Pensions Council’s Letter to Minister Heather Humphreys

February 2024

Dear Minister

In 2023, you wrote to the Pensions Council (the Council) to ask it to analyse a proposal from Mr. Colm Fagan, who suggested it as an alternative structural basis for the Automatic Enrolment (AE) system that was approved by Government in March 2022, including the decumulation phase.

Mr Fagan states that his proposal promises increased investment returns and lower expenses for participants. In return, there would be no investment choice for AE participants: the proposal requires all pension pots to be 100% invested in equities (or similar) at all times, as well as restrictions to avoid anti-selection by participants. The inherent volatility of the high allocation to equities would be managed by using a formula to value all assets and transactions at smoothed values. A buffer account would be established over time to cover net exits where the smoothed value exceeds the market value.

The Council acknowledges the positive aspects of Mr. Fagan’s proposal but ultimately does not recommend it as the structural basis for the approved AE system. The Council’s position reflects its assessment across the following five areas as requested by you in your letter:

1. **Technical feasibility**: The Council focussed primarily on the pre-retirement elements of the proposal. Paragon Research Limited carried out a technical evaluation on behalf of the Council. While it would be a departure from any existing approach to pension saving, Paragon found that the proposal was technically feasible subject to resolution, where possible, of a number of risk management issues.

   The proposal relies on the assumed outperformance of equities compared to other asset classes. While this outperformance has been observed in the past, it varied over different times and different markets. The Council found insufficient evidence to provide assurance of the consistent future outperformance of this approach.

2. **Practical feasibility:** The practical feasibility of the proposal was assessed by the Council. The scheme’s viability would be placed at risk if significant numbers cease contributions whenever smoothed value exceeds market value. Its success therefore depends on the sustained participation of a large number of individuals. There is uncertainty on whether this condition can be met on an ongoing basis, and it would therefore be imperative that the design incorporates provisions for its cessation in the future.

   The smoothing formula was carefully considered. This is intended to manage investment volatility but introduces considerations relating to equity and fairness in the distribution of investment returns across different participant groups and generations. The Council has concerns regarding the practicality of implementing some restrictions.

Under the proposal, the scheme would be established as a public corporation with trustees, the corporation having mutual status. There appears to be no provision in the proposal for the consumer protection obligations that would arise were this investment approach implemented in a private sector arrangement, whether as an insurance contract, a pension scheme, or some other type of financial entity. The purpose of insurance or pension obligations is to protect contributors and beneficiaries by providing in advance for challenges that might arise. If there are no equivalent mechanisms for the proposal, the Council concluded that this raises the question of whether there is an implicit State guarantee.

3. **Similar approaches elsewhere:** The Council did not find any precedents for an investment approach akin to the proposal in global, national, or provincial pension provisions. Some similarities exist with some private sector arrangements. In these cases, smoothing formulas depend on manual intervention while buffer accounts are established at the start rather than building up over time.

4. **Appropriateness for the provision of an AE solution:** The success of this proposal relies on intergenerational solidarity. In considering the appropriateness of such a proposal for the AE system, the Council concluded that policymakers would have to grapple with complex trade-offs. While the proposal holds the possibility of higher returns and increased pensions, it comes at the cost of restricting choices for consumers, raises questions about intergenerational fairness, and necessitates potential guarantees and/or capital requirements. It would likely come under significant political pressure to change the rules if it performed better or worse than expected.

5. **Other matters:** The Council was of the view that policy decisions should be mindful of potential consequences, including implicit guarantees, a loss of confidence, governance risks and untested aspects of the proposal. It could be considered that upon establishment, the Central Processing Agency could seek to identify a product that would capture the benefits that Mr Fagan has identified while addressing the risks that the Pensions Council's analysis has outlined.

The Pensions Council is at your service to help you or your officials with any further support or information you might need.

Yours sincerely,

Roma Burke

Chairperson