Futureproofing your DB pension scheme

Increased costs due to regulatory changes may impede smaller direct benefit schemes. Barry McCall spoke to Aon’s head of DB investment, Evelyn Ryder, about how you can reduce the burden IORP II and other regulations will bring.

The Pensions Authority’s policy in relation to the rationalisation and consolidation of the Irish pensions landscape has been well documented. The Authority’s ultimate goal is to see a reduction in the number of active DB schemes from tens of thousands currently to a few hundred over the coming years. However, this will present significant challenges for many smaller defined benefit (DB) schemes.

The main lever being used to drive this consolidation is the increasing burden of regulation, and the forthcoming enactment of the EU Institutions for Occupational Retirement Provision (IORP) II directive into Irish law will add impetus to this. This new directive will place a range of additional governance requirements on Irish pension schemes. Schemes will have to have written policies on areas like outsourcing, actuarial, and risk management, while functions like internal audit and risk management will have to be carried out by designated people. There will also be regular fit and proper tests for the trustees involved in running the schemes. In addition, the amount of time devoted to running trustee boards will increase greatly. If this weren’t enough, schemes will also have to deal with the European Central Bank (ECB) and the European Insurance and Occupational Pensions Authority (EIOPA) stress tests. There had been a belief that the full weight of the IORP II requirements would not be placed on schemes below 100 members, but this now looks not to be the case. Those smaller schemes, and indeed many larger ones, will face a greatly increased cost and management burden, and their future viability will be called into question.

DB complications
From a defined contribution (DC) scheme point of view, the solution is relatively simple: transfer the scheme into a master trust structure. Aon has had a master trust option available for Irish clients for some time (and there are others on the market). The situation is not quite as straightforward for DB schemes, however.

At present, no master trust offering in Ireland can cater for DB schemes, and it doesn’t appear likely that this position will change any time in the foreseeable future. Fortunately, there is a solution to hand in the form of UnitedPensions, Aon’s multi-employer, cross-border pension solution. This solution not only caters for Irish DB schemes, but it can also accept DC schemes and be used for cross-border schemes as well, consolidating several schemes from different jurisdictions and geographies.

UnitedPensions, based in Belgium, is an international solution for employers and pension funds aiming to bring their pension administration and pension assets under one roof. It is an appealing alternative for pension funds and companies confronted with high premiums, high administration fees and increasing pressure from regulators. The vehicle was set up five years ago in response to client demand, says Evelyn Ryder, Head of DB Investment with Aon. “We were seeing a number of multinational organisations setting up pan-European pension schemes with pooled pension arrangements,” she explains. “Our clients came to us saying they wanted a similar vehicle but weren’t big enough to do it for themselves. There was also the issue of IORP II and the increased regulatory and administrative burden that will bring. We have a master trust solution in Ireland for defined contribution schemes, but the situation is more challenging for defined benefit schemes.”

Making the move to UnitedPensions
According to Ryder, Irish DB schemes can move to the Belgian regulatory regime if their sponsors choose to use the UnitedPensions vehicle. In essence, the protections under that regime are the same for members as they are in Ireland, while there can be funding advantages for the scheme sponsor in terms of the timing of the funding. “Under EU rules, you can’t have regulatory arbitrage so it’s much the same overall,” says Ryder. “The funding mechanism is different, but has the same net results while the timing can be advantageous from a cash flow perspective.”

Irish DB schemes transferring into the vehicle are first wound up, and funding and benefits are enshrined in the rules of the new scheme that are protected under Belgian law. Arrangements are also put in place to ensure that members are no worse off under the new regime if their sponsors choose to move to the Belgian regulatory regime. Arrangements are also put in place to ensure that members are no worse off under the new regime if their sponsors choose to move to the Belgian regulatory regime. The overall investment strategy will be decided by the sponsor, but the asset management will be looked after by the UnitedPensions board.

Asset management is consolidated thereby driving down fees and other costs while common communications processes for all members in multi-jurisdictions schemes also reduce costs. She explains the funding differences, which can be advantageous. “In Ireland, there is a statutory minimum which is made up of a mix of transfer values for active and deferred members and annuities for the other members. In Belgium, they take a view of the expected return on assets based on the investment strategy of the scheme. The more aggressive and high-risk the strategy, the greater the proportion of the fund which must be held in a cash buffer. The overall calculation of what the scheme requires to fund its obligations doesn’t change, but the timing of the funding is different.”

Smart outsourcing
Of course, transferring to the UnitedPensions vehicle will require the Irish scheme to be wound up. “The cost of that is not insignificant,” Ryder acknowledges. “But with all the additional costs and governance burden coming up, the cost of wind-up is less daunting. Over time, the move will pay for itself through savings.”

Indeed, many of these schemes may wind-up anyway. Increased costs due to regulatory changes may undermine the viability of smaller DB schemes. The UnitedPensions vehicle allows employers continue to offer the perceived superior benefits associated with defined benefit schemes while outsourcing all of the administration and governance to a third party.

“It’s as close to full outsourcing of a DB pension as you can get,” says Ryder. “There are a number of benefits. We are seeing increasing requirements for trustees to be professionally qualified and engaged in continuing professional development. That governance piece totally falls away under this regime. The overall investment strategy will be decided by the sponsor, but the asset management will be looked after by the UnitedPensions board.”

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