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Pensions Review 2019

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Contents

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Des McGarry
Managing Director

EVER CHANGING AND IMPROVING

Change is not something we readily associate with pensions, yet it has been a feature of the market for many years. The basis of the industry has been an offer of some degree of certainty in terms of retirement planning. The language we used had its roots in this certainty. We spoke of defined schemes, whether in terms of benefits or contributions, and members were offered set incomes either from the scheme or an annuity.

The environment for defined benefit schemes changed beyond recognition during the 1990s and early part of this century. Fundamental alterations to member rights coupled with macro-economic shifts which drove bond yields to historic lows effectively made the traditional model no longer fit for purpose.

Those same macro-economic forces have had a profound impact on annuities as well. Annuity rates are at all-time lows and will continue to offer bad value while bond yields remain at the current low levels.

The pensions and investment industry responded to these changes with innovative solutions and approaches and continues to offer excellent outcomes to scheme members.

We are now once again entering a period of what could be quite profound change for pensions. On the one hand, we finally have proposals for a state backed auto-enrolment pension scheme while we also have to contend with the far-reaching implications of the IORP II Directive and other regulatory changes.

The biggest single issue in the pensions sector has long been and continues to be the low level of coverage. It currently stands at less than 50%, but this includes the public sector where coverage is close to 100%. The level for the private sector stands at just 36%.

Several attempts have been made to address this situation, most notably the introduction of PRSAs in the late 1990s and moves to make pension investments more attractive by allowing scheme members greater freedom in relation to how their funds are invested on retirement. Both had little impact.

A national auto-enrolment pension scheme has been discussed in this country for more than a decade and it now seems likely that we will have some form of scheme in place by the government's target date of 2022.

This could have many unforeseen consequences for the overall pensions market. Employees could opt to join the national scheme rather than existing occupational schemes. Employers could be faced with the prospect of having to run an occupational scheme at the same time as facilitating employees who are contributing to several different funds under the national scheme. Differences in contribution levels between occupational and national schemes could lead to workplace issues.

At the same time, we have to contend with the implementation of the IORP II Directive on the activities and supervision of institutions for occupational retirement provision. This has far reaching implications for the industry.

The new regulations include fit and proper standards for trustees, appointment of key function holders, a requirement to have written policies on key areas of risk management and outsourced services, and minimum standards for member communications.

Some have described the requirements as onerous but while they may place an additional burden on pension providers their objective is clear, improved governance standards for scheme members.

In this context, it is up to the industry to embrace these changes and work to ensure that they succeed in their objectives. We must also continue to innovate and become even more efficient to ensure that new structures and regulations do not have the effect of adding costs or impair outcomes for members.

Over the years, the industry has been extremely adept in responding to changing environments and circumstances and I am confident that this will again be the case in the coming years.

Des McGarry

Bronagh Traynor
Investment Consultant

Gerald Fitzgerald
Investment Consultant

INVESTING RESPONSIBLY

Bronagh Traynor and Gerald Fitzgerald look at the growing importance of Environmental, Social and Governance considerations in the investment decision making process.

Environmental, Social and Governance (ESG) has received extensive media interest in recent years and has become a key consideration for investors. The ability to generate returns is no longer enough and the manner in which these returns have been attained has to be taken into account – have the returns delivered been through means which are responsible from an environmental, social and governance perspective?

Environmental, Social & Governance investing explained

Environmental investing refers to investing in a manner which does not contravene environmental restrictions or guidelines. This includes choosing not to invest in companies which are seen as being environmentally destructive. Companies which contribute to the rise of carbon emissions, major oil producers or coal mining companies are prime examples.

Over recent years companies which have contributed to particular environmental disasters have seen significant fluctuations in their share price after these detrimental events. This price movement does not just account for those investors who see a significant litigation cost from such an event but also those investors who lose confidence in the companies' regard for the protection of the environment.

Such events include the BP oil spill in the Gulf of Mexico in 2010 and more recently in January 2019, the share price of Vale, a Brazilian mining company fell by 23% in the days following the collapse of one of their dams which caused major destruction.

Social investing refers to investing in a manner which seeks to adhere to minimum ethical standards such as the use of "Fairtrade" producers and guaranteeing a minimum level of income to those at all levels of the supply chain. Social investing also extends to ensuring portfolios do not include investments in companies such as tobacco firms, gambling organisations or firms involved in child labour or other human rights abuses.

More recently this conversation has increased the focus on palm oil producers and the impact this has both on pay and conditions of their workers.

Governance investing refers to investing in companies which are mindful of all stakeholders in business, including where executives and the board of directors' act in a manner which does not adversely affect staff or shareholders. There are a number of examples where poor governance standards has ultimately led to destruction of shareholder value and the ultimate demise of a company.

Such examples include Enron, the US listed energy distributor whose actions and poor governance led to the ultimate collapse of not just the firm itself but also Arthur Andersen, one of the "Big Five" accounting firms at the time.

Do corporates not practice ESG already?

Whilst many companies either intentionally or inadvertently engage in ESG practices, there has been a notable shift towards encouraging increased transparency of these activities to provide stakeholders with key information on their activities in the area. The increased oversight of how a company conducts itself is mainly achieved through regular reporting, with many companies detailing their stance on ESG issues as part of their annual reporting.

Whilst ESG investing can be seen as socially responsible, from an investor's point of view, ESG focused investment can contribute to enhanced safeguards against share price fluctuations and lead to better risk-adjusted returns. By having an ESG focus, companies have risk management procedures in place to ensure they conduct their business in a manner which ensures checks and balances exist which protect against situations like Enron and Vale.

The principal issue with the widespread adoption of ESG, however, has been the lack of consistent and measurable standards which empower investors to make informed decisions on which companies merit inclusion in an ESG conscious investment portfolio. We believe that whilst certain companies lead the charge through genuine engagement with ESG, there are others who merely see the marketing benefits and don't engage in a meaningful way.

The coming years will see a further evolution in ESG monitoring and reporting. Legislation and guidelines will contribute to this. The introduction of ESG considerations by pension schemes under IORPs II, for example.

Increased commitment to social change can be brought about via behavioural nudges in consumers and investor attitudes, such as the elimination of plastic straws from fast food chains, right up to oil firms changing their focus from fossil fuel to green energy production.

Putting ESG into practice

Whilst ESG investing is certainly in the midst of its own evolutionary loop there has generally been a lack of investor sign-up to ESG investing within the Irish market. Notwithstanding this, investment managers have sought to proliferate the number of ESG funds on the market. The latest research from Morningstar noted assets under management for ESG conscious funds exceeded $1.05tn in October 2018 with 2017 seeing 229 ESG funds being created in Europe alone. These funds apply varying levels of ESG screening. Some funds are arguably more focused on marketing rather than genuinely applying ESG within the investment portfolio. This adds another layer of complexity and makes it difficult to compare various offerings.

That said, there are certain funds which through circumstance of timing or otherwise have delivered enhanced returns versus non-ESG rated counterparts (see table below).

This is particularly evident in more inefficient markets such as emerging markets. Whilst the longer-term performance is superior for the ESG focused emerging market fund, the risk-adjusted returns as measured by both fund's Sharpe Ratio is superior for the ESG focused fund. The Sharpe Ratio is a measure of the performance of an investment by adjusting for its risk. The benefit of enhanced risk-adjusted returns means the returns for the ESG fund have been delivered more efficiently.

In conclusion, we believe ESG will increase in importance, particularly given upcoming regulation which will compel pension schemes to communicate their attitude to ESG. As investors we need to ask ourselves if we should all contribute to the ESG evolution by asking the right questions of companies and investment managers leading to a widespread ESG behavioural change.

Ultimately, ESG investing not only seeks to mitigate potential risks which could lead to a destruction in shareholder value, but is also aimed at contributing to enhanced risk-adjusted returns for investors over the longer-term. The benefit for investors and the wider public of raising the ESG bar is clear to see.

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Fund	3 Months %	1 Year %	3 years p.a. %	5 years p.a. %	10 years p.a. %	Since inception p.a. %	Sharpe Ratio 10-year
MSCI Emerging Market ESG Leaders	-6.2%	-14.6%	11.0%	4.9%	11.7%	4.4%	**0.67**
MSCI Emerging Markets	-7.4%	-14.2%	9.7%	2.0%	8.4%	0.7%	**0.49**
Difference	**1.2%**	**-0.4%**	**1.3%**	**2.9%**	**3.3%**	**3.7%**	

Source: MSCI 31 December 2018; Inception Date 27/09/2007; performance in $

Gerry Winters
Director

CHANGING THE CONVERSATION

The message needs to change if people are to become more engaged with pension planning Gerry Winters writes.

Sometimes we have to ask ourselves if what we have been doing for a long time has been right. For some time now, the discussion around defined contribution (DC) pensions has been centred on the likely benefit outcome at the members' normal retirement date. Studies in the area of "adequacy" in DC schemes have almost universally used replacement income ratios as the key barometer and in turn this language has been adopted by most pension practitioners in relation to target setting.

I would argue that this particular barometer or yardstick may not be the most appropriate and it may actually be counter-productive when it comes to getting people to engage with pension planning. In the first instance, you are asking people to consider an imponderable. A 35 year old has no idea what they will earn in 30 years' time or more and setting a target as a proportion of that has little basis in reality for them.

The cost of reaching this fairly nebulous target is also intimidating. If the target is set at say 50% of pre-retirement income the cost to the 35 year old could be around 20% of their income for the next 30 years. That is not going to be an attractive proposition to most people.

The key is to engage with people without frightening them and to convince them that any form of pension provision is better than none. That means changing the lexicon we use in the conversation. Terms such as Annuities and ARFs mean very little to someone who is decades away from retirement. Targeting a lump sum of a particular value is however a very different proposition.

For example, under current pensions legislation a defined contribution scheme member is allowed to take 1.5 times their salary in the form of a tax-free lump sum on retirement. This is very tangible and even without projecting forward it is easy to see the attraction of a lump sum of this size.

The conversation then comes down to what people can look forward to when they retire. Most people will get the state pension and adding a tax-free lump sum of 1.5 times salary to that means something definite.

Expressing it in these terms also has the virtue of simplifying the rest of the conversation. When discussing what a person needs to do to achieve that goal there is no requirement to go into investment market returns or compound interest calculations. If the said 35 year old above contributes 2.5% of their salary annually and this is matched by their employer, they would reach 1.5 times salary in 30 years with no investment growth at all in their fund. Everything else is a bonus. Most people on average earnings would be pleasantly surprised by the result.

This is a means to address the substantial cohort of people who are reluctant to engage with pensions. For them, the numbers are all too big and are consequently not relevant. Telling an individual that increasing their pension contributions from 5% to 6% or 7% could improve their eventual pension annuity income in retirement by anything between 5% and 7% per annum is almost meaningless. There is no perceived value in this for the majority of people.

It becomes a very different story if the conversation is about value. If people can see a direct linkage between the level of the contributions they make and value of the fund or lump sum they will have at the end of the day, they will be much more willing to engage.

These are discussions we are having with scheme members and potential members at present and the reaction we are getting to this new approach is very positive.

It also reflects the new realities of retirement which is now dictated by how healthy we feel and how long we wish to continue working.

The message is clear. If we want to get more people to engage with pensions we have to rebrand them as a long term savings scheme for when you finish work or start to wind down or reduce working hours - with exceptional tax benefits of course.

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Frank Downey
Director

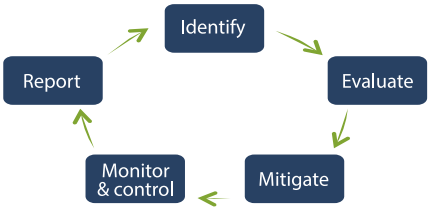
HOW RISKY IS YOUR SCHEME?

There are known knowns. These are things we know that we know. There are known unknowns. That is to say, there are things that we know we don't know. But there are also unknown unknowns. There are things we don't know we don't know.

Former US Secretary of Defense Donald Rumsfeld made semantic history on 12 February 2002 when he gave this profoundly perplexing explanation about "known knowns," "known unknowns" and "unknown unknowns" on the Iraq war. It is a useful conceptual framework for analysing complex problems and indeed a good starting point when considering risks for pension schemes.

Pension schemes need to take some level of risk in order to generate sufficient returns so that the benefits provided by schemes can be funded at an affordable cost. A risk management framework will help the trustees to determine the appropriate level of risk the scheme should take.

The Pensions Authority in their Financial Management Guidelines expect that trustees should undertake an annual risk assessment to:



This is now to be given Statutory backing under the EU Pension Directive, IORP II. Under IORP II, trustees will have to formally appoint a Head of Risk. The risk-management function is a substantial undertaking and should not be considered a box ticking exercise. A specific requirement in the Directive is that schemes must carry out and document their own risk assessment (ORA). The ORA will have to be performed at least every three years or without delay following any significant change in the risk profile of the scheme. This is a material and dynamic documentation requirement. It is quite similar to the requirements applicable to insurance companies under the Solvency II Directive and is envisaged to be a critical part of the good governance of schemes operating under IORP II.

So what does all this mean? Let's examine each of the risk management tasks.

The easy bit in theory will be to **identify** the known risks which can typically be grouped into the following categories:

- Scheme management
- Funding and solvency
- Sponsor covenant
- Legislative
- Investment

Some of these will be "known knowns", i.e. where we know and can measure the impact. Others will be "known unknowns", phenomena which are recognised, but poorly understood.

Then there are the "unknown unknowns" (unexpected or unforeseeable conditions), which pose a potentially greater risk simply because they cannot be anticipated based on past experience or investigation. By definition these are not something that can be immediately identified, but trustees always need to be conscious that there are other potential risks out there.

Risks should be **evaluated** by the likelihood of happening and their potential impact. Non-financial risks will require qualitative measure of risk. Financial risks may allow for some quantitative measures of risk. This can be done by doing a scenario / sensitivity analysis. Techniques such as "value at risk" or "VaR" are sometimes used, with any modelling proportionate to the nature and scale of risk.

It is important to remember that the aim is not to eliminate all risks. Rather the aim is to understand the risks involved and decide what level of **mitigation** is appropriate.

The risk register needs to be **monitored** for effectiveness of the risk mitigation processes previously agreed.

Finally trustees should ensure that they have regular and meaningful **reports** from the risk management function.

风险

The Chinese symbol for risk is a combination of danger and opportunity. Strategically managing risk by following a risk management framework should help trustees and scheme sponsors balance this danger and opportunity and help good decision making.

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Brian Sexton
Client Services Director

WHITHER THE STRAWMAN

Brian Sexton finds there are almost more questions than answers in the government's strawman discussion document on a national auto-enrolment pension scheme.

It may be difficult to believe at this juncture, but a national auto-enrolment pension scheme was first proposed by the late Seamus Brennan when he was Minister for Social Welfare in 2007. The proposal resurfaced under Joan Burton in 2011 and it was then the intention that a scheme would be in place by 2014. Five years later we are still in the consultation phase, albeit one where we have a much better idea of what the government envisages such a scheme would look like.

The government's outline proposal is for a scheme which would complement the state pension. Everyone between the ages of 23 and 60, earning over €20,000 and with no private pension provision would be auto-enrolled in a national scheme. That will encompass 420,000 people according to the government's estimate. Those outside these limits can opt in if they wish. Self-employed make up 16% of the working population but there is no clear proposal on how these people would be covered.

Employee contributions will be matched by employers with the government topping this up by €1 for every €3 contributed by the employee. The proposal for a government top-up is probably designed to mirror the Special Savings Incentive Scheme which succeeded by giving people a tangible reward for their savings.

It is not clear what the government intends to do in relation to existing tax relief for pension contributions. Employees on the higher rate of tax receive relief at 40% meaning that every €100 in contributions costs only €60. However, were the new top-up regime to be applied it would cost €75 due to the effective reduction in tax relief from 40% to 25%.

This could be problematic as it will impact particularly on those middle income earners where the gap between the state pension and their pre-retirement income is potentially largest. Lower income earners will actually gain from the state top-up despite the fact that the gap they have to bridge is considerably smaller. We have yet to hear how the government intends to deal with this potential inequity.

There is also the question of how the new scheme will line up with existing arrangements. Will employees who are a member of the auto-enrolment scheme have different rights and entitlements than members of an occupational scheme in the same organisation.

For example, under the current proposals the retirement age for the state pension and the auto-enrolment scheme will be the same. This suggests that early retirement will not be possible for auto-enrolment scheme members while it would be for occupational scheme members. This could possibly add another level of complexity to an already complex pensions framework.

There is also a danger or duplication of effort. It is envisaged that a Central Processing Agency will manage the overall auto-enrolment process. This will take all contributions from employers and allocate them to selected providers.

On the one hand, it makes sense to have a single agency benefiting from economies of scale, but the selected pension providers will also have to maintain the member records. It is hard to see how the economies of scale will be realised in this circumstance. Will the Central Processing Agency be an entirely new body and if so, who is going to pay for this?

The proposed upper earnings limit of €75,000 for the new scheme raises another issue. This does not tie in with current Revenue legislation that currently applies a maximum tax relieved fund of €2 million rather than an earnings cap. This poses the question of whether the government proposes to amend existing legislation to impose new restrictions on pension scheme members or if a two-speed pension structure will be allowed.

The strawman proposals don't comment on the provision of advice to members when it comes to drawing down benefits. This requires further detail from government.

Overall, the publication of the strawman is to be welcomed. We've been waiting long enough for it but we will need more clarity from the government before passing judgement on their new auto-enrolment scheme.

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Finian O'Driscoll
Director

WHAT NOW FOR SMALL PENSION SCHEMES?

Finian O'Driscoll looks at the future for small schemes in the light of pending legislation.

One of the Pension Authority's stated objectives in their reform recommendations published last year is that "the number of schemes in Ireland should be reduced from the current approximate figure of 160,000 to a medium-term target of 100 - 150 active schemes, to facilitate effective oversight".

The new IORP II Directive will require a much higher level of governance for pension schemes. The Directive allows Member States to choose not to apply most of the Directive's provisions to pension schemes with less than 100 members and indeed the UK has chosen not to apply many of the requirements to such schemes. However, the Department of Employment Affairs and Social Protection has stated that to exclude such schemes from the provisions of the Directive would "be contrary to the policy of enhancing standards for consumers".

Separately the Department confirmed that single member schemes will no longer be permitted to enter into new borrowings once the Directive is implemented. This will have implications for small self-administered schemes who wish to borrow for property investments in the future.

So how many schemes and members will this affect? The number of schemes with active members is in fact 71,300 (the balance of the 88,700 referred to by the Pensions Authority being largely closed schemes with deferred members or benefits). The membership of the active schemes can be broken down as follows:

Funded Schemes with active members at 31 December 2017						
	Defined Benefit		Defined Contribution		Combined	
	No. of Schemes	Active Members	No. of Schemes	Active Members	Total Members	
Frozen	194	n/a				
Single member	0	0	61,298	61,298	61,298	14%
2 to 99	291	6,482	8,998	86,200	92,682	21%
100 to 1,000	94	29,206	367	97,726	126,932	29%
Over 1,000	20	69,726[1]	37	84,073[2]	153,799	35%
Total	599	105,414	70,700	329,297	434,711	

Source: Pensions Authority

The above shows that 66%[1] of active DB members and 26%[2] of DC members are in large (over 1,000 member) schemes, 35% overall. On a combined basis, 14% of members are in one-member (all DC) schemes, 21% in small schemes (2 to 99) and 29% in medium sized schemes (100 to 1,000).

Looking just at schemes with less than 100 members, potentially around 154,000 active members (and maybe a similar number of deferred members) will be impacted by the objective to consolidate schemes. That is a lot of people.

Another interesting point to note is that there are some 352,000 active members in unfunded public sector schemes compared with 435,000 in funded DB and DC schemes, which demonstrates the lack of pension coverage in the private sector.

So why do we have so many schemes, at least compared with other countries? This is largely because of the Revenue requirement for pension schemes to be set up under trust, which is likely to continue. Other than the issues that the Pensions Authority says it has in regulating such a large number of schemes, there is nothing per se wrong with this as long as it results in good outcomes for members.

Smaller schemes can be broken down into a number of categories, each with their own characteristics:

- Small defined benefit schemes
- One member "insured" schemes
- Small self-administered schemes
- Small group schemes

In reality most small defined DB schemes are likely to continue to exist due to contractual or other legal obligations. They will therefore have to absorb a higher level of compliance costs until all benefits have been secured.

With a potentially high cost of complying with the requirements of IORP II, small or even some medium sized DC schemes may be forced to close and use alternative arrangements which is in line with the Pensions Authority's stated objective.

It remains to be seen how the new regulatory regime will be implemented for smaller schemes. Inevitably we are likely to see much greater use of Master Trusts and professional trustees.

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Gary Morrissey
Head of Business Development

COMMUNICATING TO A WILLING AUDIENCE

Gary Morrissey believes a confluence of events has created an opportunity for the pensions industry to get its message across to a much wider audience.

An unintended but welcome consequence of the public consultation process in relation to the proposed national auto-enrolment pension scheme is heightened awareness of pensions as a topic.

One of the key contributory factors to Ireland's very low rate of pensions coverage has been a lack of awareness of and indeed interest in the topic on the part of the public. Despite the considerable efforts of the pensions industry, social partners and government agencies coverage has actually declined since the beginning of the century. The problem is clearly not one of quantity of communication. Rather it is the nature of the communication and the topic involved.

Auto-Enrolment

The announcement by government of its intention to introduce an auto-enrolment pension scheme from 2022 has served to pique interest among both employers and employees. We are already receiving enquiries from employers who do not have a scheme in place at present and wish to establish one in advance of the launch of the national scheme.

The logic is clear. To begin with there is the possibility that individual employees will be able to choose from one of four different fund providers under the new arrangement. This could present employers with severe administrative challenges. Currently pension schemes are workplace benefits provided by employers but in a situation where the only scheme in place is provided by the state that perception is lost.

Adequacy of Contributions

The consultation paper, or strawman as it is known, is also beginning to have an influence on thinking around pension schemes and adequacy. Under the government proposal, contributions to the national scheme will eventually reach 6% for employees with a matching contribution from employers. A 2% top-up will be added by the state.

While there may be some debate about the desirability or adequacy of such an arrangement this will matter little in the long run. The 14% figure is already being seen as a de facto default contribution rate. This will have an impact on schemes and the expectations of members when auto-enrolment does come into being.

Contributions and Charges

For example, in a scheme where total employee and employer contributions are less than 14% there may well be pressure for employers to increase their contributions. On the other hand, late starters may well assume that 14% will be sufficient to deliver an adequate supplementary retirement income.

At another level, the strawman document envisages a 0.5% cap on management charges for members of the auto-enrolment scheme. If this happens, it is likely to become the default charges cap for group pension schemes.

Seize the Opportunity

This presents an opportunity for the industry to get its message across to an audience which is not only willing to listen, but which is actually seeking information on pensions. Employees who are not currently in pension schemes will want to find out what the new proposals might mean for them. Those who are in schemes will want to know how the national scheme compares with their current arrangement, while many employers will want to review existing schemes or set up new ones.

At Invesco we are already responding to requests for presentations on the potential impact of auto-enrolment from both existing and potential clients. For many years we have provided clients with an industry leading suite of member communications services. These include online benefit statements and a mobile optimised web interface for members to access information on their pension benefits. These are supported by face-to-face presentations for members and groups of members.

To find out more about Invesco's service in this area contact:

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Declan Keena
Director

REPORTING FOR PROTECTION AND STABILITY

Declan Keena looks at the new reporting requirements for pension schemes.

By the end of this year all pensions schemes will be subject to new European Central Bank (ECB) and European Insurance and Occupational Pensions Authority (EIOPA) statistical reporting requirements.

The reporting requirements under each are broadly similar, although there are some additional reporting requirements under EIOPA. We understand that these organisations are working together to investigate the possibility of common templates.

Those Irish pension schemes which are subject to detailed reporting requirements will be required to make their first submission based on their quarter three data within 10 weeks of the quarter end. All other schemes will be required to make their first submission based on their full year data within 20 weeks of year end.

The new reporting requirements will apply to all pension schemes. However, in order to reduce the reporting burden, the ECB and EIOPA will allow national authorities to grant derogations from detailed quarterly and annual reporting to smaller schemes. Pension schemes with assets of less than €25m or fewer than 100 members (based on their last annual submission data) will report data on a reduced basis (Reduced Data Reporter). However, within each country detailed data must be collected for an aggregate 75% of the total assets (rising to 80% by 2022) of all schemes. Hence, a number of schemes with assets of less than €25m or membership numbers of less than 100 will have to prepare detailed reports.

A list of all pension schemes subject to detailed quarterly and annual reporting will be available from the Central Bank (www.centralbank.ie).

The frequency, information and deadlines for submission will be as follows:

Detailed Reporter	Detailed Reporter	Reduced Data Reporter
Quarterly from Q3 2019 10 weeks after quarter end, reducing gradually to 7 weeks after quarter end	Annually from 2019 20 weeks after quarter end, reducing gradually to 14 weeks after quarter end	Annually from 2019 20 weeks after quarter end, reducing gradually to 14 weeks after quarter end
Quarterly Asset Report	**Annual Liability and Membership**	**Annual Asset and Membership**
Investment funds Deposits/Loans Debt Securities Equities Pension fund reserves Financial derivatives Other receivables/payables ISIN code Number of units + Price Securities purchased/sold Currency & Sector Change in market/ nominal value	Loans Received Debt securities issued Equity Technical reserves Financial derivatives Other receivables/payables Member numbers, split by - Active - Deferred - Pensioner	Debt securities Equity Investment fund/shares units Other receivables/payables Member numbers, split by - Active - Deferred - Pensioner

Any measures which improve investor protection and the stability of the sector are to be welcomed and the industry has been broadly supportive of the new requirements. However, there is a trade-off to be made between increased administrative costs and enhanced protections. These additional reporting requirements come at the same time as IORP II and will increase costs. In the long run, this will probably add further impetus to the rationalisation and consolidation of pension schemes in Ireland with smaller schemes choosing to move into collective Master Trust structures in order to share the costs of increased regulatory burdens.

To learn more about the new reporting requirements for pension schemes contact **Declan Keena** at:

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PLANNING FOR THE NEXT GENERATION

Conor Murray and Padhraic Kelly explain the importance of Financial Planning and Wealth Management for asset transfers.

Conor Murray
Personal Financial Advisor

Padhraic Kelly
Personal Financial Advisor

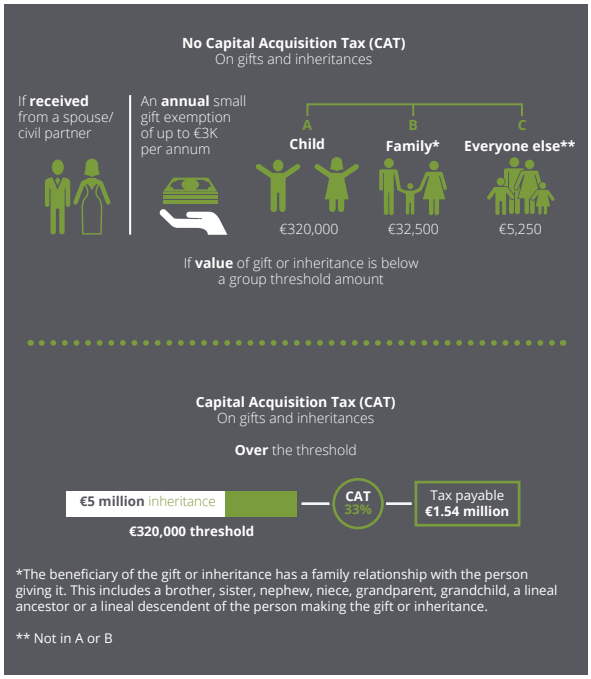
Estate Planning is often delayed or postponed. Yet even after death, inheritance tax can present major challenges for families who wish to leave assets to the next generation. It is projected that the total level of wealth available for inter-generational transfer in Ireland on death could rise to somewhere between €9.6bn and €14bn per annum by 2036. In the US, millennials are set to inherit the biggest wealth transfer in history, $30 trillion over the next 30 years.

Clearly there is a strong wish to provide for the next generation and naturally most would like to achieve this in the most tax efficient manner possible. However, despite this, many families are not preparing for this wealth transfer which could lead to the state, through taxes, becoming the biggest beneficiary of one's estate. It is therefore critically important that families take the necessary steps now to mitigate potential tax liabilities.

In Ireland, tax on transfer of assets is levied as Capital Acquisitions Tax (CAT). The biggest consideration when transferring wealth is therefore the potential impact of CAT. While this is not applicable between spouses, it will impact a transfer of assets to any other party. Under current legislation, parents can give a child gifts or an inheritance of up to €320,000 tax-free (the Group A threshold) before the child is liable for any CAT.

It should also be noted that this threshold is cumulative, so all the gifts and inheritances received since 5 December 1991 must be taken into account to ensure the threshold is not exceeded. Importantly, the standard rate of CAT for gifts and inheritances received above this threshold is currently 33%. This is significant when compared to 2009 when the allowance was €542,544 and the rate was only 25%.

There is a perception that the family home is exempt from inheritance tax but, except in a very limited range of circumstances, that is not the case. CSO data tells us that the average number of children per family is 1.38.



Therefore, as we consider rising house prices and a trend towards Approved Retirement Funds rather than Defined Benefit Pensions, it is easy to see how the assets of many Irish parents could exceed these limits and lead to significant tax liabilities for their children.

Financial planning can enable families with significant wealth to reduce their tax liabilities and simplify the inheritance process. Many of the solutions available require advance planning and so it is important to engage early to help preserve wealth for loved ones and future generations.

The timing of the transfer of wealth should be carefully considered. High property prices, rents and an increase in the cost of living has led many parents to consider ways of providing financial assistance during their own lifetime when it is needed most by their children. In order to provide a gift or inheritance in a tax efficient manner a number of solutions and reliefs can be considered, such as:

Family Home Relief - exemption from Inheritance Tax is available on the principal private "dwellings" with up to an acre of land where the beneficiary meets certain conditions which ensure that the property was, and continues to be, their home.

Business Relief – can provide a similar reduction of 90% in the taxable value of certain businesses or private companies, where both the business and the beneficiary meet the qualifying conditions.

Agricultural Relief – the value of farmland, buildings and stock can be reduced by 90% where the beneficiary is a qualifying farmer and holds the property for a minimum of 6 years.

Life Assurance Relief - If you take out a life assurance contract or savings plan and designate this to pay Gift or Inheritance Tax, the funds paid out on the plan will not be subject to Capital Acquisitions Tax - provided they are actually used to pay the tax liability. These policies are often referred to as section 72 and section 73 plans.

Small Gift Exemption - The first €3,000 of the total value of all gifts received from one person in a year is exempt from CAT. It does not impact on that person's tax-free Group Threshold.

For example, grandparents can give their grandchild €3,000 each year, without the child incurring CAT. The child can potentially receive up to €6,000 annually from both grandparents tax-free (€3,000 each). This is a method for grandparents to use the Small Gift Exemption to contribute towards grandchildren's education costs or for a deposit for a house.

These funds will not count towards the child's tax-free threshold. Parents, Aunts, Uncles and Godparents can similarly make gifts of up to €3,000 annually, without the child incurring CAT. These annual gifts can be accumulated within a Trust structure for the child to be provided at a point in the future.

While providing financial assistance to the following generations is a strong motivation for many parents, it is also important to strike a balance and ensure that they have adequate assets to provide for their own retirement and this should play a key role in inheritance plans.

Invesco's client centric approach

At Invesco our comprehensive Lifestyle Financial Planning service helps clients to proactively navigate their financial future, but also deal with the inevitable surprises along the way. We do this through our six-stage process. When you have the optimum financial plan for your family circumstances, covering every area of your family life from cashflow forecasting to estate planning, insurance needs and retirement planning – you can balance what you need today with your goals for the future.

This service also allows us to estimate the tax implications of providing gifts or inheritance either now or into the future, and the positive impact of the different strategies and reliefs that may be available. Making this more tangible for our clients can help to drive action and take the necessary steps to protect one's hard-earned wealth for the next generation.

While estate planning can be a topic which causes anxiety and stress, proper planning will give you and your loved one's peace of mind.

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IORP II – STRENGTHENING GOVERNANCE

Brid McDonnell and Robert Vard look at the implications of IORP II for pension trustees.

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Solicitor

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The deadline for transposing the new EU Directive on the activities and supervision of institutions for occupational retirement provision (IORP II) expired on 13 January 2019. The Department of Employment Affairs and Social Protection (the Department) advised in January 2019 that regulations are being drafted and that *"the Department is working towards transposition into Irish Law later this quarter"*.

IORP II places greater emphasis on prudential management of pension scheme activities. To assist trustees in meeting their obligations under IORP II pending publication of Irish legislation, the Pensions Authority (the Authority) published a paper in October 2018 on "Considerations for Trustees" arising from the Directive. This paper is not binding, but does give trustees initial guidelines about their responsibilities.

What is expected of Trustees?

The overriding message from the Authority is that trustees will be expected to have clear governance systems in place which ensure proper oversight of all aspects of a pension scheme. In addition, trustees must understand the role of the trustee board, ensure that the composition of the trustee board is fit for purpose and that trustees themselves have met fit and proper criteria. Trustees must manage their ongoing compliance requirements, ensure that meetings are held at a minimum quarterly and that appropriate agendas, sufficiently detailed minutes and supporting information are circulated well in advance of meetings.

Fit and Proper Requirements

Trustees will be required to collectively have suitable knowledge, experience and qualifications to enable them to ensure sound and prudent management of the scheme.

The Government's Roadmap for Pension Reform, which was published in February 2018, proposed that one trustee should have a qualification of level 7 in the National Framework of Qualifications. Another trustee should have at least 2 years' experience as a trustee.

The appointment of a professional trustee to either join or replace the existing board of trustees will need to be considered. The Authority expects that trustee boards will be reviewed at least every three years and will take into account issues such as adequate time and attention to the role of trustee, conflicts of interest and experience and expertise. The requirement to be "proper" means that the individual in question is of good repute and integrity.

Governance

Trustees will be expected to keep written records of governance policies covering administration, risk management, internal audit, actuarial, outsourced activities and remuneration.

Key function holders relating to risk management, internal audit and actuarial functions must be appointed and have the resources and authority to enable them to undertake their duties in an objective, fair and independent manner. Trustees will now need to advise the Authority in advance before entering into an agreement to outsource those roles.

A risk assessment must be carried out by trustees every three years to include the effectiveness of the scheme's risk management system, conflicts of interest, funding needs, operational risks and protective measures relating to funding.

Derogations

IORP II allows member states to dis-apply many of its requirements for schemes of less than 100 members. However, the Department have recently stated that:

"The general principle being followed in the transposition into Irish law is that all schemes should be subject to sound protections for pension and consumers…To exclude small schemes from the provisions of the Directive would be contrary to the policy of enhancing standards for consumers."

It remains to be seen whether any derogations will be applied here.

Conclusion

IORP II will place significant additional responsibilities on trustees and they should consider putting in place a compliance plan for IORP II. If you would like any further information concerning your obligations as a trustee under IORP II, please contact:

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Brian McGarry
Director

TAKING ALL FACTORS INTO CONSIDERATION

Brian McGarry explains that it really is never too late to start pension planning.

While the advice to everyone is to begin contributing to a pension plan as early as possible the reality is that very many put it off until a point where they believe it is too late to do anything about it.

Part of the reason for this is the way the standard pension calculators work. Take a 45 year old earning €100,000 a year who is not currently a member of a scheme and is targeting a pension of €50,000 at the age of 65. A standard pension projection calculator will tell that them they need to contribute a staggering 71% of their salary to achieve their target. The picture only gets worse as they get older. By the time they reach 50, starting a pension with the aim of reaching the same target would actually cost them more than they earn.

But that is to ignore some important facts. Firstly, the state pension hasn't been taken into account in that calculation. When it is, the required contribution level falls to 53.4% for our hypothetical 45 year old. Still very significant but a lot less daunting.

The projected retirement age also needs to be taken into account. A 45 year old today will not be eligible for a state pension until they are 68. If they delay their projected retirement from work until that age, the contribution level drops to 41.4%. If they decide to wait until they are 70, in line with the recent change for public servants, the contribution level drops to 35.2%.

That may well be affordable when tax relief is taken into consideration. It all depends on the circumstances of the individual concerned. If not, there are other factors which may warrant consideration.

Firstly, the very nature of retirement is undergoing reappraisal. Not only are people thinking about retiring later, they are considering not retiring at all – in the medium term at least. For business owners this means winding down over a period while handing over some of their responsibilities to family members or executives.

For others it means taking part-time options, in their current workplace or perhaps moving into the consultancy area or seeking opportunities elsewhere.

That should reduce the retirement income target quite significantly. If, for example, the individual concerned was to continue working just two days a week on the same terms and conditions as their current job it would give them an annual income of €40,000. Even if they only earned €25,000 a year it would potentially halve the initial pension target.

That would reduce the required contributions to a very affordable 13.5% of salary if they were to retire from full-time work at 68.

The other element which people often fail to take into consideration is their existing savings and assets outside of their pension plan. For example, a residential investment property which is currently not generating a net income because the rent is only enough to meet the mortgage repayments will present a very different prospect in 20 years' time.

That property could easily be generating an income of more than €20,000 a year by then. Again, that would have a significant impact on retirement income targets.

Finally, many people have other savings, either in the form of a rainy day fund or in other investment accounts. Cash released from these sources could be used to contribute to the purchase of an annuity or reinvested to generate investment income post retirement. In any event, those savings would have the effect of depressing the overall target for the pension plan.

Taking all these factors into account, it is clear that it really is never too late to start thinking about income in retirement. It's just a question of how you think about.

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SQUARING THE LIFESTYLE CIRCLE

John Lucey looks at the apparent conflict between lifestyle strategies for pension funds and appropriate investment strategies for ARFs.

Lifestyle strategies have been an important element of pension plans for many years. They work by reducing the risk profile of retirement savings when approaching retirement. Generally speaking, investors are happy to focus on higher risk investments such as equities when retirement is in the distant future. These investments have the potential to generate high returns but also tend to be more volatile than other assets and are therefore subject to market falls.

Over a long period of time higher risk investments tend to deliver reasonably strong growth. Unfortunately, as an individual gets closer to retirement there is less time to recover if markets fall. Furthermore, people at that stage of their lives tend to be more risk averse than when they were younger.

Lifestyle strategies are designed to cater for these circumstances by gradually shifting money into lower risk assets such as bonds which have lower growth potential but are much less vulnerable to falls in the market. These strategies remain important. Preserving the value of the fund in the run-up to retirement tends to be a high priority for the great majority of pension investors.

However, the move away from annuities in recent years calls this approach into question. Annuities, by their nature, are low risk investments. Indeed, from the perspective of many investors they are deemed to have no investment risk – the only real perceived risk is early mortality.

An annuity purchase on retirement therefore aligns perfectly with a standard lifestyle strategy. But annuities have become inordinately expensive for most pension investors. Continuing low interest rates and bond yields have depressed returns to the extent that annuity purchases have become a relative rarity.

The alternative is to purchase an approved retirement fund (ARF) which, of necessity, will have to invest in at least some risk assets if the fund is to outperform annuities. Therein lies the conundrum for pension investors. Having spent the years approaching retirement dialling down risk exposure investors now have to dial it up again.

This circle is by no means impossible to square, however. It is not a zero-sum game nor is it a question of moving from no risk to maximum risk. While the lifestyle strategy is designed to secure the investors fund up until retirement, what happens after that is another question.

The mix of assets chosen for an ARF is crucial in this respect. It can be weighted towards lower risk bonds or anywhere else on the risk spectrum depending on the attitude of the investor. Indeed, it is even possible to combine an ARF with an annuity purchase in order to guarantee a minimum pension amount which would be topped up from the returns achieved by the ARF.

In this context, it is imperative that the investor has a clear idea of the strategy to be pursued post retirement. A standard lifestyle strategy which moves much of the pension fund into bonds could suffer quite a dramatic capital impairment in the event of a rise in long term interest rates.

This emphasises the growing need for professional advice as people approach retirement. Risk appetite must be open to constant re-evaluation in light of the overall financial circumstances of the investor. Retirees with other assets and sources of income to draw upon will be in the happy position of being able to dial up risk should they so choose. On the other hand, those who are solely or mainly reliant on their pension fund for their income in retirement will probably need to be that bit more cautious.

To learn more about lifestyle strategies and investment options on retirement contact **John Lucey** at

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THE POWER OF DIVERSIFICATION

Paddy Swan and Richard White examine the benefits of spreading your capital around.

Richard White
Senior Investment Consultant

Paddy Swan
Director

One of the most important principles of investing is to ensure that you have a diversified portfolio. This means ensuring that you spread your capital amongst different investments so that you're not reliant upon a single investment for all of your returns.

By diversifying across a broad spectrum of asset classes, investors can spread their risk and potentially enhance returns, as strong performance in one market may offset weaker performance in other markets. The ability to generate uncorrelated returns within your portfolio allocation is paramount.

To diversify your portfolio, you should include a mix of growth and defensive assets:

- Growth assets such as equities (shares of a company) or property generally provide longer term capital gains, but typically have a higher level of risk than defensive assets.
- Defensive assets such as cash or fixed interest (bonds) generally provide a lower return over the long term, but also generally have a lower level of volatility and risk than growth assets.

Diversification within each asset class is very important in building a successful and balanced portfolio. By diversifying your investments, you can achieve smoother, more consistent investment returns over the medium to longer term.

For most retail investors a multi-asset fund is the most efficient way to achieve diversification within an investment portfolio. A range of risk rated multi-asset funds is proposed by Invesco to meet the needs of both corporate and retail investors.

Equities play a major role

Equities are the asset that drive long-term growth. However, they often experience short-term volatility as they react to market events. We capture the benefits of this long-term growth while minimising the impact of short-term volatility by making equities part of a diversified portfolio. Our portfolios are tailored to the client's risk tolerance profile and also include assets such as fixed interest (bonds), alternatives, property and cash.

Investors confront two main types of risk when investing:

Undiversifiable risk

Also known as "systematic" or "market risk," undiversifiable risk is associated with every company. Common causes are things like inflation rates, exchange rates, political instability, war and interest rates. This type of risk is not specific to a particular company or industry and it cannot be eliminated or reduced through diversification; it is just a risk that investors must accept.

Diversifiable risk

This risk is also known as "unsystematic risk," and it is specific to a company, industry, market, economy or country. It can be reduced through diversification. The most common sources of unsystematic risk are business risk and financial risk. Thus the aim is to invest in various assets so that they will not all be affected the same way by market events.

Why you should diversify

Let's say you have a portfolio of only airline shares. If it is publicly announced that airline pilots are going on an indefinite strike and all flights are cancelled, share prices of airline companies will drop. Your portfolio will experience a noticeable drop in value.

If, however, you counterbalanced the airline industry stocks with a couple of railway shares, only part of your portfolio would be affected. In fact, there is a good chance that the railway share prices would climb, as passengers turn to trains as an alternative form of transportation.

The bottom line

Diversification can help an investor manage risk and reduce the volatility of an asset's price movements. Remember, however, that no matter how diversified your portfolio is, risk can never be eliminated completely.

You can reduce risk associated with individual shares, but general market risks affect nearly every company and so it is also important to diversify among different asset classes. The key is to find a happy medium between risk and return which will ensure that you can achieve your financial goals while still getting a good night's sleep.

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Andy Kelly
Director

CATCHING UP ON THE LOST DECADE

It is time for people to make up for lost time in making provision for their retirement, writes Andy Kelly.

It is now more than 10 years since the onset of the most severe recession in living memory. During that period we saw the destruction of wealth on a hitherto unimaginable scale, the removal of household names from the financial markets and a loss of confidence from which many predicted it would take generations to recover.

For the great majority of owner managers and senior directors survival moved to the top of the agenda. It was a time for retrenchment with costs pared to the minimum and, in many cases, assets disposed of in order to keep the trading business afloat.

Often pension contributions were among the first items to be jettisoned. Indeed, cessation of pension contributions was frequently followed by deep salary and benefit cuts as austerity became the watchword.

Thankfully, the turnaround in our economic fortunes and general business performance has been a lot more rapid than was predicted. Our GDP per capita is comfortably above 2008 levels, there are more people at work in the country than ever before and our economic growth rates are among the highest in the developed world.

Even though there is some economic and trading uncertainty presented by Brexit and ongoing international trade negotiations, the outlook is very good for Irish business. Yet, we are still seeing a marked reluctance on the part of some business owners to begin catching up on the lost decade in terms of their pension contributions.

These are people who have led their businesses through some of the toughest trading conditions imaginable and have overcome many difficulties. Their businesses have been trading successfully for the past few years, but this has yet to result in the significant pension contributions necessary to address the deficit in their pension funding.

The suddenness of the downturn has made a great many business owners ultra-cautious when it comes to new spending commitments. There is also the fear that credit won't be available should it be needed.

The reality is that we do live in a changed environment for credit. Borrowing is now a much more difficult process than it was pre-crash. This is not necessarily a bad thing. Adequate checks and balances need to be in place to prevent excessive risk taking on the part of banks and other credit providers. Restricted credit means that business owners are loath to deplete cash reserves. They are retaining cash on their balance sheets to protect their businesses against a sudden reversal in trading fortunes.

There is also another factor at play. The contributions required to address the funding deficit can be somewhat daunting and there is a mistaken belief that it is too late to address the issue. This is not the case at all.

Fortunately, the message seems to be getting through that it is now time to make up for the lost decade and to translate some of the renewed profitability into pension contributions.

This needs to be addressed in a structured fashion. In many instances we are seeing people waiting until the end of the financial or tax year to see how much they can afford or how much they want to contribute. While any contribution is better than none, this form of ad hoc planning will not necessarily offer a solution.

What is required is a clear goal and a strategy to reach it. If that goal is the €2 million funding threshold, the strategy should be to set contributions at a level aimed at reaching it by a certain age. Alternatively the goal may be to attain a fund of €800,000 in order to avail of the maximum tax free lump sum of €200,000 (25% of fund value).

The most important thing is to put the strategy in place and adhere to it. It's not too late to make up for the lost decade but every year that passes makes the task more difficult.

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