for lower charges against competitors on an actively managed basis. In this situation, pension funds are paying fees for active management when its true style is becoming increasingly passive: adding less and less value, and offering less and less innovative stock selection strategies

- All fees that are paid by members should be quoted on explanatory communications

- A reminder that fees are payable should also be noted on annual benefit statement information.

STRUCTURE SIMPLIFICATION

There is a compelling case for simplifying pension provision generally by consolidating the types of arrangements for future pension provision, such that the available options are:

- Trust based DC plans or contract based PRSAs suitable for individuals or groups
- and, DB as applicable

The rules and regulations for each should be well defined but as closely aligned to each other as possible.

To give some context, there is currently a wide variety of types of pension arrangements and as a result, amongst other things, a range of ages that members can take regular retirement benefits as follows:

Personal pension plan – retirement annuity contract (RAC)
Between 60 and 75 (earlier in certain limited circumstances)

PRSAs
Between 60 and 75 (earlier in certain limited circumstances) or from age 50 if retiring from employment [60 if self-employed]

OPS
Currently retirement age must be set between age 60 and 70 although early retirement is permissible from age 50

State Pension
New rules provide that the State pension is effectively payable from age 66 from 2014, 67 from 2012 and 68 from 2028.

Public sector (new entrants)
In line with new State Pension rules – 66 to 68 with the option of deferring until 70

The IAPF would strongly support improved simplification and standardisation in respect of retirement vehicles and associated retirement ages as set out above. Of course there are further differences between the various pension vehicles – for example, tax relief on OPS compared to PRSAs and differences in lump sum calculations. There is a current particular need to resolve the differential treatment of PRSAs and OPS that has emerged in recent years. All of these differences in rules contribute towards a system that is difficult to understand for pension contributors.

Suggested courses of action regarding the uniformity on the rules surrounding pension benefits:

- Remove trust based and individual RACs in place a full move to PRSAs for personal and group contract arrangements
- Standardise the retirement age rules and tax relief systems across all models which would promote simplification and understanding, and then allow improved transferability between same. All Personal Retirement Bonds should be defined as DC schemes, especially for the purposes of taking lumps sums and/or exercising ARF options.

EARLY ACCESS

We would also recommend the consideration of the possibility of some individual early drawdown of pension funds from their DC (and/or DB AVC) portfolio. We believe that this will offer several advantages as articulated below and the risks associated with reducing the accumulated pension pot can be diminished through ring-fencing the amount that can be drawn down (e.g. as a multiple of the annual state pension).

Advantages

- Releases funds that are otherwise locked up until person retires
- Cash flow advantages to government in that released funds are taxed now
- May relieve critical individual cash flow problems (e.g. mortgage arrears, unemployment etc)
- Increases movement of money within the economy
- Improves the likelihood that people will save into a pension arrangement.

Disadvantages

- Will affect individual's retirement income.

Other Considerations

Expand the legislation around release of trivial sized pension pots which can be cashed in upon leaving service, up to certain limits. There are a number of different triviality rules at the moment. There is a "€330 limit" and a different "€20,000 limit" with further varying complexities attached. One single scenario would be clearer to explain and easier to manage than the current multiple scenario system and linked in some fashion to the State pension.

INTERNATIONAL EXPERIENCE

There are many well-developed DC systems internationally. Almost all struggle with many of the issues we have outlined here. Traditionally, DC systems have moved much of the decision making onto the individual savers. It is often up to the individual to decide how much to save, where those savings should be invested and in what form the benefits should be taken at retirement. There has been a reliance on providing savers with lots of information to enable them to make those decisions.

It is becoming clear that savers need more than this. Too often, the information they are provided only serves to confuse them and often that leads to difficulty in making decisions which ultimately means their outcomes are less than optimal. There is a growing understanding of the need to make the decision making process as simple as possible. Information provided to participants should be intended to communicate rather than satisfy compliance obligations.

A pension scheme or contract is a long-term savings account and getting savers to understand that basic concept is a good start. Outcomes can be improved when savers take ownership of their accounts and countries like Australia and the US have been successful in this regard. The nature of DC provision is evolving with the introduction of features such as auto-enrolment, auto-increase of contribution levels, flexible retirement, investing past “normal” retirement and it is important that these developments are researched and applied where they can improve outcomes.

We therefore recommend that international developments are tracked and researched to ensure we can introduce those elements and features that can help to improve the outcomes for DC savers.