

## **2nd Public Pension Fund Management Conference**

### **PUBLIC PENSION FUNDS ACCOUNTABILITY: THE CASE OF IRELAND**



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## **1. Background to the Irish Fund**

### **Present Pension Arrangements**

Ireland has:

- a First Pillar pension arrangement providing either (i) an old age contributory pension for those who satisfy certain contribution conditions (work-related), or (ii) an old age non-contributory pension subject to a means test for those who do not qualify for a contributory pension. The amount at (i) is currently 31% of average industrial earnings and (ii) is slightly less;
- the First Pillar pension arrangement is funded on a pay-as-you-go basis. This does not have a sustainability problem and if pensions are indexed to prices, spending on First Pillar pensions will fall relative to GNP over the next 50 years. If pensions are indexed to wages, spending will rise relative to GNP from the present level of 4.8% to approximately 8% in 2056;
- a public service pension scheme which faces greatly increased cost. The existing level of gross benefit expenditure is expected to more than double over the next 15 years;
- a demographic situation which is expected to evolve more favourably than that in other countries during the early decades of this century. At present there are 5 people who are economically active to every one retired;
- an economy which has seen double digit GDP growth over the last decade but which has recently been encountering a downturn. Current forecasted GDP growth this year is 3.5% and next year 4.1%;
- experience of domestic and international investment; and
- a well developed funded occupational pension and personal pension plan sector.

### **Recommendation for Fund**

Ireland was conscious of the problems being encountered by other countries faced with demographic challenges and had time to address this problem because of its relatively strong demographic position for the first two decades of this century. There was also serious concern about the increase in cost in public service pension provision which followed from a boom in social provision in the 1970s and which would begin to hit early in the century. Ireland was also examining its total retirement provision position through a National Pensions Policy Initiative. The objective of this Initiative was to examine and debate the overall pension system and agree a pension reform package. Arising from this background the establishment of an explicit mechanism to fund, at least partially, in respect of the substantial growth that is expected to occur in First Pillar and public service pensions was recommended by:

- National Pensions Policy Initiative Report, 1998 on overall pension reform which recommended partial funding of First Pillar pensions;
- Commission on Public Service Pensions Report, November 2000 which recommended partially funding future public service pension costs;

- Department of Finance Report of the Budgetary Strategy for Ageing Group, July 1999 which recommended partial pre-funding of pension liabilities as part of overall national economic planning.

### **Fund Establishment**

In July 1999 the Minister for Finance announced that the Government had decided to begin now to provide resources on a planned basis to secure the pensions in retirement of a progressively ageing population. It had decided that an annual provision of 1% of GNP should be set aside in future to pre-fund part of the prospective cost. Government had also decided to allocate a tranche of the proceeds of the recent Telecom Éireann floatation to supplement the annual allocations.

In December 1999 legislation was passed setting up a Temporary Holding Fund in order that 1999 monies could be set aside.

In June 2000 the Minister for Finance published legislation which provided for the establishment, financing and management of a National Pensions Reserve Fund. In December 2000 the National Pensions Reserve Fund Act, 2000 was passed in to law to provide for the establishment of a fund to be known as the National Pensions Reserve Fund and a body to be known as the National Pensions Reserve Fund Commission to control and manage the fund and to dissolve the Temporary Holding Fund for superannuation liabilities.

The actual establishment day of the Fund was 2 April 2001 which was also the day of the official appointment of the seven Commissioners for the Fund.

### **National Pensions Reserve Fund Act, 2000**

This Bill provides for the establishment, financing, investment and management of a Reserve Fund aimed at meeting part of the escalating Exchequer cost of social welfare and public service pensions from 2025 onwards, when, according to demographic projections, the proportion of people over 65 in the population will rise significantly. The Act provides for:

- the establishment of a National Pensions Reserve Fund, to provide toward the Exchequer cost of social welfare and public service pensions from 2025 onwards;
- a statutory obligation to pay a sum equivalent to 1 per cent of GNP from the Exchequer into the Fund each year until at least 2055, with provision to enable additional sums to be paid into the Fund from time to time by resolution of Dáil Éireann (Irish House of Parliament);
- the establishment of an independent Commission, the National Pensions Reserve Fund Commission, to control and manage the Fund, with discretionary authority to determine and implement an investment strategy for the Fund, based on commercial principles. The Minister for Finance appoints the Commission consisting of a Chairperson and six other Commissioners, subject to a statutory requirement for substantive expertise at a senior level in specified areas;
- a strictly commercial investment mandate for the Fund with the objective of securing the optimal return over the long-term subject to prudent risk

management. The Fund will not be allowed to invest in Irish Government securities. This restriction is to ensure that the Fund may not be used at some future date to artificially support Government borrowing. There are also restrictions to ensure that the Fund does not acquire a controlling interest in any company;

- a prohibition on drawdowns from the Fund prior to 2025, with drawdowns thereafter to be determined under ministerial rules by reference to projected increases in the number of persons over 65 in the population at that time and with a view to avoiding undue fluctuations in the net Exchequer balance from year to year;
- the appointment of the National Treasury Management Agency as Manager of the Fund to act as agent of the Commission and to carry out such functions as are delegated to it for this purpose by the Commission – the appointment of the Agency will be for a period of 10 years, following which there will be the option, at five yearly intervals, to extend further or to appoint an alternative Manager;
- the appointment by the Commission of (i) investment managers to invest and manage the portions of the Fund and (ii) custodians to ensure the safekeeping and security of the assets of the Fund;
- accountability of the Commission to the Minister for Finance and to the Dáil (Irish House of Parliament), including provision for detailed annual reports and for appearance of the Commission Chairperson and/or the Chief Executive Officer of the Manager before the Committee of Public Accounts;
- annual audit of the Fund by the Comptroller and Auditor General;
- the transfer of moneys from the Temporary Holding Fund to the Reserve Fund and the winding up of the Temporary Holding Fund.

## **2. Progress of the Fund since establishment**

### **Objective and Mission Statement**

The Fund started with a clear objective set out in the National Pensions Reserve Fund Act which was as follows:

“19. – (1) Moneys standing to the credit of the Fund shall, from time to time, be held or invested for the benefit of the Fund by the Commission, in or outside of the State, so as to secure the optimal total financial return, as to both capital and income, having regard to –  
(a) the purpose of the Fund as set out in section 18(1), and  
(b) the payment requirements of the Fund as provided for under section 20, provided the level of risk to the moneys held or invested is acceptable to the Commission.”

The Mission Statement was “to meet as much as possible, within prudent risk parameters to be agreed by the Commission, of the cost to the Exchequer of social welfare and public service pensions to be paid from the year 2025 until the year 2055 as provided for in the National Pensions Reserve Fund Act, 2000”.

### **Decision on Investment Strategy and Portfolio Construction**

The Commission determined, following external consultancy input, that the appropriate long-term strategic asset allocation for the Fund should be 80% equities/ 20% bonds reflecting (a) the fact that under the Act drawdown of the Fund would not commence until the year 2025 and that it would take place over a term of at least 30 years (b) the funds strong cash flow (c) the nature of the promises made with regard to the pensions to be partly prefunded by the Fund (d) an assumed average equity risk premium of 3% per annum over the life of the Fund. The Commission further decided, as required under the legislation, that the benchmarks against which the Fund’s investment performance would be measured would be as follows:

<b><u>Asset Class</u></b>	<b><u>Allocation</u></b>	<b><u>Benchmark</u></b>
Bonds	20%	Merrill Lynch Eurozone Government Bond Index (excluding Ireland)
Equities	80%	40% FTSE Eurozone 26.4% FTSE North American 6.8% FTSE Europe ex Eurozone 5.2% FTSE Japan 1.6% FTSE Pacific Basin

The Commission also decided that half of the non-Eurozone currency exposure should be hedged into the euro. See **Appendix A** for details of the Portfolio Construction.

Notwithstanding recent poor performance and concerns over the equity market the Commission has remained resolute over its selected equity weightings.

### **Appointment of Service Providers**

Global tenders were held for the appointment of institutional investment managers, a global custodian and a transition manager. In the case of the investment managers almost 600 applications were received for a total of 15 separate mandates. These applications were processed and the managers appointed. A global custodian has been appointed for the safekeeping of assets. A transition manager has also been appointed in order to ensure the Fund's smooth and efficient entry to the international capital markets. All of these appointments were made using competitions for service providers based on the Restricted Procedure under Public Services Directive 92/50/EEC. This involves two phases. The first phase is a notice published in the Official Journal of the EU inviting service providers to submit requests to participate in the tendering process and allow 37 days for this. The second phase involves a limited number of applicants being invited to reply to request proposal (RFP) within 40 days. There were also site visits by the Fund Manager, and presentations (beauty parades) by a further short list. The award criteria was the most economically advantageous tender.

### **Decision on Market Entry Strategy**

The Commission considered whether for the period up to end-2001, when the investment managers were expected to be appointed, arrangements should be made for the Fund to gain interim market exposure. In the circumstances and given the particular uncertainties attaching to short-term market prospects, the Commission decided against adopting an interim strategy.

The assets of the Fund were accordingly held in cash from establishment of the Fund in April 2001 to end December 2001, pending the selection of investment managers. The Commission delegated to the National Treasury Management Agency authority to manage the cash against a short-term benchmark of an equal mix of 1, 3 and 6 month deposits at Euribor minus five basis points, provided at least 75% of the investments matured before December 2001 and 100% matured before March 2002.

The Commission then decided to commit funds on an "averaging-in" basis to the appointed institutional investment managers, commencing in January 2002. As a consequence of its averaging-in approach the Fund held strong cash balances through 2002 – on average about 35% of the Fund value – enabling it to buy into equity markets at the lower levels. See **Appendix B** for details of the market entry strategy.

### **Performance**

The Fund generated a return of 3.27% from its inception in April 2001 to end December 2001 compared with a return of -0.6% for the average Irish managed fund and -3.5% for the Fund's long-term strategic benchmark. Audited figures for end 2002 are not available at time of writing but estimates of performance figures to that date are shown in **Appendix C**. The size of the Fund at end-2002 was €7.4 billion with 25% of this in cash. It has a €1 billion cash flow and 90% of its cash flow is still to be received.

### 3. Accountability – Requirements and Practice

#### **Responsible Party**

The Act setting up the Fund establishes the National Pensions Reserve Fund Commission with absolute discretion to control, manage and invest the assets of the Fund in accordance with the Fund investment policy.

The Commission is a body corporate with perpetual succession and a common seal and power to sue and be sued in its corporate name and to acquire, hold and dispose of land or any interest in land and to acquire, hold and dispose of any other property.

The Commission consists of a Chairperson and six Commissioners. They are appointed by the Minister for Finance but the Minister shall only appoint persons to be Commissioners who have acquired substantial expertise and experience at a senior level in any of the following areas:

- investment or international business management;
- finance or economics;
- the law;
- actuarial practice;
- accountancy and auditing;
- the Civil Service;
- trade union representation;
- the pensions industry;
- consumer protection.

The Minister is not allowed to appoint a person who currently holds a position in the Civil Service. Periods of office are set out in the legislation and remuneration is determined by the Minister. A Commissioner is disqualified where he/she:

- is adjudged bankrupt;
- makes a composition or arrangement with creditors;
- is convicted of an indictable offence in relation to a company;
- is convicted of an offence involving fraud or dishonesty; or
- is disqualified or restricted from being a director of any company.

Where a Commissioner has a pecuniary interest or other beneficial interest in any matter which falls to be considered by the Commission he/she must disclose this interest in advance of any consideration of the matter. They must neither influence nor seek to influence a decision to be made in relation to the matter and they must take no part in any consideration of it. Where relevant they must absent themselves from the meeting or the part of the meeting where the matter is being discussed and they must not vote on any decision relating to the matter. Such a disclosure must be recorded in the minutes of the meeting and the Commission may, at its discretion,

refer to the disclosure in its report to the Minister. The Commission is to issue guidelines as to what constitutes an interest for this purpose.

The Commission is accountable to the Oireachtas (Irish Parliament) and the accountability requirements are set out in the National Pensions Reserve Fund Act.

### **Accountability Requirements in the Legislation**

The National Pensions Reserve Fund Act, 2000 provides for:

- preparation of accounts and audit by the Comptroller and Auditor General of these accounts. The Comptroller and Auditor General is the senior auditor in the State;
- the publication by the Commission of an annual report of its activities and of the audited accounts of the Fund;
- the Chairperson of the Commission must appear before and give evidence to the Committee of Public Accounts on the policies of the Commission in relation to the Fund; and
- the Chief Executive Officer of the Fund Manager must give evidence to the Committee of Public Accounts on the regularity and propriety of all transactions on the Fund and on the economy and efficiency of the Commission and the Fund Manager in regard to the expenses of operation of the Fund.

See **Appendix D** for legislative provisions on Accountability and Reporting.

### **Accounts and Audits**

The Commission must keep all proper and usual accounts of monies and other assets appropriate to the Fund. The accounts shall include a separate account of the administration fees and expenses incurred by the Commission in the operation of the Fund.

The audited accounts must note a record of expenses incurred by the Fund Manager.

Accounts kept in pursuance of this requirement, signed by the Chief Executive Officer of the Fund Manager and by a Commissioner authorised for that purpose, must be formally adopted by the Commission and must be submitted as soon as may be, but not later than four months, after the end of the financial year to which they relate by the Commissioner to the Comptroller and Auditor General for audit.

A copy of the accounts as audited by the Comptroller and Auditor General must be presented to the Minister for Finance as soon as may be and the Minister must cause a copy of the accounts as so audited to be laid before each House of the Oireachtas (Parliament).

### **Report and Information to Minister**

Not later than six months after the end of each financial year the Commission must make a Report to the Minister for Finance of its activities during that year and the

Minister must cause copies of the report to be laid before each House of the Oireachtas.

Each report must include:

- information on the investment strategy followed;
- a report on the investment return achieved by the Fund;
- a valuation of the net assets of the Fund and a detailed list of the assets of the Fund at the year end;
- information about the investment manager and custodianship arrangements in relation to the Fund; and
- information on fees, commission and other expenses incurred by the Commission and by the Fund Manager in the operation of the Fund.

The Report must also include any information in such form and about such matters as the Minister for Finance may direct.

### **Appearance before Committee of Public Accounts**

The Committee of Public Accounts is a parliamentary committee responsible for examining and reporting on departmental expenditure. It holds public hearings and conducts tough examinations of those required to appear before it. These hearings are widely publicised and reported where they relate to matters of public interest.

The Chairperson of the Commission must appear before, and give evidence to, the Committee of Public Accounts at such times as the Committee may reasonably request. Any evidence given must, subject to confidentiality requirements concerning commercially sensitive information, relate to the policies of the Commission in relation to the Fund.

The Chief Executive Officer of the Fund Manager also must, whenever required by the Committee of Public Accounts give evidence to the Committee on a variety of topics including:

- regularity and propriety of transactions recorded in any record subject to audit;
- economy and efficiency of the Commission and Fund Manager;
- systems, procedures and practices employed by the Commission to evaluate its effectiveness; and
- any matter affecting the Commission referred to in any report of the Comptroller and Auditor General.

The Chief Executive Officer must not question or express opinions on the policy of the Commission.

### **Other Requirements for Accountability**

The Minister may, from time to time, appoint a person to carry out an examination of any or all aspects of the operation of the Fund and the Commission. The Fund Manager is required to assist this examination in every respect and to afford the

person appointed by the Minister access to all records, books and accounts for this purpose.

The Commission is required to commission, from time to time, independent valuations of the assets of the Fund. It is also required to commission, from time to time, independent assessments of the investment performance of the Fund.

Public procurement procedures must be used for appointment of all service providers including EU procedures under Public Services Directive 92/50/EEC. These are stringent procedures ensuring fairness and transparency in all appointments of service providers.

Another function of the Commission is to appoint custodians for the assets of the Fund. The legislation sets out the requirements which the Commission shall have regard to in evaluating prospective custodians. These include:

- custodianship expertise;
- risk management systems and other information systems and technology, as appropriate;
- corporate structure;
- reporting capabilities;
- financial strength;
- internal ethical and compliance guidelines;
- external regulatory obligations; and
- management fee, commission and other expenses.

The Act also deals with issues which the contracts for the appointment of custodians should seek to ensure. Also, in appointing a custodian, the Commission may include a provision in the relevant contract enabling it to engage auditors to carry out an audit of the books of the custodian. In this case, the custodian would be required to give access to the auditors to all appropriate records relevant to the assets of the Fund.

There is generally a commitment in the National Pensions Reserve Fund Act to open and transparent reporting subject to preserving confidentiality on commercially sensitive information.

### **Other Ways of Accounting to the Public**

The Fund Manager has a website where all relevant information to the Fund is available. This would include Fund reports, press releases and public procurement notices. The website is available at [www.ntma.ie](http://www.ntma.ie)

The Commission and the Fund Manager hold press briefings from time to time to announce their reports and results. These are usually widely reported in the media.

The Fund Manager also speaks at a variety of conferences and is available to make presentations to relevant bodies or organisations.

### **Meeting the Requirements in Practice**

The National Pensions Reserve Fund Commission Report and Financial Statements for the period 2 April 2001 to 31 December 2001 were prepared and published as required.

Public procurement procedures have been strictly followed for appointment of the various service providers.

The Chairperson or Chief Executive Officer of the Fund Manager have not yet been called to appear before the Committee of Public Accounts.

As previously mentioned, the Fund information is available on the Fund Manager website. Also press briefings have been held, for example at the end of 2002 when there was public interest in the returns of the Fund during the current difficult economic climate. Presentations which have been made by the Fund Manager in relation to the Fund have been informative and open.

### **Public Reaction**

There would not seem to be a wide awareness of the existence of the Fund and where people know about it they do not appear to understand the importance and relevance of it on a personal and national basis.

There has been intermittent questioning by economists and politicians of the merits of payments to the Fund during the recent period when we have seen a level of economic downturn in Ireland or of the merits of having such a Fund at all. Most of the economists' arguments have been looking at the issue from a very broad perspective rather than considering the need to address this specific and unavoidable national issue. The debate has not been a good one and to some extent may have resulted in the spreading of misinformation.

During Ireland's most recent national Election 2002 campaign some of the political parties took positions on the Fund and various suggestions were made including suspending contributions to the Fund for a time. The parties who were returned to Government were, in fact, the parties in power at the time the Fund was established and they continued their clear commitment to it.

To date there does not seem to be any strong sense of the National Pensions Reserve Fund as being the "People's Fund".

#### **4. Conclusion**

I believe that accountability is a vital ingredient for public funds and must not only exist but must be seen to exist by the public. Public awareness and involvement is probably the strongest discipline for such a fund.

In the case of Ireland we have good legislative requirements in relation to accountability and transparency. It would appear to meet the criteria for a successful public fund and we have not yet thought of any addition which we wish had been included in our legislation. With good legislation in place the only thing which we need to do is to work hard at making accountability and transparency achieve its objective with the public for whom this Fund has been put in place.

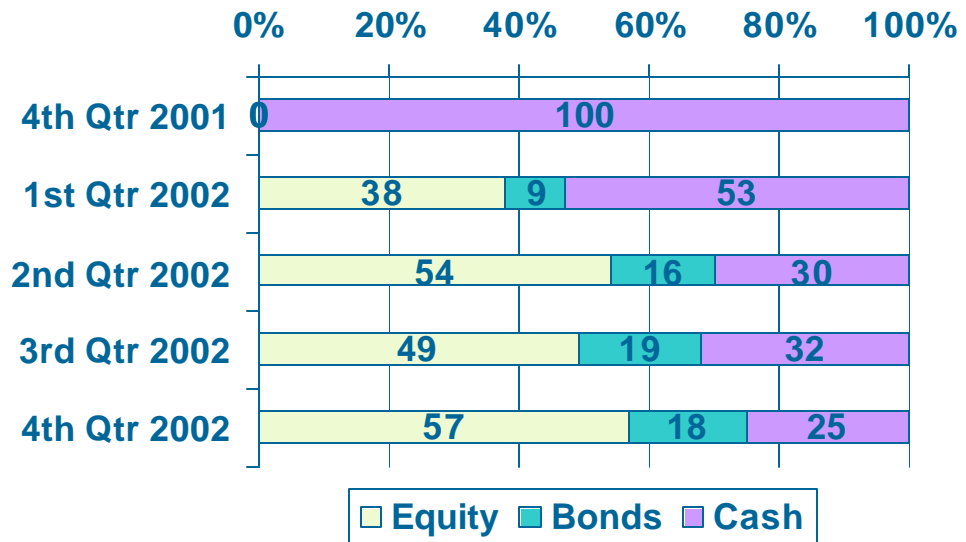
## Appendix A

### Portfolio Construction

<b>Asset Class</b>	<b>Investment Style</b>	<b>Alpha</b>	<b>Tracking Error</b>
Eurozone Equity X2	Passive	0.00%	0.10%
Pan-European Equity X3	Active-Core	0.75%	5.00%
US Equity	Passive	0.00%	0.10%
US Equity	Enhanced	0.25%	1.50%
US Equity X2 (Value & Growth)	Active	0.90%	6.00%
Japanese Equity X2	Active	1.00%	6.00%
Pacific Basin Equity	Active	1.00%	6.00%
Global Equity X2	Active-Core	0.90%	6.00%
Long Euro Bonds	Passive	0.00%	0.05%
Long Euro Bonds	Active	0.30%	2.00%

### Market Entry Strategy “Averaging In”

#### Asset Allocation



**Appendix C****Progress**

	<b>National Pensions Reserve Fund</b>	<b>Average Irish Managed Pension Fund</b>	<b>Fund's Long Term Strategic Benchmark</b>
April 2001 to Dec 01	3.27%	-0.6%	-3.52%
Year to 31 Dec 02 (tentative estimates)	-16.0%	-19.0%	-21.8%
Inception to 31 Dec 02 (tentative estimates)	-13.25%	-19.5%	-24.5%

*National Pensions Reserve Fund Act, 2000*

**PART 4**

**Accountability and Reporting**

**25.** –(1) The chairperson of the Commission shall appear before, and give evidence to, the Committee of Public Accounts at such times as the Committee may reasonably request.

(2) Any evidence given under *subsection (1)* shall, subject to preserving confidentiality in relation to such commercially sensitive information, as determined by the Commission, relate to the policies of the Commission in relation to the Fund.

**26.** –(1) The Commission shall keep in such form as may be approved of by the Minister all proper and usual accounts of all moneys and other assets appropriate to the Fund . The accounts shall include a separate account of the administration fees and expenses incurred by the Commission in operation of the Fund.

(2) The audited accounts prepared under ~~section~~ 12 of the National Treasury Management Agency Act, 1990, shall note a record of expenses incurred by the Agency as the Manager.

(3) Accounts kept in pursuance of this section, signed by the chief executive officer of the Manager and by a commissioner authorised for that purpose, shall be formally adopted by the Commission and shall be submitted as soon as may be, but not later than 4 months, after the end of the financial year to which they relate by the Commission to the Comptroller and Auditor General for audit. A copy of the accounts as so audited shall be presented to the Minister as soon as may be and the Minister shall cause a copy of the accounts as so audited to be laid before each House of the Oireachtas.

(4) The chief executive officer of the Manager shall, whenever required by the Committee of Public Accounts, give evidence to that committee on –

- (a) the regularity and propriety of the transactions recorded or required to be recorded in any book or other record of account subject to audit by the Comptroller and Auditor General which the Commission is required by or under statute to prepare,
- (b) the economy and efficiency of the Commission and the Manager in the use of the resources made available to them under *sections 17* and *23*, respectively,
- (c) the systems, procedures and practices employed by the Commission for the purposes of evaluating the effectiveness of its operations, and
- (d) any matter affecting the Commission referred to in a special report of the Comptroller and Auditor General under section 11(2) of the Comptroller and Auditor General (Amendment) Act, 1993, or in any other report of the Comptroller and Auditor General (in so far as it

relates to a matter specified in *paragraph (a), (b) or (c)* that is laid before Dáil Éireann.

(5) The chief executive officer of the Manager, if required under *subsection (4)* to give evidence, shall not question or express an opinion on the merits of any policy of the Commission or the objective of such a policy.

**27.** –(1) As soon as may be, but not later than 6 months, after the end of each financial year the Commission shall make a report to the Minister of its activities during that year and the Minister shall cause copies of the report to be laid before each House of the Oireachtas.

(2) Each report under *subsection (1)* shall, having regard to the need for open and transparent reporting on the operation of the Fund, but subject to preserving confidentiality in regard to commercially sensitive information, include the following for the year under review:

- (a) information on the investment strategy followed;
- (b) a report on the investment return achieved by the Fund;
- (c) a valuation of the net assets of the Fund and a detailed list of the assets of the Fund at the year end;
- (d) information on fees, commission and other expenses incurred by the Commission and by the Manager in the operation of the Fund.

(3) Each report under *subsection (1)* shall include information in such form and regarding such matters as the Minister may direct.

(4) The Minister may from time to time appoint a person to carry out an examination of any or all aspects of the operation of the Fund and the Commission and the Manager shall be required to assist this examination in every respect and to afford the person appointed by the Minister access to all records, books and accounts for this purpose.