An Bord Pinsean
The Pensions Board

Presentation to IAPF Annual DC conference

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"The future of DC regulation"

Brendan Kennedy, Chief Executive, The Pensions Board

- Thank you for the opportunity to address this conference. Most future pensions provision is likely to be defined contribution, and so one of The Pensions Board's objectives for 2013 is a review of the regulation of DC. We want to consider how best to structure such provision, and what regulation is needed to make sure it works to prove the best outcome for contributors. My objective this morning is to give you an outline of the issues we are considering and the direction of our thoughts.

- The benchmark for our DC review is contributors, and how well the current system serves them. There is undoubtedly good defined contribution provision out there, but equally there is much provision that could be a lot better. The specific problems that we see are:

  (a) Costs – costs for some DC schemes, particularly smaller schemes, are much higher than are being achieved by other schemes.

  (b) Investments – the investment choices offered to DC members are in many cases too complex, and, most importantly, the default strategies are not always appropriate.

  (c) Communications – it is clear that many members do not understand enough about their pension schemes to make informed decisions about investments, benefit options, etc.

  (d) Administration – there are instances where the administration of DC schemes is not as good as it should be.

- We need to improve the current system to address these problems, so that many more DC savers better understand their pensions, understand the decisions they need to make, and achieve value for money.

- We should not take it for granted that trusteeship is the appropriate structure for DC pensions. Given that trusteeship adds a layer of complexity and regulation, we must consider whether it adds value and justifies itself.

- The simplest structure for DC provision is a contract – two parties – contributor and provider, written terms, no uncertainty. However, there are some problems with this structure:

  - ✗ Retirement saving is a very long term plan: it is difficult to draw up a contract that covers everything possible that will happen over that time.

  - ✗ In general, pension savers through contracts achieve poorer value for money than scheme members. This is probably a combination of poor understanding by the purchaser and the inherent lack of scale in a single person contract.

- But the biggest problem with contracts is exactly that they are two-party affairs. These two parties are very unequal in bargaining strength and in knowledge. There is plenty of evidence that the contributors do not fully understand and make poor decisions – they pay more than they could, they make poor investment choices, and in general they fail to hold the other party to proper account.

- Of course, this inequality in contracts could be addressed by regulation – this is after all the purpose of regulation. But it is very difficult for regulation to deal with costs, especially over time, and it is not easy (though not impossible) to deal with investment matters. More generally, the greatest challenge is that retirement provision is a long-term commitment, which needs dynamic management to cope with the personal and environmental changes that will inevitably arise over time. A contract may not be flexible enough.

- There will always be a place for contracts. But it would be good if there was a third party in the equation, that is, someone who acted on behalf of the contributor, but overcame the drawbacks under which the contributor labours.

- And this is, or should be, the argument for trustees in DC pensions. The justification for trustees would be that they make better decisions on behalf of the member than the member would make on his or her own. In order for this to be true, the trustee should be knowledgeable enough to make informed decisions on behalf of the member where appropriate, to ensure that the member is provided with appropriate information, to keep an eye on the administration, and to secure good pricing terms.

- If I describe the trustees who tick these boxes, I think they would

  - ✓ Know more than the members.

  - ✓ Have enough time and commitment to do the job properly.

  - ✓ Have enough bargaining power to secure good terms.

  Of course, they should have no conflict of interest and therefore no connection with the providers of the services.

- Clearly, there are existing trustees of existing schemes who meet these criteria. But there are too many who do not. This is no disrespect to the many thousands of people who perform that job. Nonetheless, many are not achieving as much for their members as they should be.

- The biggest problem is the number of schemes, especially small ones. There are about 140,000 DC schemes – this includes frozen schemes and AVCs. This is more than half of the pension schemes in Europe, and is plainly too many. The consequences are:

  - ✓ This number must mean that we have about a quarter of a million trustees. For the current system to work properly, this means we would need to have about 250,000 informed and active pension trustees, which I do not think is practical.

  - ✓ Fewer than 1% of schemes can have any significant bargaining power to reduce costs.

  - ✓ There are far too many schemes for The Pensions Board to be able to adequately oversee the governance of these schemes.

- A much smaller number of schemes would bring significant advantages, and the Pensions Board is committed in principle to achieving this. We do not have a specific target in mind, but in the very long term, it has to be difficult to justify more than 100 DC schemes in a country of our size.

- The changes needed to achieve this goal are not simple, and further consideration is needed, including consultation with relevant stakeholders. We certainly must ensure that any change does not discourage pension provision, and is aligned with other initiatives, including auto-enrolment, if this becomes Government policy. Legislative change would probably be necessary, and this always takes time.

- It may well be that the best place to start would be with new schemes. One possibility is to introduce regulation requiring new occupational schemes to satisfy the Board before they can be registered. This would mean that the Board would have to be satisfied that the scheme design and the trustees are fit for purpose before granting approval.

- I am very clear that what I have proposed here involves a lot of change for Irish defined contribution provision. But it is my view that there is considerable scope for improvement in DC pensions, and therefore we must try to achieve it.

Brendan Kennedy