Department of Employment Affairs and Social Protection

Feedback on the Strawman Proposal for Pension Automatic Enrolment in Ireland

Submission prepared by

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1. Introduction

Background

As part of the State's plan to introduce an Automatic Enrolment pension provision in Ireland a series of consultations has been undertaken around the country and submissions have been requested to comment on the strawman proposal.

Actuarial and investment consultants within our firm have reviewed the strawman proposal, taken part in public discussion and have prepared this report to highlight practical matters arising from the proposal.

We congratulate the Department of Employment Affairs and Social Protection (DEASP) on seeking to positively address the lack of pensions coverage within elements of Ireland's workforce and the detailed research underlying the strawman proposals.

We also recognise that there will be many different views from different interested parties, so formulating a single policy will involve compromise. It is important that such compromise does not undermine the objectives underlying the proposal nor unnecessarily undermine existing employer sponsored provision

The elements being considered by the Department of Employment Affairs and Social Protection (DEASP) may be summarised as:

1) Automatic Enrolment for certain classes of worker (the strawman proposal contains suggested thresholds but the parameters are yet to be finalised)

2) Non-mandatory contributions (with suggested levels in the strawman proposal) from
   a) Employees
   b) Employers
   c) The state (such contributions being in lieu of tax relief)

3) A new supervisory authority

4) Administration and investment administration services to be provided by a limited number of private full-service providers

5) Provide options to opt out (strawman again gives indications of possible alternatives)

It is clear from the consultation process that the Automatic Enrolment proposal will not proceed to a fully mandatory initiative – despite this being, arguably, the best option to ensure the overall coverage levels reach the targeted levels.

As a result, this response only examines the hybrid state/private sector framework underlying the strawman proposal and concentrates in highlighting areas of the design that best fit the requirements of increasing coverage (measured by numbers of participants and adequacy). In looking at an Automatic Enrolment system for Ireland, we considered the position of the targeted worker:

- Lack of investment knowledge

- No engagement to date
- Limited tolerance to any investment risk
- Requirement to grow assets in order to gain an adequate pot at retirement
- Multiple employers likely in the "gig" economy

We also comment on detailed administration design, the proposes level of contributions, the proposed investment and administration models for Automatic Enrolment.

Another theme highlighted by the DEASP and others during the consultation sessions was the aim to avoid contagion leading to problems with the coverage already provided to members of existing private sector schemes. This requires careful consideration as existing private sector defined contribution schemes may, in many cases, be less generous than those envisaged in the strawman proposal.

While this could be seen to be detail at this stage of the process, we believe it is important for the State to consider Environmental, Social and Governance (ESG) Factors at an early stage. These could be built into the legal requirements so that in establishing the master trusts, the trust could require ESG to be a consideration. This would allow other factors besides return to be seen as be built into the governing legislation/fund objectives/master trusts.

This submission seeks to draw attention to higher level matters and does not go into detail, as at this stage we do not believe this is warranted.

Purpose and Scope

This report is addressed to the Automatic Enrolment Management Office at the DEASP.

The report includes an Executive Summary while subsequent sections give our more detailed comments on;

- The proposed structure and the use of the Central Processing Agency (CPA).
- The general membership, contribution and fee proposals, including areas of possible impact on the stability of current employer sponsored defined contribution schemes.
- The provision of Investment and Administration services
- Environmental, Social and Governance Standards
- Investment options, including lifestyle and default options

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Disclaimer

This submission has been prepared for and addressed to the DEASP and is not for the use or benefit of any other party or for any other purpose. We do not accept or assume any responsibility, liability or duty of care for any use of or reliance on this report by any other person.

The report should be read in its entirety; reading individual sections in isolation could be misleading.

2. Executive Summary

- We congratulate the Department of Employment Affairs and Social Protection (DEASP) on seeking to positively address the lack of pensions coverage within elements of Ireland's workforce and the detailed research underlying the strawman proposals.

- We also recognise that there will be many different views from different interested parties, so formulating a single policy will involve compromise. It is important that such compromise does not undermine the objectives underlying the proposal nor unnecessarily undermine existing employer sponsored provision

- We suggest that Environment, Social and Governance considerations be brought into the regulation covering the Automatic Enrolment Plan so that such objectives can be incorporated into trust wordings and investment management mandates

- We are in agreement that a central authority established on a statutory basis needs to take a central role in the Automatic Enrolment process in order to ensure trust, transparency and portability

- While the general proposals on coverage and contributions seem reasonable in seeking adequacy, the State needs to fully understand the cost impact for employers, especially those in competitive industries where wages form a significant proportion of overall costs

- The contribution levels proposed are based on **total salary**. For workers in the key target cohort basic salary is often a much lower amount and many existing employer sponsored defined contribution schemes use a definition of salary which is considerably less than total salary, Thus, a typical "5 and 5" scheme may provide much less than 10% of total salary

- As a result, there will be additional costs for those employers and employees in existing arrangements and there may be significant disruption to existing arrangements

- The 25% uplift is reasonable and appropriate, but to simplify the situation should be implemented for all Irish pension plans, not just the Automatic Enrolment Plan

- The individual should be able to make additional contributions and continue to gain a state uplift above the 2%, as long as total contributions are within Revenue limits

- Should members of private pensions (e.g. PRSA's, Group Pension Schemes) continue to receive tax relief on contributions at their marginal rate, then this will add complexity to the decision making when choosing the most appropriate approach for an individual.

- An unintended outcome from the introduction of Automatic Enrolment, may be that it becomes THE defined contribution scheme in Ireland

- For a privately provided investment management and administration arrangement to be attractive, the split of the 0.5% total charge to the member between that required to fund the CPA and that going to the investment manager/administrator will be crucial.

- It may prove difficult to find sufficient providers to achieve this private/public sector mix outlined in the strawman proposal. There is not enough detail provided to allow us to assess the viability of this crucial element of the proposal

- Lessons need to be learned from the impact of "pension freedom" in the UK and we would not favour an ARF like flexibility. We would favour a high degree of annuitisation to ensure a minimum level of income, while also making full use of enhanced annuity options for those members with shorter than average life expectancy after retirement

- Consideration should be given to appointing the investment providers and administration provider separately, determining what role the State should play in each

- Given the planning required, we think Environmental, Social and Governance standards should be incorporated at the earliest opportunity, making use of the NTMA's expertise where appropriate

- A maximum of two "full-service" providers should be appointed at outset

- To appropriately address each risk faced by a member we recommend each provider has three "lifestyle" options (the lower risk acting as default) and then a limited range of individual funds for those members wanting a more active role.

- Good communication, transparency and consistency are essential

It should be noted that within our review we do not make any allowance for political considerations, except in so far as the assumption is that fully State solution will not apply.

3. *Organisational Structure – The Central Processing Authority*

We are in full agreement that a central authority established on a statutory basis needs to take a central role in the Automatic Enrolment process in order to ensure trust, transparency and portability. Key reasons include:

- Being able to access records through a central State managed portal will provide confidence to workers that they will be able to trace their pot in 30 or 40 years hence – providers may change, companies get taken over but the State facilitating this central access point is crucial

  At present it is very difficult for employees to trace all pensions entitlements if they have worked for multiple employees and there is no central register

- Whether appointing external providers to provide administration and/or investment services or having the State manage the Automatic Enrolment offering internally, there has to be a supervisory role played by a statutory body such as the CPA

- In order to ensure transparency to the worker, consistency of information and presentation, a central portal is required. This will help provide confidence in the system. It is important for a member to be able to see their own individual pot, trace its development and have consistency of information

4. *General Membership Proposals*

While a key objective of Automatic Enrolment is to boost pension coverage, particularly at low and middle-income levels, there are a number of objectives that apply to all elements of the revised roadmap:

- Transparency
- Sustainability
- Simplicity (i.e. reduce complexity)
- Adequacy

Coverage should address the numbers participating but must also look at the adequacy of the coverage provided. When we use the term "coverage" below we will try to distinguish between the two elements.

While the number one objective is coverage, the above needs to be taken into consideration. Quoting from the publication, 'A Roadmap for Pension Reform 2018-2023':

> *"The Government is determined to take measures to provide a more coherent and transparent environment for private pension provision with the goal of delivering a system that is trustworthy, transparent and well managed".*

Eligibility

We have no major issue with the strawman proposals in relation to the set ages for mandatory enrolment or the financial constraints (minimum annual earnings and earning's cap). There are arguments for not having an age restriction in place at all, particularly at the lower age levels, in particular the fact that saving for retirement is introduced as an intrinsic part of employment, as soon as a worker enters the work-force.

Contribution Levels

a) Adequacy

The Strawman proposal is for a target contribution rate of 14% of gross earnings (6% Employee, 6% Employer, 2% State). We believe this to be a realistic lifetime rate for a new entrant with the proposed starting age of 23 years.

However, it should be communicated to those automatically enrolled at later ages that a higher contribution rate is required to minimise the income drop at retirement (i.e. to provide adequate income at retirement).

There is a separate argument for increasing contribution rates with age, in much the same way that Revenue recognises the need to accommodate a maximum pension contribution rate which increases with age. However, for simplicity a flat 14% total rate would be a reasonable starting point.

For those in the hospitality sector who rely heavily on tips to achieve an adequate income it is hard to see how the target real replacement levels will be met, as much of this income will not always be visible

and hence will not be subject to the contribution requirement. Thus, replacement income targeting will be nigh on impossible for this group. This nuance, however, is impossible to target in any arrangement.

We also believe that a phased in approach, whereby contributions start off at a lower initial value and are gradually increased is favourable in order to gain acceptance.

From an employee's perspective we would favour a shorter period of phasing (1% year 1, 3% in year 2 and then 6% thereafter). A similar phasing in period has already been successfully adopted in the UK.

However, considering some of the industries (such as hospitality and tourism) most likely to be affected by the introduction of a mandatory plan, a longer phasing-in period is likely to be more acceptable to the employer. On balance, we believe it more important for the plan to gain acceptability, so would not shorten the phasing-in period below that in the strawman proposal.

b) Impact on Employers

Employers who currently do not contribute to a scheme, or pay minimal contributions to existing arrangements (and who typically operate in very cost competitive industries with small workforces), may be asked to contribute a higher percentage of earnings for each employer than those already offering some form of defined contribution scheme.

While a short phasing period makes sense for adequacy, a 6% rise in staff wages for employers who currently do not sponsor a scheme may, nonetheless, be counter-productive. Such employers are often in cost competitive industries, have a low headcount and wages, which are often at minimum pay levels and can represent a significant proportion of overall expenses.

At 6%, such a level of employer contribution is likely to be significantly higher than the level of contributions being paid under other existing employer defined contribution schemes We expand on this below. Any employer with a preponderance of minimum wage employees has little ability to offset any of these costs through increased efficiency, i.e. it is a straight increase on the expense base.

It may also increase costs for those employers with existing pension arrangements. The targeted group is likely to have a higher proportion of their total salary not typically pensioned under existing private sector schemes. In such private schemes, many employers' contributions are set as a percentage of base salary, **excluding** such items as:

1) Overtime
2) Shift allowances
3) Bonuses

Therefore a 6% employer (and employee) contribution of **total salary** may be significantly higher than the prevalent 5% of something less than full salary in a standard defined contribution scheme.

References were made in the consultations to "generous" schemes which have a higher employer rate than 6%, but these rates are often lower than 6% of **total salary** for the reasons outlined above.

This may lead to increased cost (and more adequate coverage) for this cohort of employees, but the picture will be patchy across employers, across multiple schemes from the one employer and within cohorts of a scheme of an employer. Combined with the possibility of varying tax incentives (see below)

between the Auto Enrolment contributions and private provision it could lead to de-stabilisation within the existing provision structure.

The effect of the proposal on existing employer sponsored schemes will need careful consideration.

State Incentives and Simplicity

We would firstly note that this review forms part of a much wider review of the Irish pensions system, so changes recommended by other reviews may have an impact on the comments below.

The incentive put forward by the strawman proposal is for the state to contribute 1% for every 3% of employee contribution, with a maximum state contribution of 2%. This is equivalent to tax relief of 25%. For a lower income earner only subject to tax at the current 20% base rate, this is clearly attractive. However, for those workers paying a higher level of marginal rate tax the benefit is more open to debate.

Should members of private pensions (e.g. PRSA's, Group Pension Schemes) continue to receive tax relief on contributions at their marginal rate, then this will add complexity to the decision making when choosing the most appropriate approach for an individual.

Further complexity then arises where the member wishes to make additional contributions (within revenue limits). As it stands why should a member not get further incentives from the state to contribute more if they so wish, as would happen through marginal tax relief if utilizing a PRSA or Group Scheme? It would seem illogical and overly complicated to force employees to take out a separate PRSA just for a small additional voluntary contribution in order to gain a top up from the state.

In discussions at the consultations, it was argued that the potential for arbitrage was not necessarily a bad thing, as it would gain focus on the pensions issue. However, we believe that where there are inconsistencies and complexities, these should be minimized.

The following points should assist in providing greater consistency and make for a simpler pensions environment:

- Make it clear that contributions are to be based on gross pay
- We believe that the 25% uplift is reasonable and appropriate, but is better implemented for all Irish pension plans, not just the Automatic Enrolment Plan
- The individual should be able to make additional contributions and continue to gain a state uplift above the 2%, as long as total contributions are within revenue limits.

While we recognize that this may be difficult to achieve politically, we nonetheless believe this should be the goal.

Fees

We believe that a total fee of 0.5% borne by the member would be attractive to many individuals whose only other choices tend to be small company schemes or PRSAs where fees are more likely to be in the 0.75% to 1.0% per annum range.

If this total charge is achievable it, combined with the contribution rate being based on total salary, will certainly cause disruption to the existing employer sponsored defined contribution arrangements.

For a privately provided investment management and administration arrangement to be attractive to third party providers the split of the 0.5% total charge to the member between that required to fund the CPA and that going to the investment manager/administrator will be crucial and it may prove difficult to find sufficient providers to achieve this private/public sector mix outlined in the strawman proposal.

There is not enough detail provided to allow us to assess the viability of this crucial element of the proposal.

Additional comments include:

- As passive management tends to lead to minimized costs this may lead to a predominantly passive approach in the early stages (we do not have an issue with this, given the cohort of workers targeted by the proposal and the non-advice nature of the investment)
- As assets grow one might expect to see a resultant decrease in the fees being levied, but sustaining sufficient third-party providers will always be a delicate balance
- While focus is on the total headline figure of 0.5%, we would underline the importance of verifying the Total Expense Ratio (TER) of the fund on the net growth of members' investment.
- There has been no mention of any charge levied on new monies
- The charges for the UK's National Employees Saving's Trust (NEST) are set at 1.8% on new contributions and 0.3% annual management charge, which it is claimed is broadly equivalent to a 0.5% annual management charge. The Auto Enrolment scheme envisaged for Ireland will clearly be covering far fewer members and will not enjoy the same benefits of scale

Drawdown of Benefits

The proposal is, by the DEASP's own admission, quite sketchy on the drawdown of benefits. It is important that given the non-advice nature of the strawman proposition the options for drawdown be as prescriptive, clearly communicated at outset and consistent over time as is possible.

Lessons need to be learned from the impact of "pension freedom" in the UK and we would not suggest that ARF like flexibility be built into the system.

We would favour a high degree of annuitisation to ensure a minimum level of **lifetime** income, while also making full use of enhanced annuity options for those members with shorter than average life expectancy after retirement.

Member Contracts

As with PRSA arrangements, the strawman proposes that each enrolled member has a contract with the outsourced provider rather than with the State.

This may work where an employee has an open choice of such providers, but where the number of providers is limited and the State retains responsibility for the retention or replacement of the providers, it is difficult to see how such a system could operate.

Due to economies of scale and limiting options to improve decision making, we believe that the right approach is to limit providers selected by the CPA (or another agency). Members' perceptions are likely to be that the contract is between the member and the CPA / State and that perception will be increased as they move through their working lifetime.

Communication

The Strawman proposal includes the following:

> *"International experience suggests that the success of Automatic Enrolment will depend, inter alia, on good communications and the implementation of an effective, easy to use customer service and operating system."*

We echo these comments; no matter how good the options and the plan may be, if these are poorly presented and difficult to understand, it will not be possible to gain the confidence of the worker.

The use of the central portal should be able to ensure the consistency and quality of information provided to members.

However, consistency of communication of benefits to members will inevitably require assessment and communication of the relative benefits to members provided by employer sponsored defined contribution arrangements and those within the Automatic Enrolment sector.

Financial advisers to/employee representatives of members of employer sponsored schemes may be forced to advise them they would be better off within the Automatic Enrolment space. This could lead to a transfer from existing arrangements of some (or all) employees which will introduce additional cost and administration to those schemes and employers, leading to diseconomies of scale.

Without being the intention, Automatic Enrolment may become the only game in town for Ireland's defined contribution schemes.

5. Administration and Investment Services

The Strawman proposal envisages appointing a number of external [private] providers for "Full Service" provision. That is, each provider would carry out member record keeping and provide investment options for the member, including a default option.

This effectively ties in the administration and investment options. Thus, one has to be able to offer administration services, or team up with a separate administration provider, in order to submit a proposal.

While small Irish defined contribution schemes are normally limited to such "full service" providers, many larger defined contribution schemes would have appointed an administrator separate to the investment provider. Key points for such a move are

- The transfer of administration records is not a straightforward exercise and thus where members may be hurt by uncompetitive investment returns, there may still be a reluctance to make changes if administration is seen to be satisfactory.
- If investment returns are seen as good there may be a reluctance to change administrator if this would also result in a change of investment options
- By appointing separate entities to the role of administrator and investment fund provider such compromises may be overcome and there is only a need to appoint a single central administrator, thus helping to reduce costs
- To gain access to a fuller choice of investment managers, including the best in their field
- It is relatively straightforward to change investment fund / manager options where the functions are separated
- The strawman proposal had suggested a 5, 7 or 10 year contract for the appointed providers, citing set up costs and the need for providers to be able to cover investment costs. This is clearly most likely to be an issue at start-up where the assets under management are at their lowest and teething troubles will inevitably occur in relation to the administration. In this light a minimum term may be appropriate for an administrator, but such terms are hard to justify for the appointment of an investment manager.

Taking the above into consideration, a preferable alternative may be to appoint a single administrator and appoint the investment fund providers separately.

With the State already undertaking revenue administration and tax collection, a statutory body could be seen as a natural choice for the role of Administrator of any State Automatic Enrolment Pension Plan.

The role that the National Treasury Management Agency (NTMA) can play in incorporating ESG considerations into the fund/trust objectives should be considered, given its experience with investment managers and implementing strategy for the Pensions Reserve Fund and, more recently, the Ireland Strategic Investment Fund. At a very minimum there is an advisory role that the NTMA can play, regardless of the ultimate structure pursued.

6. Environmental, Social and Governance Standards

While this may be seen to be detail at this stage of the process, we believe it is important for the State to consider Environmental, Social and Governance (ESG) Factors at an early stage. These could be built into the legal requirements so that in establishing the master trusts, the trust could require ESG to be a consideration. This would allow/require other factors besides return to be seen as fiduciary duties.

Indeed, it can be argued that ESG factors should be included at all three stages, namely:

- the design of the Automatic Enrolment Plan in order to provide better cover for the lower and middle earnings bracket
- the appointment of any outsourced provider, including administration / investment providers
- the investment options being provided for members, including the default fund

Here we solely comment on the third point, the consideration of ESG factors in the investment options provided to members. As noted earlier, at its heart the Automatic Enrolment plan is designed to be "transparent" and as such we believe it appropriate for the Plan to adhere to IORP II regulations.

Under IORP II it states*:*

> *"Environmental, Social and governance factors, as referred to in the United Nations-Supported Principles of Investment, are important for the investment policy and risk management system of IORPs. Member States should require IORPs to explicitly disclose where such factors are considered in investment decisions and how they form part of their risk management system."*

If IORPs are being required to undertake these considerations by the state, then surely the state is beholden to undertake any such approach for any mandatory Automatic Enrolment Plan.

To date we believe that such considerations are very hard to achieve for many Irish defined contribution plans as a result of scale. However, we believe this should be fully considered for the Automatic Enrolment Plan. We would note the following:

- The NTMA are looking at applying an ESG framework to its approach to investments within its discretionary Irish portfolio, which currently stands at in excess of €3bn.
- It is in keeping with IORP II regulations
- Positive impact on society and research has suggested that plan members are generally in favour of such an approach
- Becoming more prevalent within the investment industry, leading to greater opportunities
- Provides leadership for the rest of the pensions industry in Ireland

We would consider incorporating ESG principles into the design of the investment options a positive step to take, were it to be accommodated within the Automatic Enrolment initiative. Historically there

have been concerns at potentially lower investment returns, but with emphasis on sustainability and changing views on "profit at any cost", we believe these have somewhat lessened.

In terms of incorporating ESG factors into the investment options, we believe that the NTMA, with practical experience, be involved with the providers. A possible solution may even be for a percentage of contributions to be invested in an ESG portfolio managed by the NTMA.

Given the planning required, we think this should be incorporated at the earliest opportunity.

7. Investment Options, including Default

The strawman proposal has put forward the appointment of a number of providers, with it being expected that each provider will offer a range of funds including a low risk, moderate risk and medium risk fund.

It also states that the low risk fund would "serve as the default fund for each provider" and contain a mix of government bonds, blue chip private bonds and indexed (i.e. passive equities). The strawman also states that each of the three funds would hold a mix of asset classes, though the medium risk fund would be "predominantly equities".

The strawman underlines the importance of the default option with around 90% of members likely to fall into this category and draws attention to the importance of how the choice is presented to the worker. We fully concur with these two points.

Key Risks for Workers

In considering the options to provide it is worthwhile considering the key risks that the investment options should be looking to address, namely:

- Provide an expectation of real growth on the invested assets over the long term – the strawman paper highlighted that a 0.5% difference over the long term can impact the size of the resultant pot by around 20%
- Prevent capital loss through the use of low risk asset classes such as short-term government bonds, deposits and other cash instruments
- Provide protection against fluctuating annuity prices, which would indicate a portfolio of high-quality Euro Government Bonds
- High fluctuations in fund values, causing a loss of confidence in the member and a subsequent opt out

As with all investment decisions, a balance will have to be made and at different stages of the member's working life the risks will change in terms of priority and will need to reflect changing legislation and taxation treatments.

Number of Providers

All of the above underlines the importance of the investment strategy, as opposed to the investment provider and the importance of different risks at different stages of the worker's life-cycle. We would make the following points:

- One of the stated aims of Automatic Enrolment is to use scale to reduce costs as much as possible
- In discussions on the default option (to be offered by each proposer) it is claimed that returns will have minimal variation from each other

- It has been stated that members get overwhelmed by too much choice and that research shows that the ideal number is around five (we would not disagree with this)
- One of the key issues that has affected defined benefit schemes in Ireland, the UK and other countries is the focus on different manager performance, rather than the investment strategy in place. However, it is the investment strategy that normally accounts for c.90% of the risk and return characteristics, rather than the investment manager. If the key driver is investment strategy and not the investment provider, that is where the key focus should lie. Having more providers may only serve to distract the member from the most important issue.
- Assets will grow very rapidly in the initial years of Automatic Enrolment and gaining scale to provide low costs is more likely to be an issue in these early years. It may therefore be better to start with fewer providers.

Taking all the above into account we see no reason to appoint more than two full service providers at this stage. Appointing two will lead to at least 6 different options for the member to choose from, plus lifestyle and default options.

Any more than two may impinge on cost objectives and will unnecessarily increase complexity for the worker.

In time, with increased assets, a third provider could be considered but they would have to offer something different rather than being just another option. At this stage the CPA (or other overseeing agency) would also have greater experience, having already worked with two providers

Number of Options / Lifestyle

Given the "low risk" fund is to be used as the core for the default, this has to provide an element of growth over the long term. For those members approaching retirement they should have the option to be able to invest in relatively safe capital assets (such as cash and short-term notes) in recognition that part of the capital value may be taken as a cash free lump sum.

For the same reasons a member should be able to protect against annuity price fluctuations, should they wish to buy an annuity at retirement. It is therefore appropriate to offer a longer dated high quality Euro Government Bond fund.

In offering three fund types (a high growth fund, a bond Fund and a cash fund), any member could select a combination of these funds to suit their own risk profile and objectives.

However, as underlined in materials produced by the DEASP, most members may not have the expertise or inclination to make that decision and would like the funds to be readily packaged for them. This forms a good logic behind offering the ready packaged Low, Moderate and Medium Risk Funds.

Inertia is a further major issue that requires consideration. Once a fund choice has been made, a member is often reluctant to make changes, even when advised to act. So as the member nears retirement, unless action is undertaken on the member's behalf, it is unlikely that the strategy will evolve to reflect the member's changing needs.

As inertia will tend to affect all members, not just those that fall into the default option, we would propose that a member is offered three "lifestyle" choices from each provider,

Thus, if they choose the medium risk, they are still on a lifestyle option, but the core fund is the medium risk fund (predominantly growth assets such as equity).

Only if a member selects a "Do it Yourself" Option for more experienced investors might a full range of funds become available, including the cash and bond fund (annuity protection) in addition to the three core growth funds. Further options may also be provided. In going down this "Do it Yourself" route it would be highlighted to the member that they are responsible for changing the strategy of their savings as they near the drawdown phase.

To recap, we would recommend that for each full-service provider selected there would be:

- A choice of three lifestyle options (or target date funds), reflecting different levels of risk acceptance
- A default lifestyle option, based on the lower risk lifestyle option
- A fuller range of at least 5 funds, in order that a member can tailor their own investment strategy, including any switches in strategy to reflect changing requirements

Such a selection allows a member to address the different risks that they will face, but also safeguards members against inaction.

The Default Option

Based on changing risks and the ability to make investment decisions, we fully agree that it makes sense for there to be a default option and for this to be lifestyle or target date fund based. The use of passive funds should also help to eliminate "manager risk", given the lack of strong evidence to support active management in many investment markets.

What is unusual, however, would be to have more than one default option. If, as was stated in the consultation session, returns are unlikely to differ to any significant degree, it would question the rationale for more than one default, especially as greater scale could be achieved in using a single default option to drive down costs.

Our preference would therefore be for a single default option, based on a lifestyle (or target date fund) option. The exact nature of the core growth fund is open to debate but should reflect a multi-asset approach and observe suitable diversification.

We understand that the State is keen for there to be more than one full service provider and given that the majority of monies can be expected to enter the default option, it is proposed that more than one default option is to be utilized.

Carousel Default

On the basis of two or more full service providers and each provider putting forward similar default options the only way to select a default option is by drawing lots, or in other words a carousel type approach.

However, we would propose two modifications:

- For a single employer all new enrolments would go into the same default option
- Where a worker changes employment and was already in a default option, they would remain in that same default option in the event of no selection being undertaken

The above should minimize confusion amongst the same workforce, while also ensuring that members are not unnecessarily switched, simply because they change employer.

Target Date Vs. Lifestyle Options

We would not have a strong preference for one format over another, the driving principle is the same. However, where a single central administrator is used (our preferred option) then a Lifestyle Option is preferable as:

- it requires less funds
- is likely to increase the universe of potential managers
- costs should be lower.

Submission prepared by

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