Pensions

New rules will see pension providers improve compliance

A new EU directive and the government reform plan will see greater protection for those saving for retirement, writes Lorraine Courtney

Pension supervision is changing, and occupational pensions in Ireland are changing in an unprecedented way.

Triggered by the EU's Institutions for Occupational Retirement Provision Directive (the IORP II) and the government's roadmap for pensions reform, these changes will see a significant improvement in consumer protection for pension savers and beneficiaries.

Last year was particularly challenging, given the effects of the Covid-19 pandemic, and one of the most important activities of the Pensions Authority in 2020 was its programme of engagement with a number of master trusts and larger defined benefit (DB) and defined contribution (DC) schemes, Brendan Kennedy, the pensions regulator and chief executive of the Pensions Authority, said.

"The objective of this programme was to assess the state of preparedness for IORP II, and the results were mixed, with some areas of concern identified. It was a valuable exercise, and we have seen good progress in our follow-up engagements."

On April 22, 2021, the Minister for Social Protection signed the regulations which transposed the directive into Irish law. "There must be no misunderstanding about the significance of this event: few if any occupational pension schemes were wholly compliant at the transposition date and, for the great majority of schemes, compliance will involve very significant changes," Kennedy said.

"The implementation of IORP II will also have implications for how the authority supervises in the future, with a greater emphasis on forward-looking risk-based supervision. The purpose of these changes is to strengthen consumer protection."

Kennedy said retirement savings were a significant financial commitment for contributors, and they were entitled to high standards in the management of their savings. "This should encompass not just protection against fraud or error, but proper accounting, expert investment, good value for money and good communications.

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

Brendan Kennedy, the pensions regulator and chief executive of the Pensions Authority

The immediate priority for all pension schemes and for the Pensions Authority is to put in place the additional structures and processes required by the transposition of IORP II, he said. "Compliance with the amended legislation is not an end. The purpose is to make pension schemes more efficient and accountable, and to ensure that there are trustees in place who are able and willing to address the significant responsibilities involved in overseeing and investing pension assets for up to 50 years.

"When this transitional phase is complete, there is both the opportunity and an obligation on trustees to address major issues. The long-term multi-generational investment of retirement savings has always been a profound and often underestimated challenge: there is no simple formula that identifies the right balance between investment return, risk and liquidity.

"This challenge has become even greater in recent years, where monetary policy has contributed to high levels of negative yielding debt and where expectations of continuing economic growth will clash with the need to respond to climate change."

The continuing replacement of defined benefit (DB) by defined contribution (DC) means a transfer of investment risk to individual pensions savers, said Kennedy. "However, very few savers are equipped to make investment decisions for themselves, and DC scheme trustees must recognise that they have no less investment responsibility than their DB scheme counterparts. It is likely that most scheme members will rely on the default investment options.

"Although there are no guarantees provided, trustees must nonetheless be clear about the objectives of these investments. Trustees must adopt a structured approach to setting and achieving their objectives and be open and objective about their performance. The investment choices offered by DC schemes must also be carefully chosen and managed by trustees in the same way."

Low and negative yields are a particular challenge for DB schemes because of the specific benefit promises given to members. "It is especially important that trustees ensure that they have enough information and analysis to understand their scheme and in particular, the aggregate risk borne by the scheme and how it is distributed among different classes and cohorts of members.

For both DB and DC schemes, the trustees must decide whether to take account of environmental, social and governance (ESG) factors in making their investment decisions, he said. Some DC schemes incur high charges and trustees have a responsibility to address this issue.

"Providing additional information to members about charges may have a part to play, but such information should be comprehensible to those for whom it is intended, and we must recognise that too much complex information may overwhelm members," Kennedy said.

"In a number of other jurisdictions, trustees of pension schemes or their equivalents are required to justify whether their pension schemes are providing good value for money or whether their members could do better elsewhere."

Effective regulation and well-managed pension schemes are a necessary part of supplementary pension provision in Ireland, Kennedy said. "But they will not in themselves increase pensions coverage, and the recent announcement by the Minister for Social Protection about the objectives for implementation of auto-enrolment are very welcome."

In future, the supervision of pensions by the regulator would be more intrusive, more qualitative and more demanding, said Kennedy. "It is not the authority's job to dictate to trustees how they should run their pension schemes, but it is our job to assess how well they are doing it.

> **Consolidation is fundamental to improving the Irish pension system**

"Our long-term goal is that we can take for granted trustees' compliance with all their obligations, and our engagement with trustees will be a dialogue about how they intend to achieve the best outcomes for their members. Our short-term goal is to get to that position as quickly as possible."

Make it your business to invest in an exit strategy

Consider splitting investment risk and cutting tax exposure by building up your pension fund

BY LORRAINE COURTNEY

Business owners are not always aware of how to extract wealth tax using a pension, Eoghan Gavigan of Highfield Financial Planning, said.

"Business owners are very conscious of how much tax they pay, but relatively few fully appreciate the scope they have to extract wealth tax effectively using a pension.

"Most people are familiar with the age-related tax-relievable percentages that apply to pension contributions.

However, if you have your company establish an occupational pension for you, the limit on company contributions is calculated based on your salary and service and the level of pension provision you have made, taking into account how long you have left until your chosen retirement date.

This means that the company can backfund if you are a late starter and the contributions which are allowed are usually substantial.

"So company directors have significant scope to do some very easy tax planning at a time when their business may well be cash rich and when they may be thinking about how much tax they pay and their exit strategy."

Eoghan Gavigan of Highfield Financial Planning

Some business owners favour building up the value of their business instead of funding a pension. There could be a number of issues with this, he said. "They will invariably pay more tax. They lose the benefit of gross roll-up (the fact that investment growth isn't taxed within a pension vehicle). Also, having a large proportion of your net worth wrapped up in your business can lead to concentration of risk."

Gavigan said every business owner should make pensions a part of their tax planning.

"They should revisit their contribution levels at least once per year, and if they are going through a restructuring. Apart from the annual review of funding, they and their adviser should carry out an in-depth review at least ten years prior to their intended retirement date.

"There are a number of reliefs available against capital gains tax and capital acquisitions tax which can be used when exiting a business, and pensions can be used in conjunction with these."

"Conditions apply, so I would recommend that anyone who owns a valuable business consult a tax adviser to start the process of devising an exit plan as early as possible."

Start taking a nominal income from day one of your business, said Gavigan. "Your pensionable service starts when you start taking taxable remuneration, so starting early could help you extract funds tax effectively down the line.

"One of the obstacles to effective retirement planning is that because it is long term in nature, it's easy to kick the can down the road. Even if you don't have the capacity to make the level of contributions that would provide you with the pension you want, start a pension now.

"If you are in your 40s, the 20 odd years you have left until retirement age is likely to pass as quickly as the 20 years since the first Harry Potter movie, which was released in 2001."

Devising an investment strategy and sticking to it is important, said Gavigan. "Advisers are required to risk-rate pension savers, but there is too much focus on short-term volatility.

A young investor might produce a relatively low risk rating, but you have to ask the question: how relevant is short-term volatility to a 30-year-old pension saver who won't be accessing the funds for at least three more decades?"

Gavigan said that for these types of savers, the key focus should be on "volatility resilience". "Even if you are a member of a company scheme, there's nothing to stop you from retaining an adviser to help you with your investment strategy.

"You'll need a fee-based (rather than commission-based) adviser, but due to the long-term nature of retirement saving, the benefits of doing it right should more than offset the fee."

If the current debate in relation to the state pension should tell us anything it's that you can't rely on it being there when you get to retirement. "A debate that isn't really taking place in any meaningful way is the pensions apartheid that exists between public sector [workers] who have gold-plated pensions, and the private sector, where there is a time bomb [waiting to go off]. When combined with the lack of affordable housing, we are storing up a huge problem for the future.

"Addressing the imbalance between public and private sector might go some way towards solving the problem, but it's not on the cards."