

18 November 2022

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**Joint Committee on Social Protection, Community
and Rural Development and the Islands
Houses of the Oireachtas
Ireland**

Submitted via: spcri@oireachtas.ie

**Re: General Scheme of the Automatic Enrolment Retirement Savings System
Bill**

Dear Sir/Madam:

State Street Global Advisors welcomes the opportunity to provide comments to the Joint Committee on Social Protection, Community and Rural Development and the Islands regarding the *General Scheme of the Automatic Enrolment Retirement Savings System Bill*.

State Street Global Advisors, the investment management arm of State Street Corporation¹, has a strong commitment to defined contribution (DC) pensions globally, with over 30 years' experience and more than €570 billion in global DC assets.²

With only 47% of Irish workers saving for their pensions, we are pleased to see the auto-enrolment plans moving forward.³ As part of these plans, the design of the investment options, including the default investment strategy should be a high priority. We believe having a robust default investment strategy which is suitable for the majority of members will be critical to the success of auto-enrolment and, ultimately, in order to deliver good outcomes for savers.

Enclosed separately are State Street Global Advisors' recommendations for default design, drawing upon our experience in working with DC plans around the world. Over the coming weeks, we will also be publishing results from a global survey of savers around the world, which we hope will provide further insight into the risks and opportunities that Ireland will be presented with as coverage increases.

1 With €3.61 trillion in assets under management, SSGA is one of the largest asset managers in the world. For more information, please visit SSGA's website at www.ssga.com.

2 This figure is as of September 30, 2022 and includes approximately €65.92 billion of assets with respect to SPDR® products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

3 <https://www.gov.ie/pdf/?file=https://assets.gov.ie/69522/92c139a0d2c247f09c4d4078e7bf30be.pdf#page=1>

We are happy for our submission to be quoted and would be delighted to attend public sessions at Committee meetings.

Please feel free to contact alistair.byrne@ssga.com should you wish to discuss the content of this submission further.

Yours sincerely,



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DC Investment Strategy in a New World

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- Default funds are critical for the success of auto-enrolment plans.
- A key challenge for the implementation of Ireland's automatic enrolment system will be the investment design and governance of the default strategy.
- Based on overseas experience, we expect the vast majority of scheme members (in excess of 80%)¹, to use the default strategy.
- Default investment options need to be suitable for members, based on analysis of membership profiles and retirement behaviour.
- Integration of Environmental, Social and Corporate Governance considerations is becoming increasingly important for managing long-term investment risks.
- Robust, ongoing governance is critical to ensure the suitability of the default over time and achieve good member outcomes.

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Auto Enrolment Default Design Principles: What We Know So Far

After the hurdles that have been faced over recent years, we are pleased to see the auto-enrolment plans set out in the 2019 consultation documents, finally moving forward.² One key milestone is the design of the investment options, including the default investment strategy. The final design principles announced by the government last year, set out the following details for investment design:³

- Commercial providers will be invited to tender to become a Registered Provider of investment management services. Up to four Registered Providers will be selected and each will provide three risk graded funds plus a default investment option for members who do not make a choice.
- The default investment option will follow a lifecycle/lifestyle investment approach which will automatically de-risk as members approach retirement.
- The Registered Providers will offer investment products in compliance with standards set by the Central Processing Authority which will include specific ethical/ESG criteria.
- Charges will be capped at 0.5%.

As of 29 March 2022.

Age Appropriate Investment Objectives

As seen in other markets with automatic or mandatory pension scheme participation, it is typical for the majority of members to have their savings invested in the default investment strategy. This high take up of the default strategy is not a bad thing and typically may lead to better outcomes than individuals making their own detailed investment choices. Evidence has shown that individuals are prone to behavioural biases such as taking too much/too little risk, failing to update their investment strategy over time or concentrating their portfolios to particular sectors/countries. These biases can lead to suboptimal outcomes when making complex financial decisions.⁴

For default investment strategies, which have a multi-decade time horizon, we believe different objectives are applicable depending on how far a member is away from their expected retirement age.

The table below sets out some example objectives for various life stages:

Life Stage (age)	Qualitative Objective	Quantitative Objective (nominal)
Growth (pre age 45)	Helping members grow their pots and avoiding short-fall risk	5%
Consolidation (45–65)	Providing members with a smoother journey, protecting their pots from market shocks when they are approaching retirement	4%
Preservation (65+)	Being robust to the uncertainty that members face at retirement (in terms of what they will do with their retirement savings)	3%

The information contained above is for illustrative purposes only.

The default must be suitable for the employees being enrolled in it. Good practice calls for schemes to analyse the characteristics of their membership and use that information in the design of the default. Key characteristics include age, gender, wage profile, retirement date, life expectancy, risk tolerance and likely use of assets at retirement.

Setting an Objective for the Preservation Phase

The default objectives should take account of how members may access benefits at retirement. Irish legislation allows for members to purchase an annuity, use income drawdown (via an Approved Retirement Fund), withdraw a cash lump sum, or a combination of the three.

One option would be to have different investment strategies and corresponding objectives tailored to member's preferred or anticipated retirement benefits. In practice, members have very little certainty of the choice they will make. In our New Choices, Big Decisions⁵ research carried out in the UK over 2015–2020, we found that most members were uncertain about their retirement options and changed their decisions several times as they approached retirement.

In our 2016 Retirement Confidence Monitor,⁶ 42% of Irish savers didn't know or wouldn't know how they would access their retirement benefits until they are within two years of their retirement date.

As such, we believe the preservation phase should be robust to the uncertainty that members face at retirement. In practice, this means having an appropriate blend of growth and defensive asset classes at the point of retirement.

Default Design Features

The Default Should Incorporate ESG

Pension scheme members view it as increasingly important that their funds are invested sustainably.

Within lifecycle strategies, there are three main ways that ESG can be incorporated:

- 1 Stewardship** — Asset stewardship is the engagement with investee companies to seek long-term value and mitigate risks.
- 2 Exclusion** — Exclusion involves removing companies from investment portfolios that do not meet certain minimum ESG criteria.
- 3 Integration** — Emphasising (i.e. hold a greater proportion of) investments with positive ESG characteristics.

Diversification via Liquid Alternatives

The design principles as set out by the government mention the inclusion of property in some of the risk graded funds. The inclusion of illiquid assets such as property in the asset allocation of DC pension scheme defaults can provide several advantages that DC savers could benefit from such as diversification, inflation protection, return enhancement and risk mitigation. However, the proposed cap of 0.5% would allow little scope for substantial allocations to illiquid assets which typically have higher management costs.

In our view, diversification can be effectively achieved via liquid exposures to asset classes such as high yield debt, emerging market debt and infrastructure.

Exposure to alternative asset classes via liquid or illiquid funds may add to overall costs. However, we believe the CPA should focus on value for money rather than lowest cost.

Default Governance

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

Case Study of Default Evolution

Below we set out a case study of the evolution of our Timewise Target Retirement Funds which are our flagship funds for workplace DC schemes in the UK and Ireland.

Over time, the funds have been adapted based on changes in member behaviour, the regulatory environment and investment innovation.

2014	2015	2016	2017	2018	2019	2020	2021
<p>Launched funds in 2014 targeting annuity purchase.</p> <p>March 2014, pension freedoms announced.</p> <p>Changes made to landing point to account for increased options available to members at retirement.</p>	<p>Review concluded allocation remained suitable. No changes made.</p>	<p>Addition of smart beta, high yield and emerging market debt.</p>	<p>Increased allocation to smart beta.</p> <p>Evolved use of volatility management.</p>	<p>Review concluded allocation remained suitable. No changes made.</p>	<p>ESG funds integrated to equity allocation.</p>	<p>Allocation to infrastructure added.</p> <p>ESG exclusions applied.</p>	<p>Further ESG funds added.</p>

Source: State Street Global Advisors as at 30 September 2022.

Recommendations for Policy Makers

Based on our work with DC schemes around the world in setting their default investment strategy, we believe the following design features should remain front of mind when defining the design criteria. Default investment options should:

- Be simple for members to understand. The default strategy may be sophisticated, however, it should be able to be communicated to members in clear and transparent terms.
- Adopt age appropriate objectives based on analysis of the expected membership.
- Have an at retirement asset allocation which reflects the reality of the uncertainty that members face when making retirement choices.
- Consider if and how environmental, social and governance considerations can be incorporated within the default.
- Focus on value for money rather than lowest cost. Value can be added through diversification and risk management, which may add to costs.
- Be covered by a strong governance framework, incorporating annual evidence based reviews.

Contact Us

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Endnotes

- 1 99% of the members in the UK's National Employment Savings Trust are in the default fund: [Retirement Outcomes Review: interim report \(fca.org.uk\)](#).
- 2 [gov.ie — Launch of the Final Design Principles of an Automatic Enrolment \(AE\) Retirement Savings System for Ireland \(www.gov.ie\)](#).
- 3 [gov.ie — Launch of the Final Design Principles of an Automatic Enrolment \(AE\) Retirement Savings System for Ireland \(www.gov.ie\)](#).
- 4 [Workplace-defaults-better-member-outcomes_FINAL-.pdf \(thepeoplespension.co.uk\)](#).
- 5 New Choices Big Decisions (2015-2020), Ignition House.
- 6 Global Retirement Confidence Monitor (2016), State Street Global Advisors. This survey was conducted in partnership with TRC Market Research and BRT, using a panel of 2,817 retirement savers. Data collected in May 2016.

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Information Classification: General Access

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ID1214051-4974490.11.EMEA.INST 0922
Exp. Date: 31/10/2023