Insights
**Defined Contribution**

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# Solving Ireland's Pension Gap

## Good Default Design Critical For Success of Auto-Enrolment Plan

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- Only 47% of Irish workers are saving for their pension and coverage is even lower for private sector workers.[1] There has been consensus for several years that in order to effectively increase pension coverage, Ireland should introduce automatic enrolment which has been tried and tested around the world.[2]
- After the hurdles that have been faced over the recent years, we are pleased to see the auto-enrolment plans set out in the 2019 consultation documents, finally moving forward.[3] However, a 2024 date for the first employee contributions is an ambitious deadline for the build of the new system. One key challenge is the design of the investment options, including the default investment strategy. We believe having a robust default investment strategy which is suitable for the majority of members is central to the success of auto-enrolment and ultimately for delivering good outcomes to savers.

## What Do We Think of Some of The Key Features Set Out by The Government?[4]

- **750,000 employees will be enrolled initially. This will include individuals who meet certain age and income criteria and are not already participating in an occupational pension scheme. A conservative estimate is that savings within the auto enrolment system will amount to over €20bn ten years after the commencement of the system.**

  In order to maximise coverage and make best use of inertia, we believe the system should have as few barriers to being automatically enrolled as possible. We would have liked to have seen the age (23) and income (€20,000) minimums for being enrolled set lower.

- **A new Central Processing Authority (CPA) will be created which will be an independent, statutory body regulated by the Pensions Authority. The CPA will pool and allocate investment returns from each fund manager to ensure that all members in any fund type will receive the same, weighted average return. It will also facilitate a "pot follows member" design.**

  The remit and design principles set out for the CPA cleverly address a number of issues faced by other defined contribution pension systems e.g. the CPA's ability to facilitate "pot follows member" will aim to mitigate a large number of small/stranded pension pots within the system as experienced in the UK.[5] However, based on our observations of the UK's National Employment Savings Trust (which isn't set to repay its government loan until 2038)[6], we expect the set up and ongoing running costs of the CPA to be significant.

- **Commercial providers will be invited to tender to become a Registered Provider of investment management services. Up to four Registered Providers will be selected and each will provide three risk graded funds plus a lifecycle strategy which will be the default investment option for members who do not make a choice.**

  Given that the four Registered Providers will provide a near identical fund line up, it will be important for the CPA to have appropriate governance and monitoring in place to ensure there is space for innovation and idea generation. We believe having a small set (i.e. four funds) is suitable and will give members some choice without overwhelming them with too many investment options — too much choice can sometimes lead to inaction (the Paradox of Choice[7]).

- **Charges will be capped at 0.5%**

  This has been set ambitiously lower than the UK's 0.75% charge cap and is set to include both administration and investment management costs. When it comes to investment management, we believe focus should be on value for money rather than lowest costs. Diversification and risk management tools can add value but may add to costs.

## We Expect The Majority of Members to be Invested in The Default

As set out above, it is essential that a default investment strategy is offered because by definition and design, automatic enrolment requires no engagement from the enrolled employee. Based on global experience, we would expect take up of the default fund to be high (in excess of 80%).[8]

High take up of the default is not a bad thing and typically leads to better outcomes. Evidence has shown that individuals are prone to behavioural biases such as taking too much / too little risk, failing to update their investment strategy over time or concentrating their portfolios to particular sectors/countries. These biases can lead to suboptimal outcomes when making complex financial decisions.[9]

### Based on Our Global DC Experience at State Street Global Advisors, We Believe a Good Default will Incorporate The Following Features:

- Simple for members to understand — the default strategy should be efficient and effective in delivering good outcomes to members whilst offering sophistication, however, it should be communicated to members in clear and transparent terms
- Incorporate environmental, social and governance considerations — funds should be invested in a responsible and sustainable way, driving positive change in the companies that members' pension savings are invested in
- Focus on value for money rather than lowest cost — value can be added through diversification and risk management, which may add to costs

## Governance will be Key in Ensuring Suitability and Fostering Innovation

In addition, whilst setting a good default is important in achieving good member outcomes, we expect member behaviour and the market environment to change over time. It is therefore crucial that a strong governance framework is in place between the CPA and the Registered Providers. We believe the design of the default strategy should undergo an evidenced based review annually to ensure that it remains fit for purpose and is expected to deliver a suitable risk-return profile across age groups. Innovation and new investment ideas should be considered as part of this review.

We look forward to seeing the Government's plans develop further over the coming months and will be releasing further thoughts on investment and default design.

## Endnotes

1 A Strawman Public Consultation Process for an Automatic Enrolment Retirement Savings System for Ireland — 92c139a0d2c247f09c4d4078e7bf30be.pdf (gov.ie).

2 In the UK, automatic enrolment raised private sector pensions participation from 42% to 73% over the period 2012 to 2016. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/883289/automatic-enrolment-evaluation-report-2019.pdf.

3 Launch of the Final Design Principles of an Automatic Enrolment (AE) Retirement Savings System for Ireland. https://gov.ie/en/publication/27bab-launch-of-the-final-design-of-an-automatic-enrolment-ae-retirement-savings-system-for-ireland/.

4 https://gov.ie/en/publication/27bab-launch-of-the-final-design-of-an-automatic-enrolment-ae-retirement-savings-system-for-ireland/.

5 The Pensions Policy Institute has forecasted that there could be 27 million small DC pension pots (under £2000) by 2035 Small-pots-cross-industry-co-ordination-group-update-report.pdf (plsa.co.uk).

6 Current forecasts are that NEST is due to repay its loan from the government by 2038 Nest, the National Employment Savings Trust: Annual report and accounts 2020/21 (large print) (publishing.service.gov.uk).

7 The Paradox of Choice, Barry Shwartz.

8 99% of the members in the UK's National Employment Savings Trust are in the default fund: Retirement Outcomes Review: interim report (fca.org.uk).

9 Workplace-defaults-better-member-outcomes_FINAL-.pdf (thepeoplespension.co.uk).