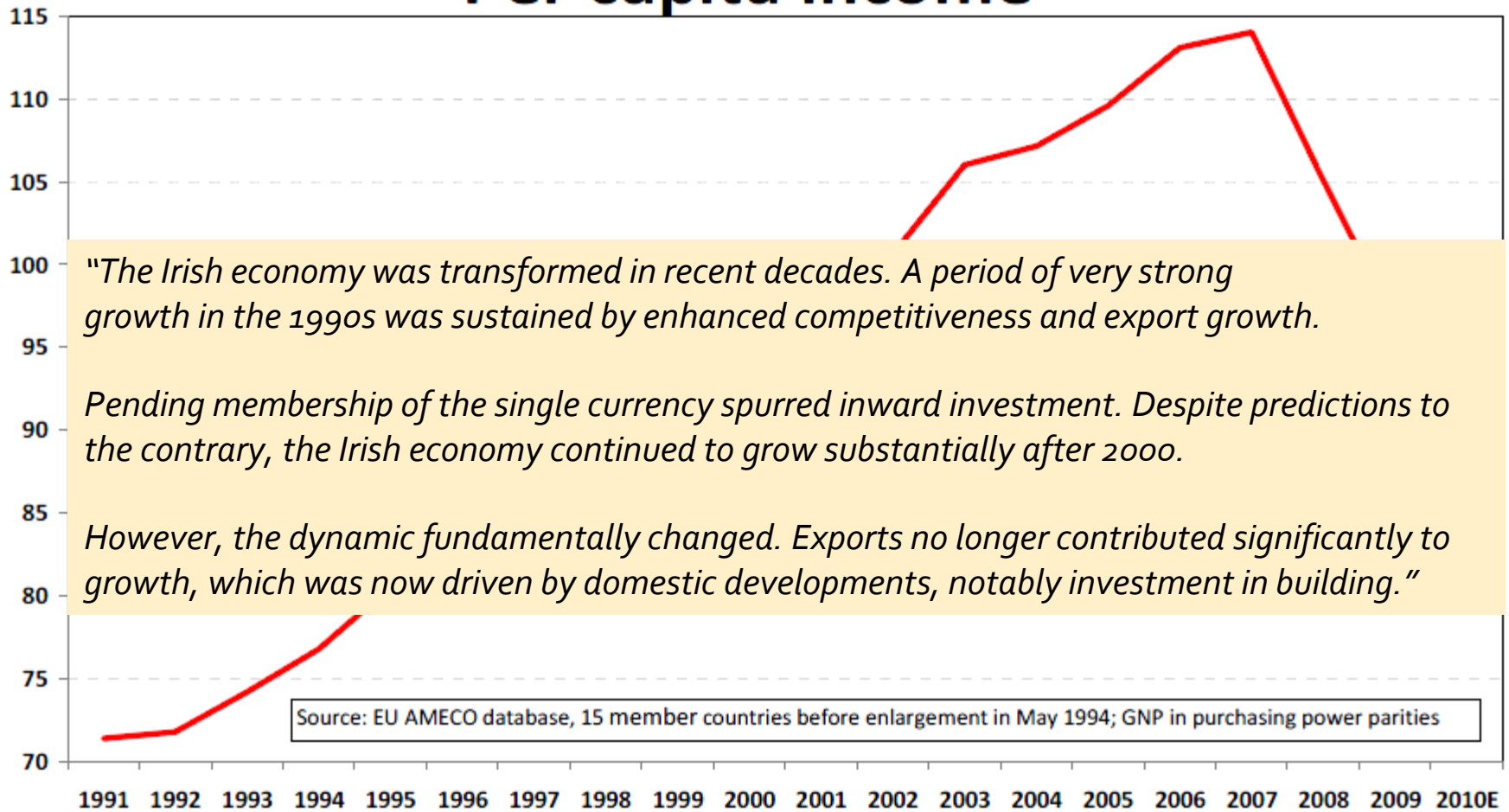


Will the private pensions industry survive?

Tony Gilhawley FSAI FIIPM
Technical Guidance Ltd.

Per capita income



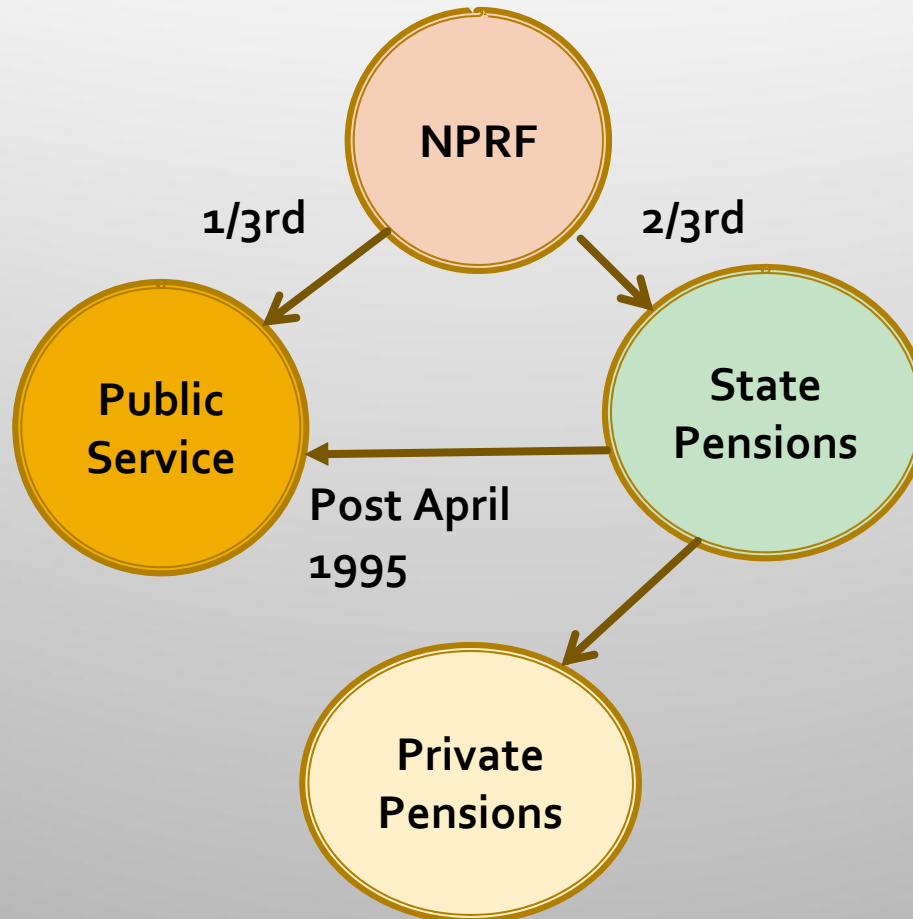
"The Irish economy was transformed in recent decades. A period of very strong growth in the 1990s was sustained by enhanced competitiveness and export growth.

Pending membership of the single currency spurred inward investment. Despite predictions to the contrary, the Irish economy continued to grow substantially after 2000.

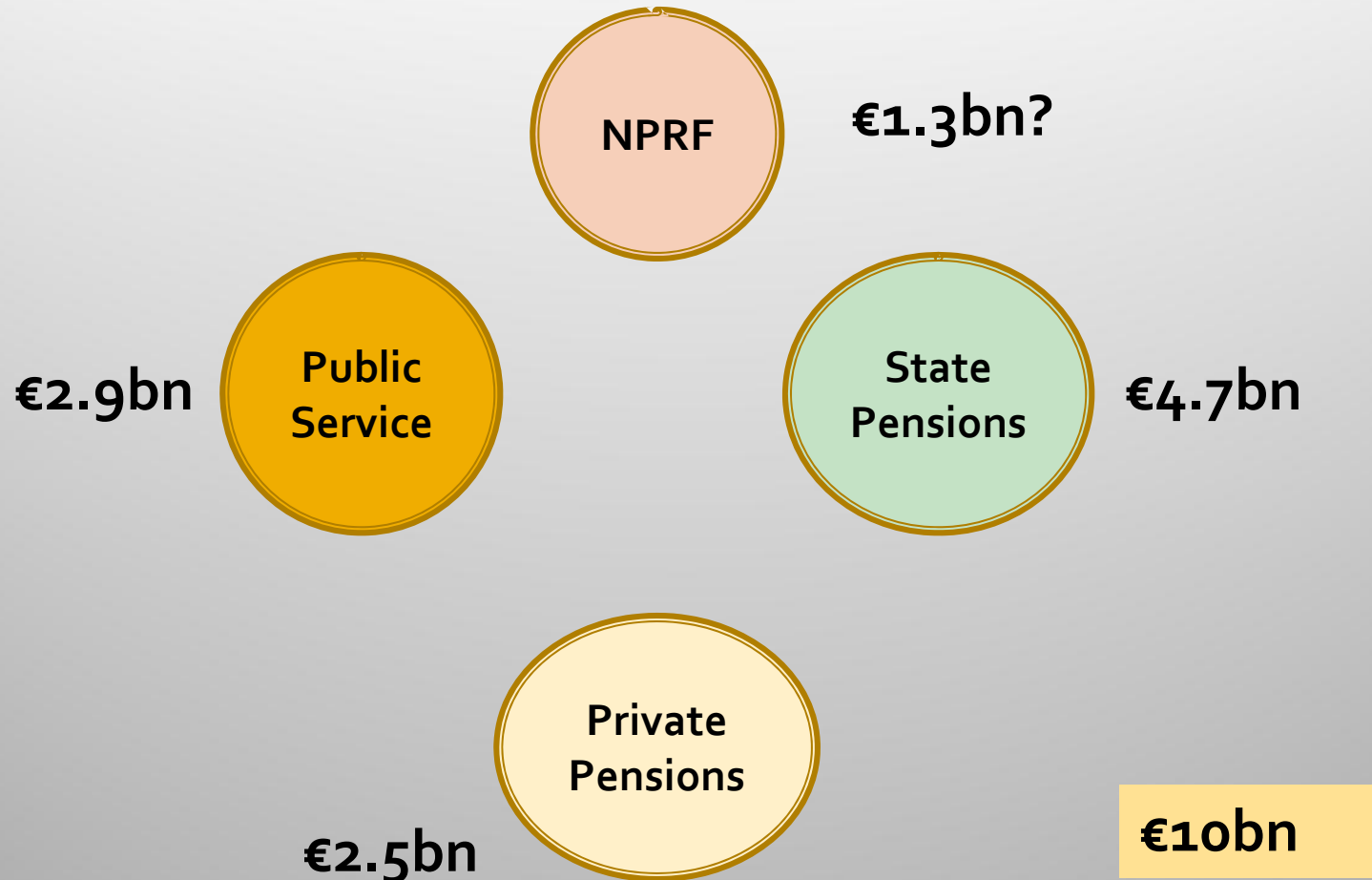
However, the dynamic fundamentally changed. Exports no longer contributed significantly to growth, which was now driven by domestic developments, notably investment in building."

Source : Wright Review of Dept of Finance

Everything is connected



Gross Exchequer outlay

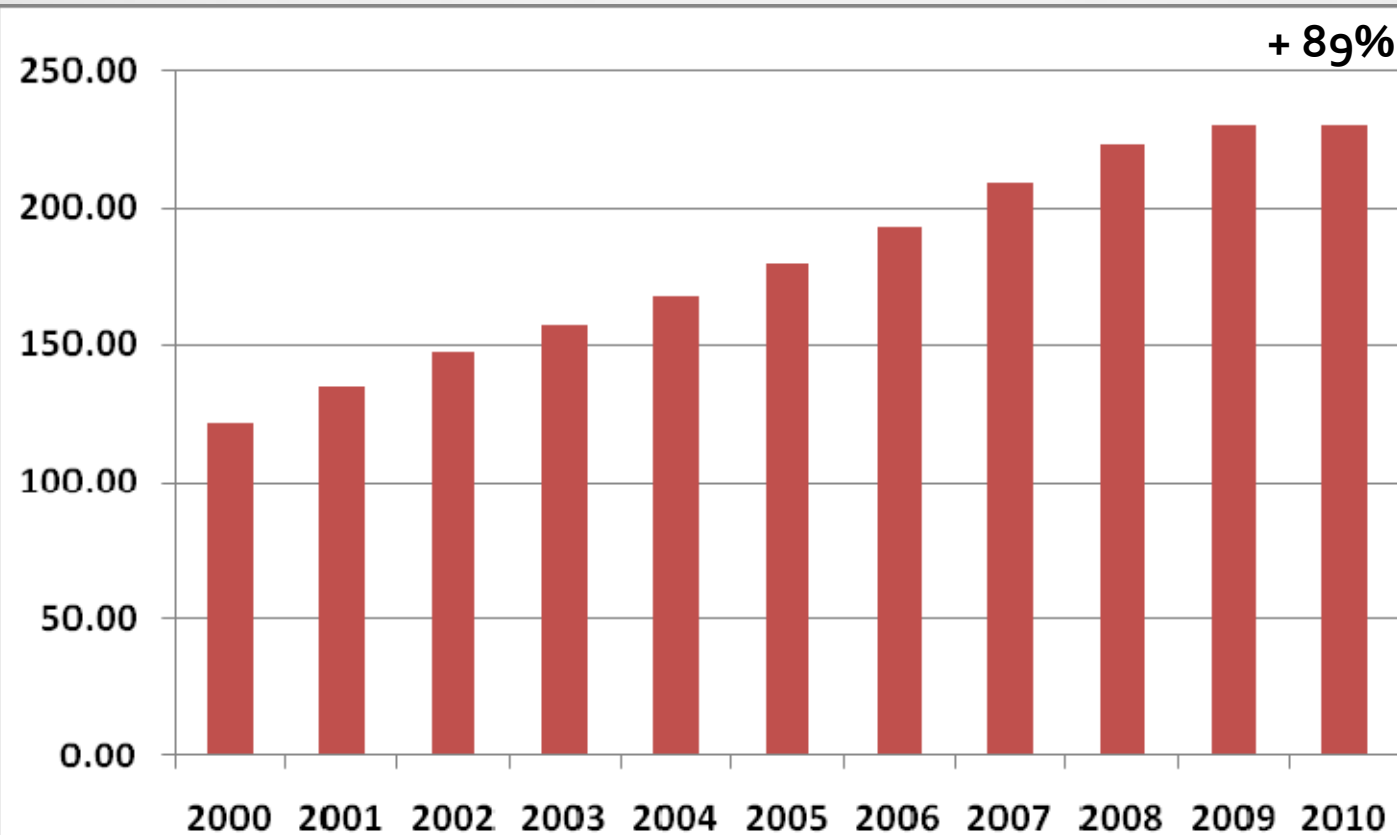


Areas

- **State Pension**
- **Public service pensions**
- **Private pensions**
- **Taxation changes**

State Pension

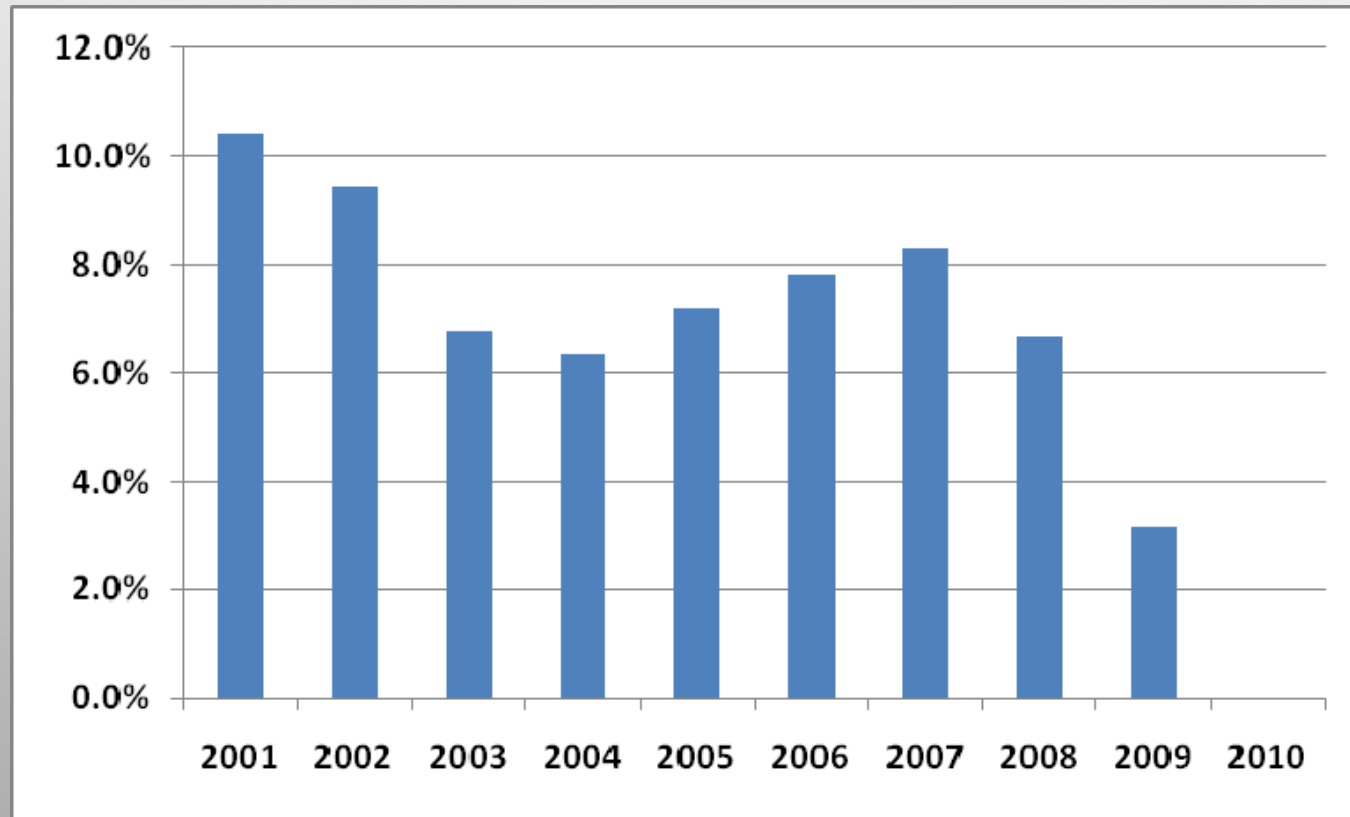
State Pension € weekly rate (max)



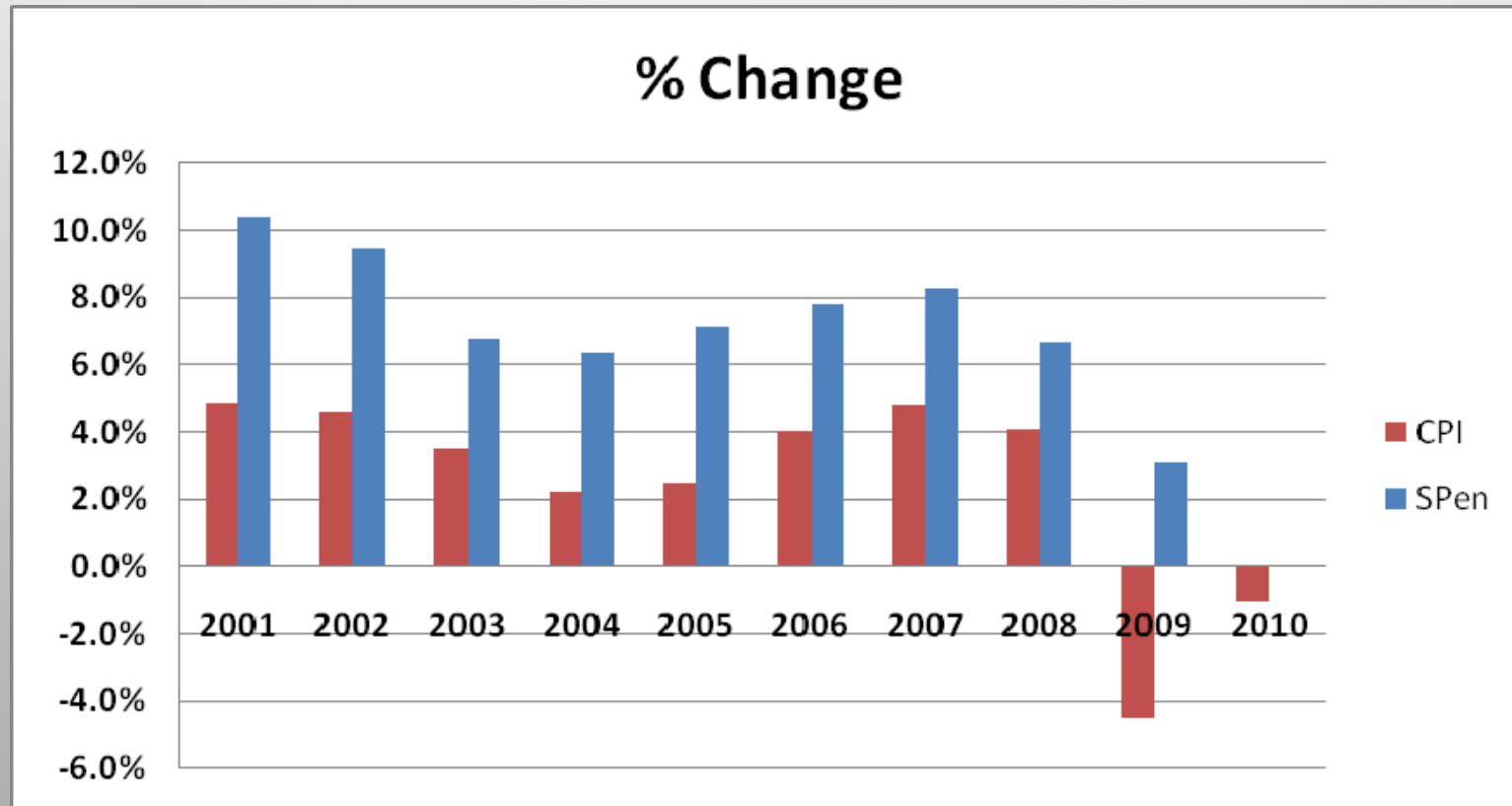
CPI + 28%

"Over the period 2004 to 2009, this policy has resulted in a sharp fall in both consistent poverty and at risk-of-poverty rates for older people."

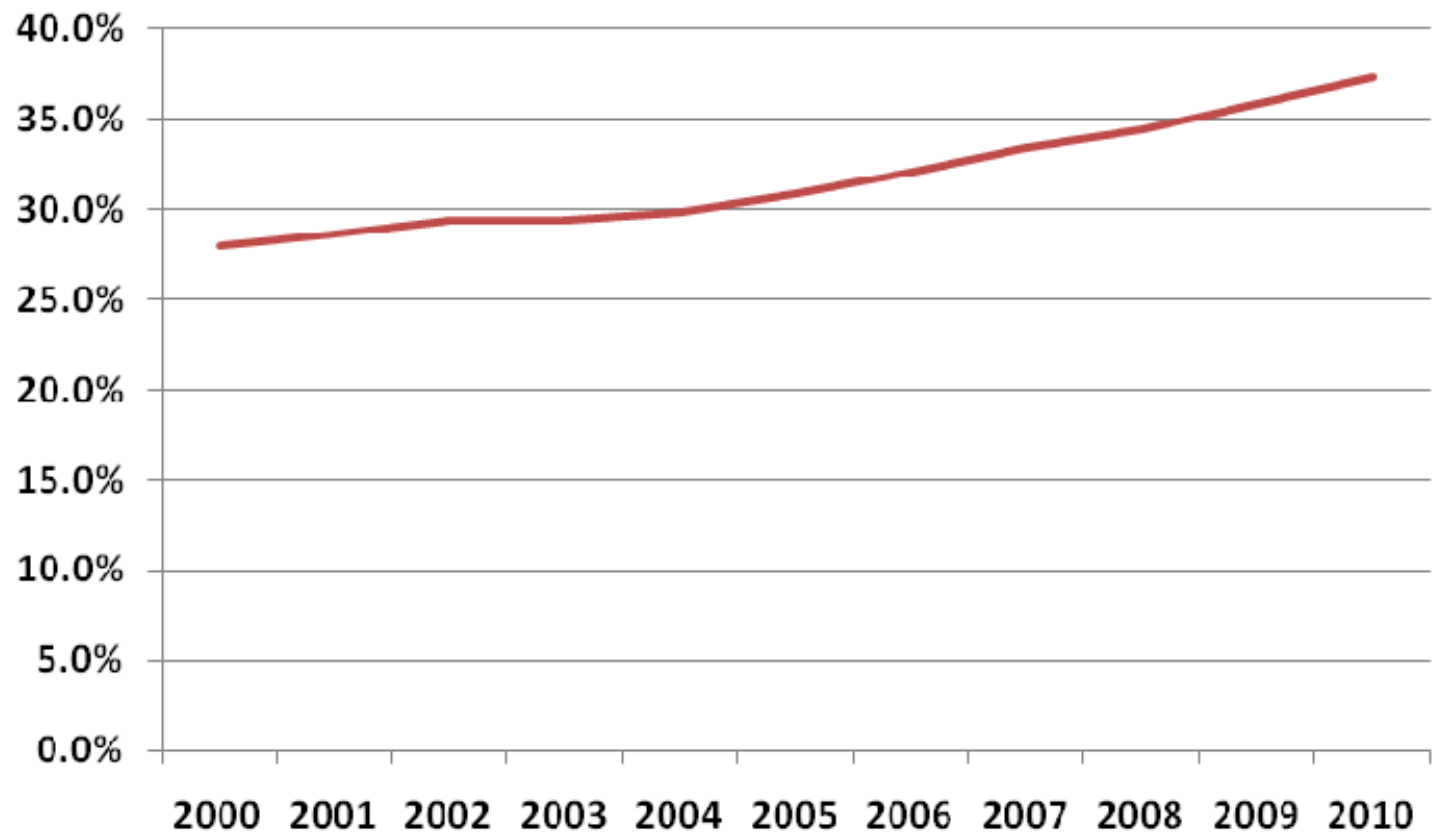
State Pension % increase



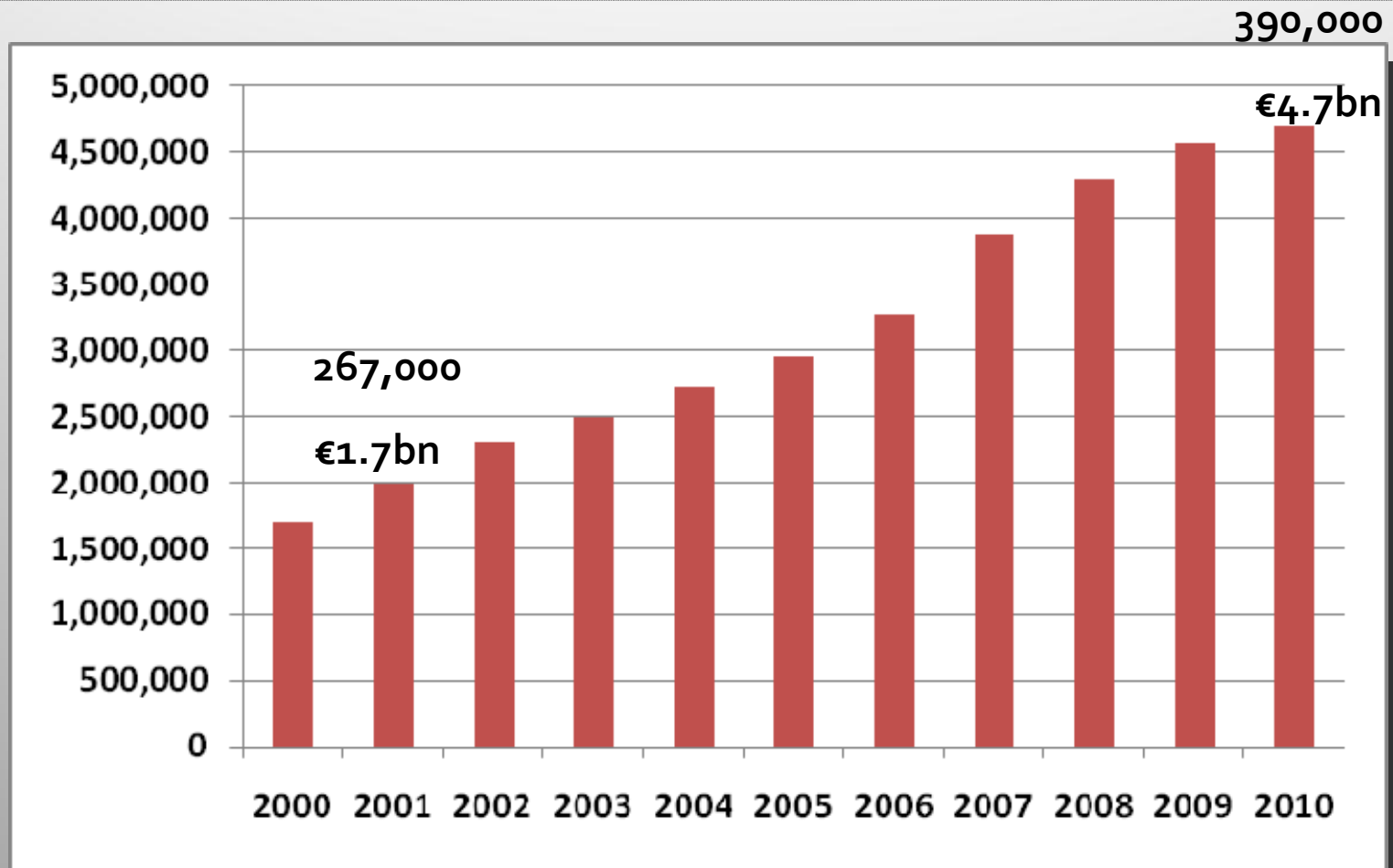
State Pension % increase



State Pension as % AWIE

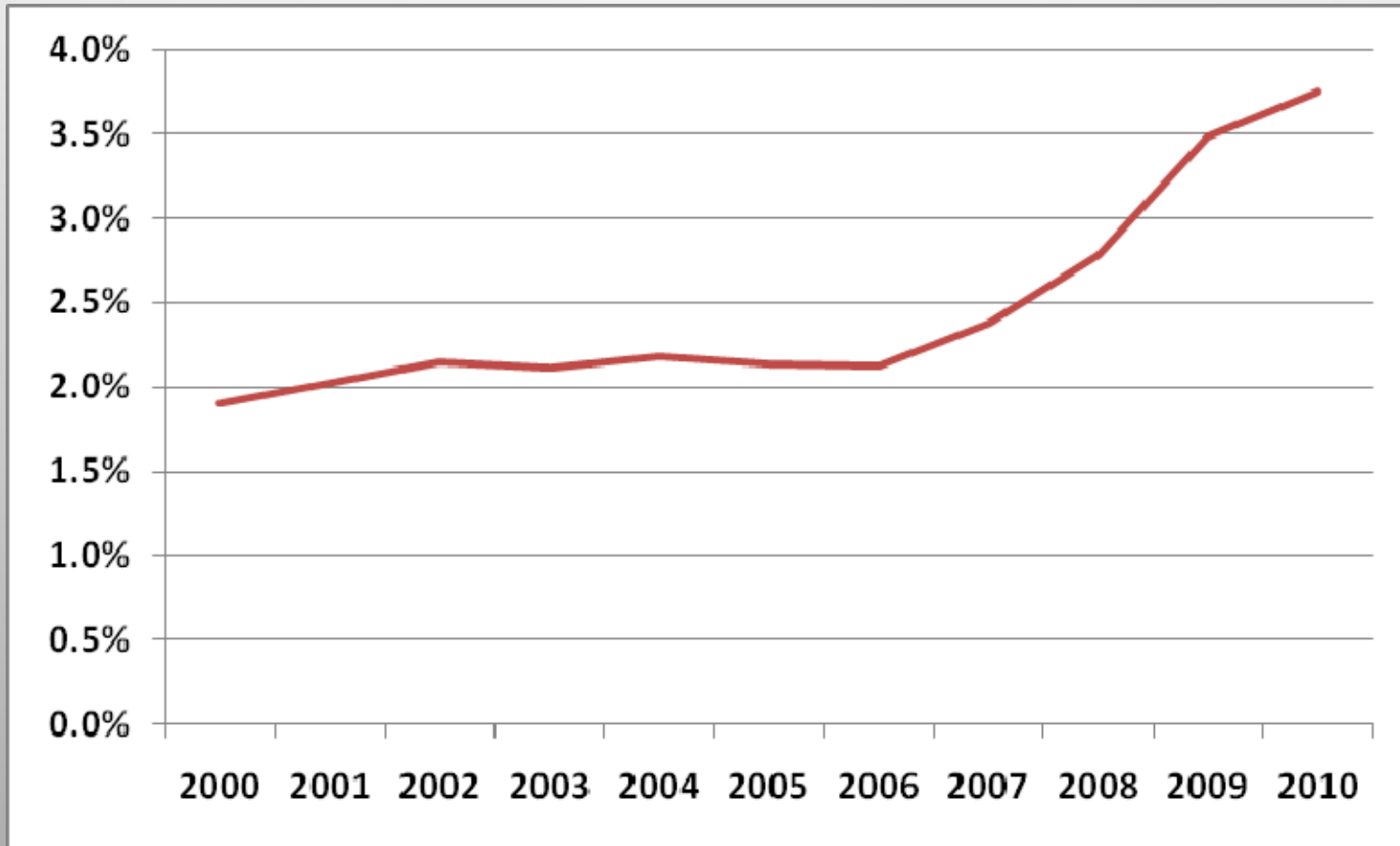


Gross expenditure on State Pensions



Source: Social Welfare Statistical Reviews

State Pension gross expenditure as % of GNP



Number of over 65's

Year	Number of over 65's
2011	536,000
2016	648,600 (+ 113,000)
2021	774,700 (+ 126,000)

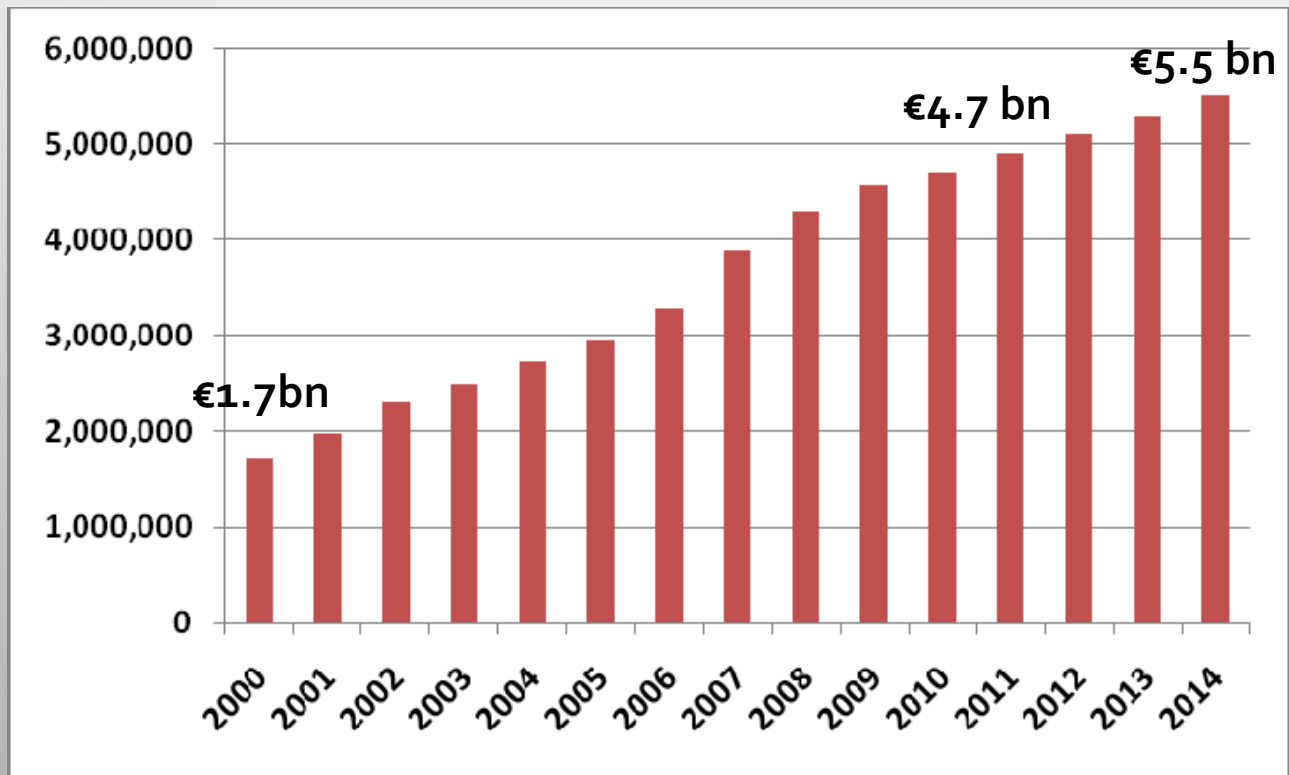
Source: CSO Population Projections

Government 4 Yr Plan

"The projected costs of the State pension out to 2014 are set to increase by about €800 million between 2010 and 2014 or 16%.

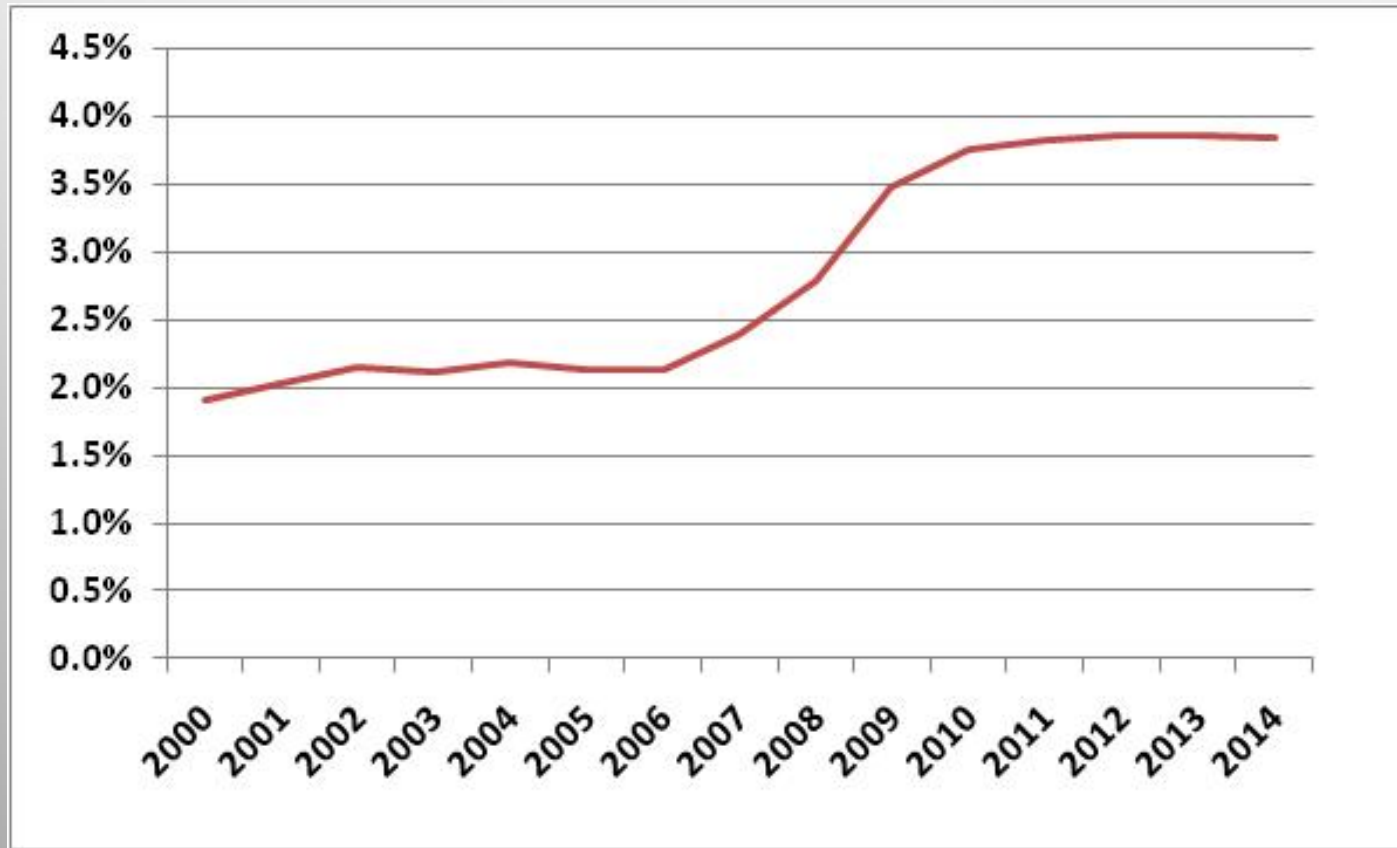
These pressures, which will arise over the period of the Plan and beyond, will require some structural change to ensure the sustainability of State pension provision. "

Gross expenditure on State Pensions

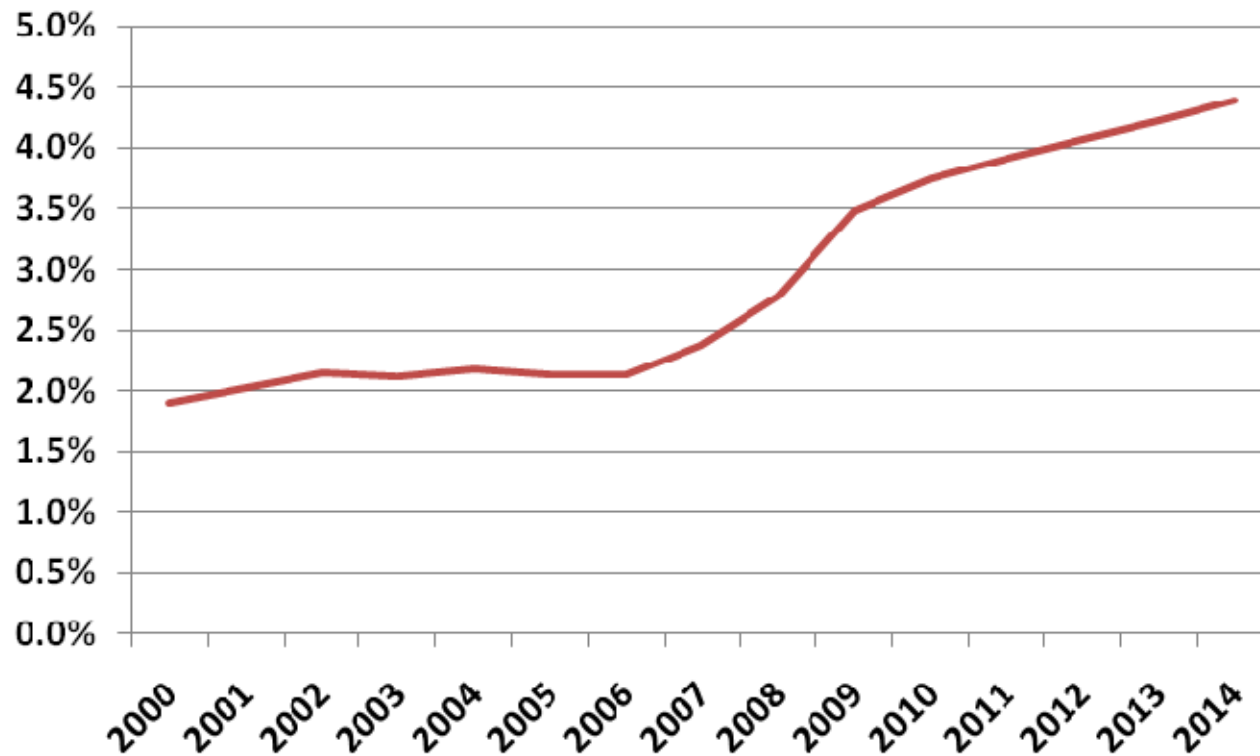


Source: Social Welfare Statistical Reviews

State Pension gross expenditure as % of GNP



State Pension gross expenditure as % of GNP – no growth



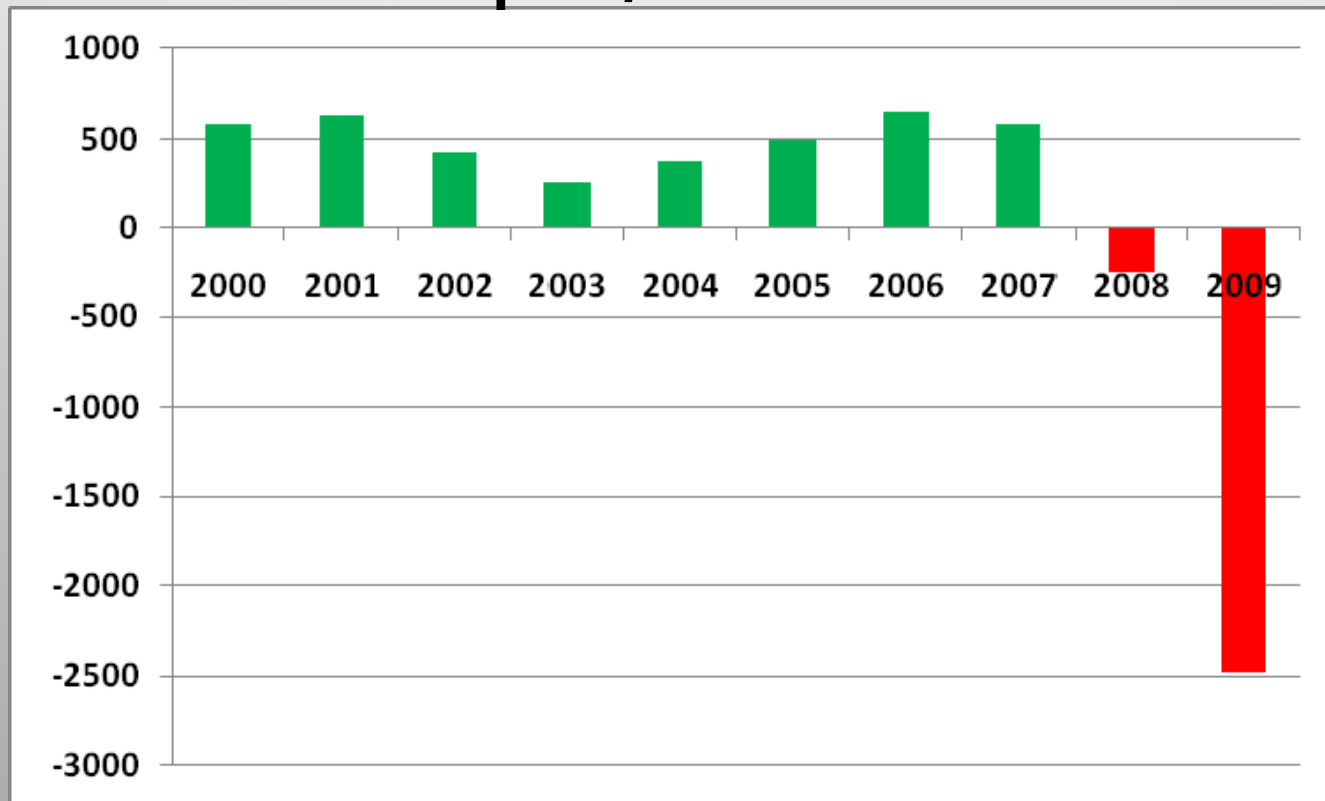
National Pensions Framework

The surplus built up in the SIF since 1996 will be exhausted in 2010 and will again require a subvention from the Exchequer of the order of €1.55 bn.

The Government will seek to sustain the value of the State Pension at 35 % of average weekly earnings and will support this through the PRSI contribution system.

Social Insurance Fund

Surplus/Deficit € m



No Exchequer contribution between 1996 and 2007

National Pensions Framework

- **State Pension (Contributory)**
 - Min 520 contributions from April 2012
 - $1/30^{\text{th}}$ for each year of contributions from 2020
- **State Pension Age**
 - 66 from 2014
 - 67 from 2021
 - 68 from 2028
- **Option to postpone State Pension**
 - Actuarial increase

4 Year Plan

Table 4.5 Proposed Expenditure on Social Protection

	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>	<i>% change</i>
	<i>€m</i>	<i>€m</i>	<i>€m</i>	<i>€m</i>	<i>€m</i>	<i>2010-14</i>
Opening Expenditure Level	20.9	21.0	20.9	20.8	20.7	-1
Consolidation Objectives						
- Measures from 2011		0.9	0.9	0.9	0.9	-
- Measures 2012-2014		-	0.6	1.4	1.9	-
- Total		0.9	1.5	2.3	2.8	-
Expenditure Ceiling	20.9	20.1	19.3	18.5	17.9	-14

Government 4 Yr Plan

No reduction in Social Welfare rates?

Options for protecting the State Pension?



Immediate options?

- **Freeze benefits at current levels and hope!**
- **Increase PRSI rates**
- **Increase Exchequer subvention**
 - Higher taxes
- **Ration through**
 - means testing
 - stricter qualification conditions
- **Reduce benefits ... most likely**
 - €15 pw cut would return to 35% AWIE

Public Service Pensions

Wide range schemes

- Civil Servants
- Education
- Health
- Gardai
- Defence
- Local authorities

Commission on Public Service Pensions

"The main difficulty with pay-as-you-go is that, because it does not make advance provision for future liabilities, there is a lack of transparency about the real cost of pensions.

*As a result, **benefits, not costs, tend to become the main focus of attention.***

Substantial increases in personnel covered and/or improvement in pension terms, which usually have only a minor impact on costs in the short term, may result in a disproportionate increase in medium to long-term expenditure.

In a funded system, the existence of contribution rates for a pension fund would bring home to members the value of their pension entitlements and the costs of improving them."

Source : Commission on Public Service Pensions Interim Report, 2000

Benefit creep!

- Fast accrual/added years
- 'Professional' added years
- Pensionable allowances
- 'Incentivised' early retirement deals

Fast accrual

Figure 3.2 Superannuation Schemes with Fast Accrual Terms

Sector	Minimum Years Service Required to Earn Maximum Retirement Benefits		Minimum Age For Payment of Pension ^a	
	Pre 2004	Post 2004 ^b	Pre 2004	Post 2004
Garda Síochána	30	30	50	55
Permanent Defence Forces	31	31	- ^c	50
Fire Fighters	30	30	55	55
Prison Officers	30	30	50	55
Teachers	40	40	55	65

Source : C & AG Report on Public Service Pensions, August 2009

Fast accrual

"The Group notes the existence of a range of accelerated / 'added years' arrangements across various areas of the public service.

These accelerated arrangements are more costly to the Exchequer, and their existence and budgetary implications do not appear to be widely known or appreciated by the general public."

"...some hospital consultants may be entitled to up to 10 added years of service;

a High Court judge, who might typically be appointed to the bench at 50 years of age, is entitled to full pension at age 65 (an effective 25 added years)."

Source: Bord Snip Nua Report, 2009

'Established practice'!

*"The Department of Finance confirmed that Mr Doyle, who had served 38 years in the civil service, was **topped up to the 40 years to enable him to obtain the maximum possible pension.***

A department spokesman said that Mr Doyle's top-up was in line with public sector norms.

He said the amount of the top-up was "fairly small".

Sunday Independent, July 2010

Additional pension @ 60 : € 5,700 pa

Additional gratuity @ 60 : €17,100

Pensionable allowances

*"Teachers who **teach through Irish** can claim an annual allowance of €1,666 which counts as part of pensionable salary, boosting the pension on retirement.*

*A Garda's weekly **boot allowance** of €2.93 is considered a pensionable allowance, as is the €2.77 per week payable as a **bicycle allowance**, according to an emailed response from the Department of Justice."*

Source : Irish Independent, March 2009



Up to 7 years added service!

- Teachers 'three strands' early retirement deal

- I : *'experiencing professional difficulties in their teaching duties.'*
- II : *'... retirement will provide their school with an opportunity to enhance the education service'*
- III : *'in posts which are surplus to requirements'*



'Incentivised' early retirement 2009

- Non application of Cost Neutral Early Retirement Factors

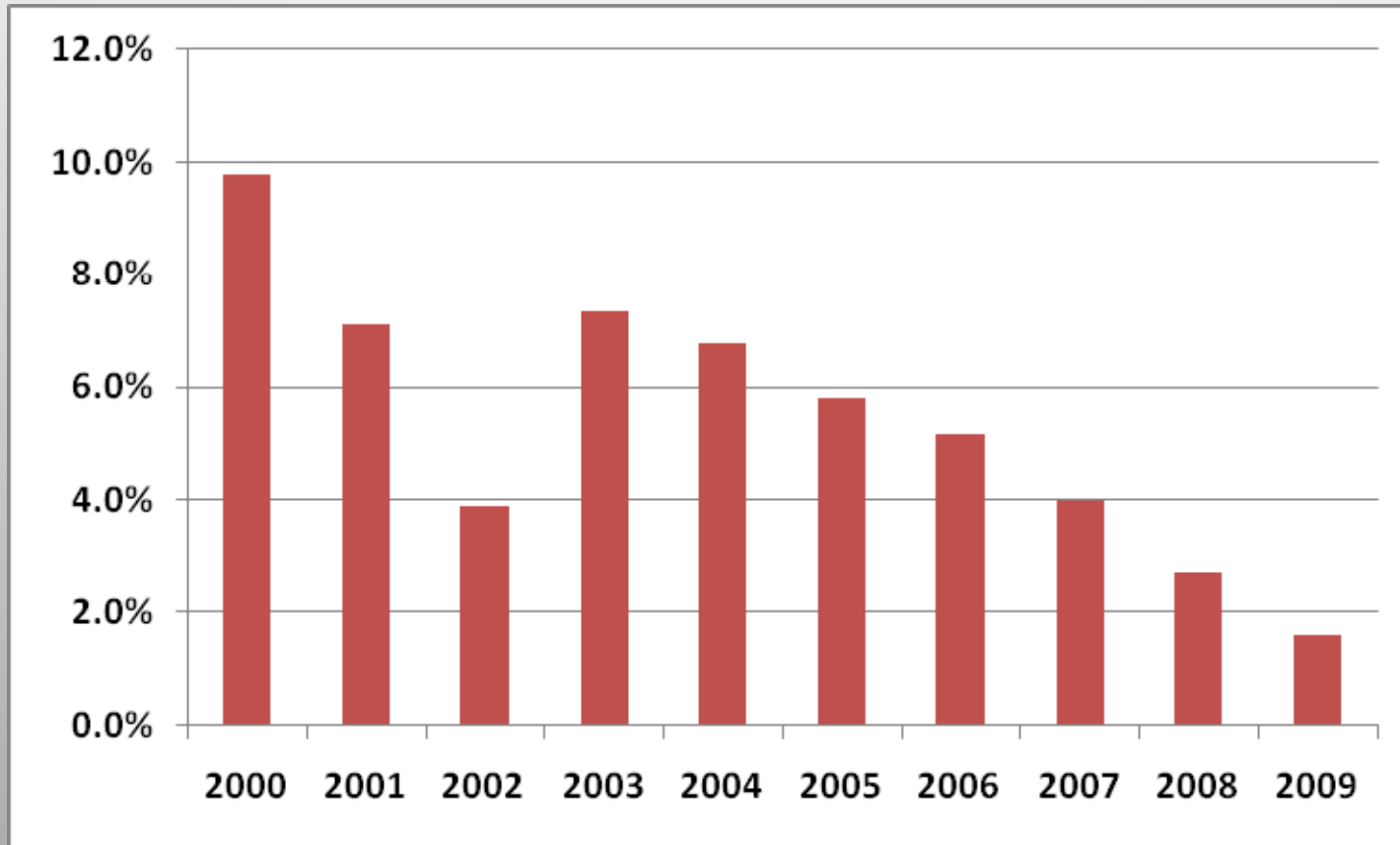
	Pension
50	62.5%
51	65.1%
52	67.9%
53	71.0%
54	74.3%
55	77.8%

$30/80\text{ths} \times \text{€}60,000 \times 62.5\% = \text{€}14,063 \text{ pa}$

$30/80\text{ths} \times \text{€}60,000 = \text{€}22,500 \text{ pa (+ €}8,437 \text{ pa)}$

+60%

Average public service earnings increase



+ 70%

Source: CSO Public Service Employment & Earnings Index

'Pay parity'

"These increases are, in general, at the discretion of the organisation subject to the approval/consent of the Minister responsible with the consent of the Minister for Finance.

The application of the Minister's discretion for the past 20 years has been based on full parity whereby, for the most part, general increases to serving staff are passed on to pensioners on the same basis."

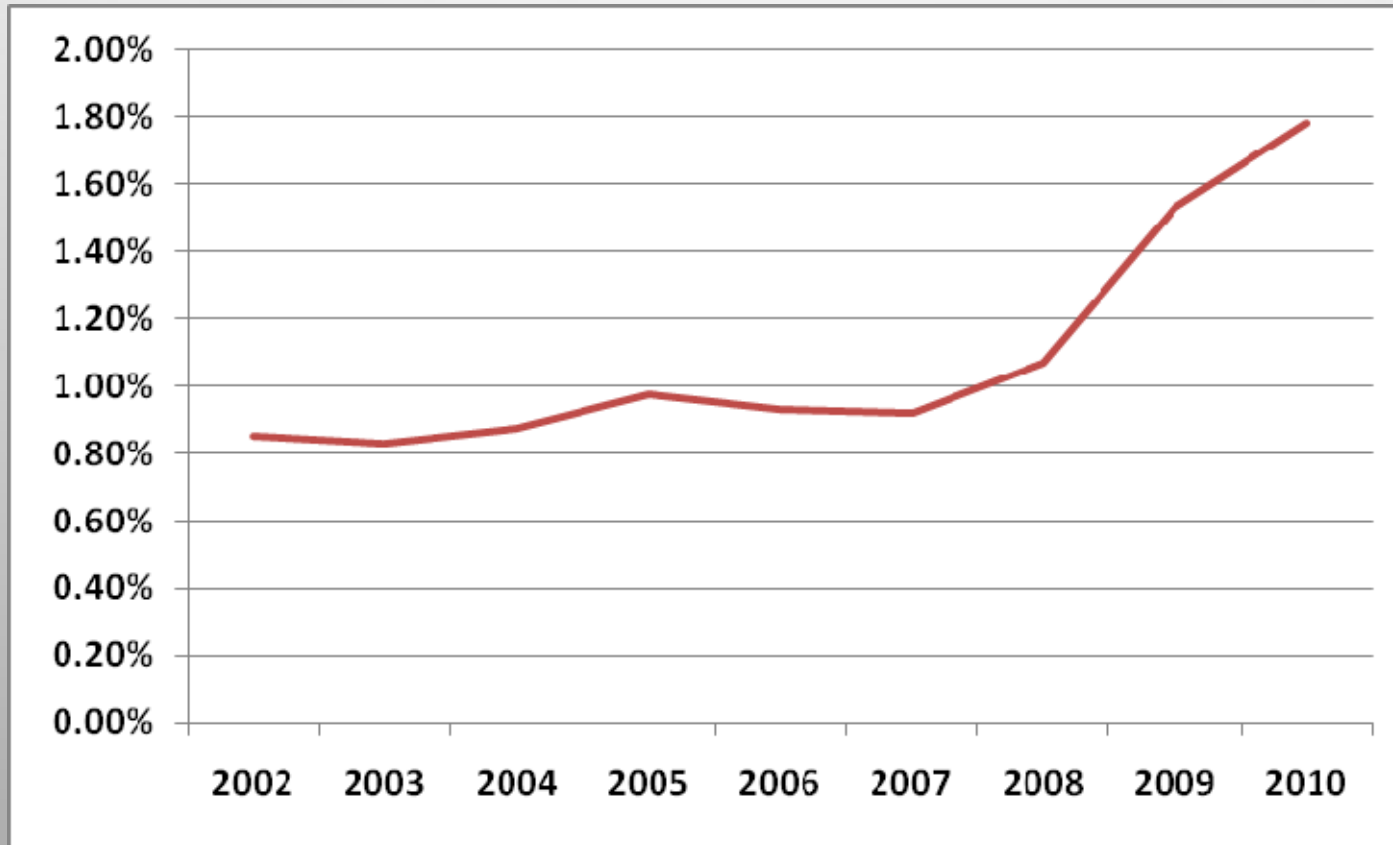
Source : C & AG Report on Public Service Pensions, August 2009

'Pay parity'

"In relation to existing and future public service pensioners, the Government will consider using the CPI as the basis for post-retirement increases."

Source : National Pensions Framework

Exchequer Net Pension Cost % GNP

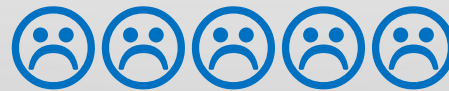


Gross cost has increased from €1.35 bn in 2005 to €2.8 bn in 2010

Exchequer gross pension costs

	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>	<i>% change</i>
	<i>€bn</i>	<i>€bn</i>	<i>€bn</i>	<i>€bn</i>	<i>€bn</i>	<i>2010-14</i>
Opening Expenditure Level	2.8	2.8	2.9	3.0	3.1	13%
Impact of Retirements		0.2	0.2	0.1	0.1	
Pension Adjustment		-0.1	-0.1	-0.1	-0.1	
Expenditure Ceiling	2.8	2.9	3.0	3.0	3.1	12%

Source : Government 4 year plan



" ... there are now two Public Service pensioners for every five serving public servants."

Source : Government 4 year plan

Containing the cost

- **April 2009 – Pension Related Deduction (PRD)**
 - Average 7%
 - €875m in 2010, less tax relief
- **Jan 2010 – pay cut**
 - Average 6.5%
- **Jan 2011 - Public Service Pension Reduction (PSPR)**
 - Average 4% cut
- **New career average pension scheme for new entrants**
 - SW Pension Age
 - CPI linking in retirement

Annual pension cost

Figure 2.9 Annual Pension Cost of Public Servants^a

Sector	Gross Pension Cost as a Percentage of Pensionable Remuneration	Net Pension Cost as a Percentage of Pensionable Remuneration
	%	%
Civil Service	22.3	13.0
Health	16.1	4.3
Gardaí	27.9	15.9
Prison Officers	29.6	19.8
Defence Forces	28.2	19.5
Teachers ^b	22.4	9.6
VECs and ITs	19.9	7.2
Universities	19.3	7.8
State Sponsored Bodies	21.2	10.4
Constitutional, Ministerial and Judicial Office-Holders	70.0	61.1

Source : C & AG Report on Public Service Pensions, August 2009

New entrant contribution rate

Category of Employment	As a Percentage of Pensionable Remuneration			
	Total Cost	PRD	Employee Contribution ^a	Net Cost
Civil Service				
Established	24.6	8.1	4.6	11.9
Non-Established	9.5	7.0	0.3	2.2
Education				
Primary Teacher	20.5	8.4	4.9	7.2
Post-Primary Teacher	23.1	8.4	4.9	9.8
Security				
Garda	29.6	8.5	5.1	16.0
Prison Officer	27.8	7.7	4.5	15.6
Commissioned Officer	41.2	8.1	4.8	28.3
Enlisted Personnel	22.4	7.2	0.4	14.8
Health				
Consultant	25.9	9.5	6.0	10.4
Nurse (General)	17.7	8.0	4.7	5.0
State Sponsored Bodies				
Established Officer	22.7	8.5	4.9	9.3

Source: C & AG Report on Public Service Pensions, August 2009

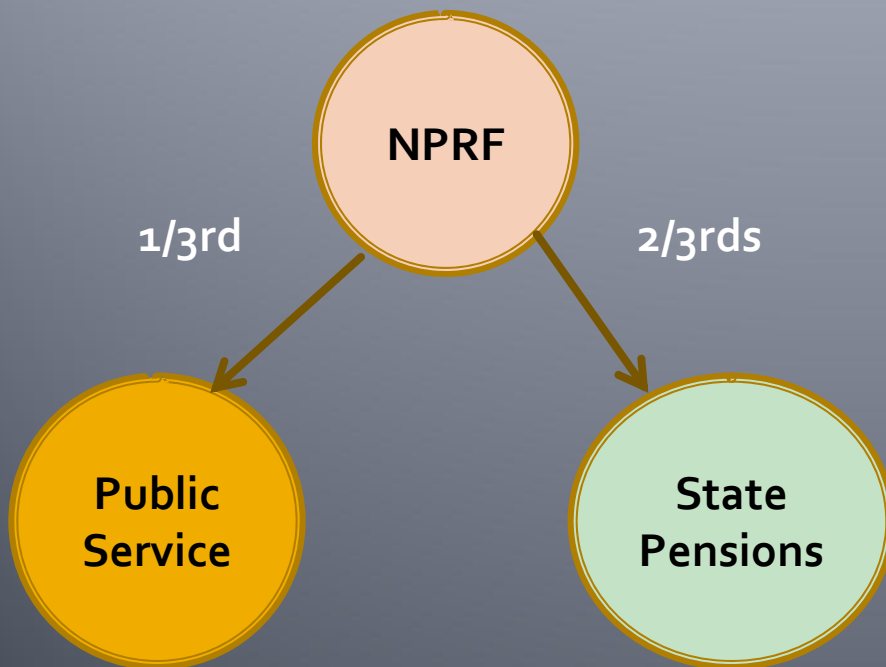
The National Pensions Reserve Fund



"National Pensions Reserve Fund, born April 2001, died November 28th, 2010; survived by a sister, Nama"

Irish Times, 30th November 2010

The National Pensions Reserve Fund – 1% pa GNP

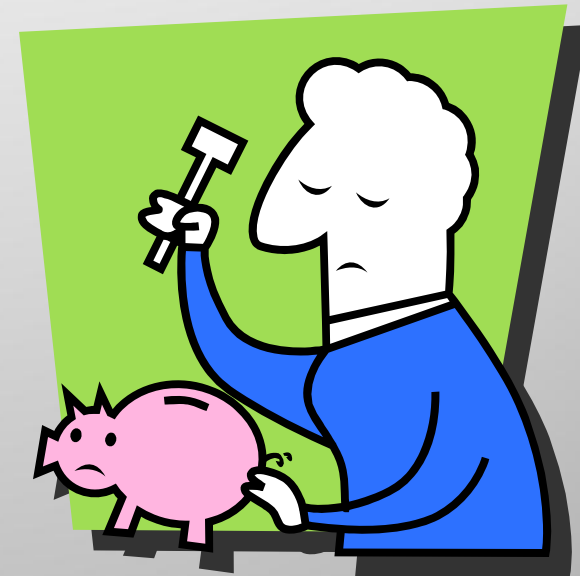


"It is estimated that this prefunding arrangement should allow for a cap of around 6.25% of GNP to be placed on net Exchequer outlays on pension over the period from 2025 to 2055 which otherwise, are projected to rise to 12.5% of GNP."

NPRF Chairman, 2003

NPRF @ 30th September 2010

	€ bn
Total	24.5
Less	
Directed investments	- 6.6
Further bank recapitalisations?	-15.0 +
Left	???



The future

"Substantial increases in the effectively flat-rate state pension have reduced pensioner poverty.

The current system will become unsustainable as the population ages, even with the resources in the National Pension Reserve Fund."

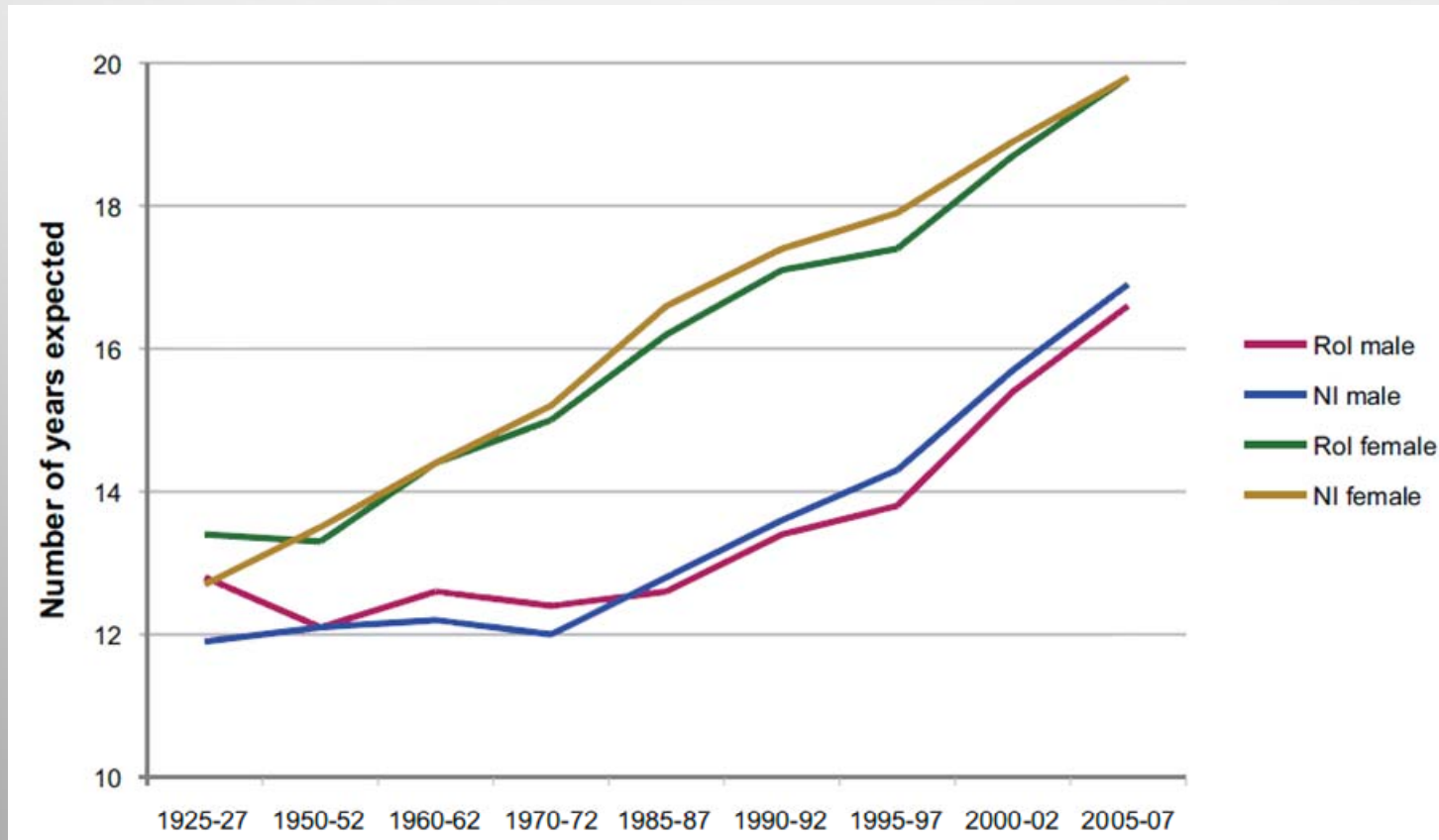
Source : OECD Economic Survey 2008

Private pensions

Headwinds

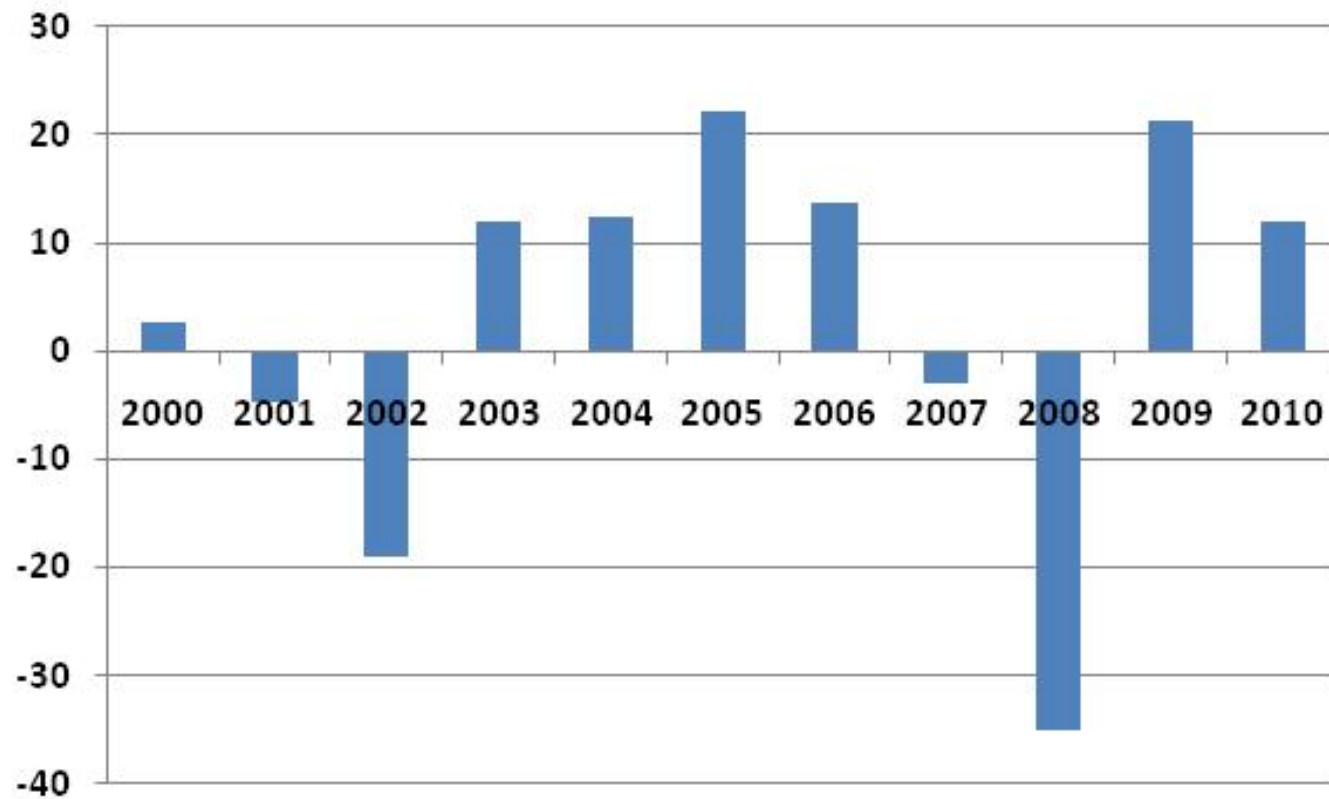
- Increased longevity
- Investment returns
- Salary inflation
- Coverage
- Economic Crisis
- Taxation

Life expectancy at age 65



Source : CARDI, 2010

Consensus Managed Fund

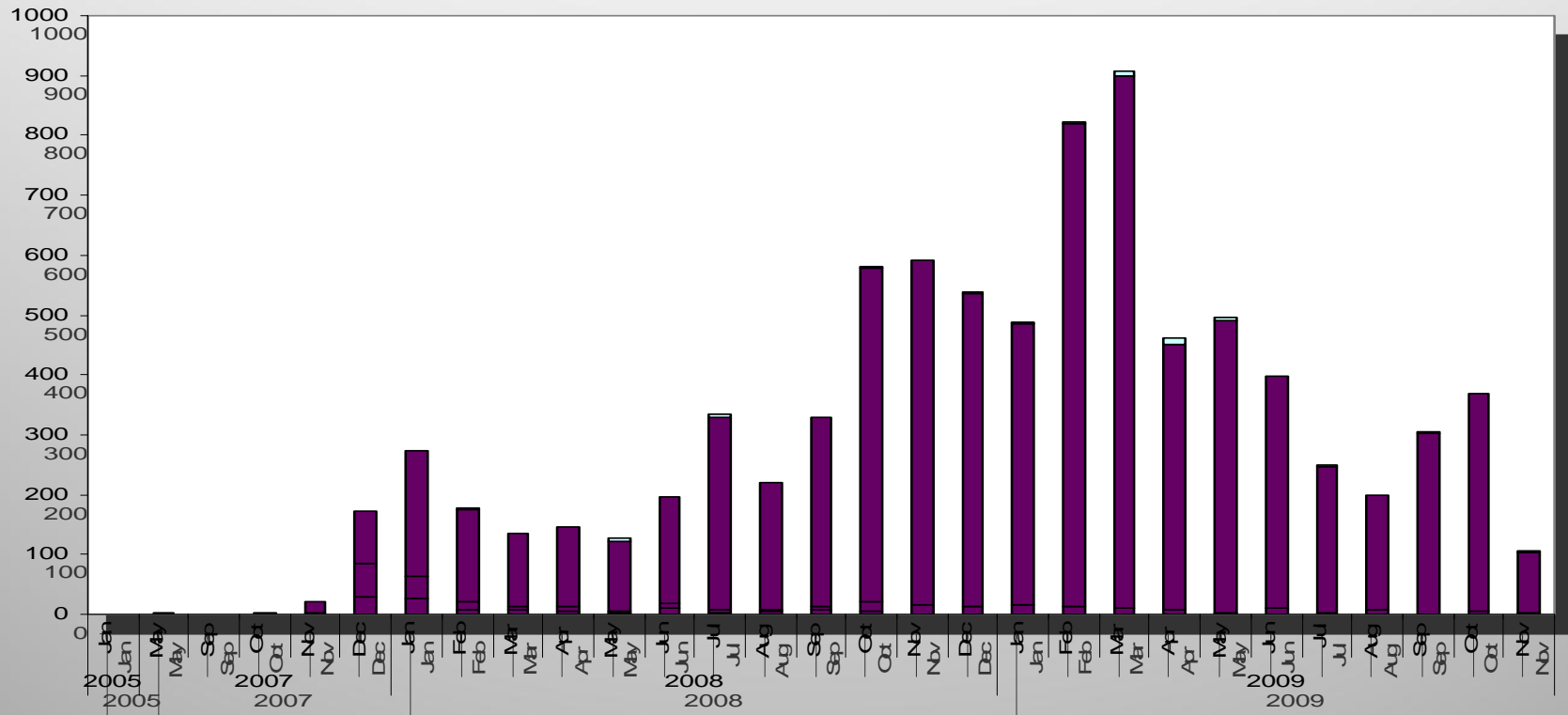


+ 19%

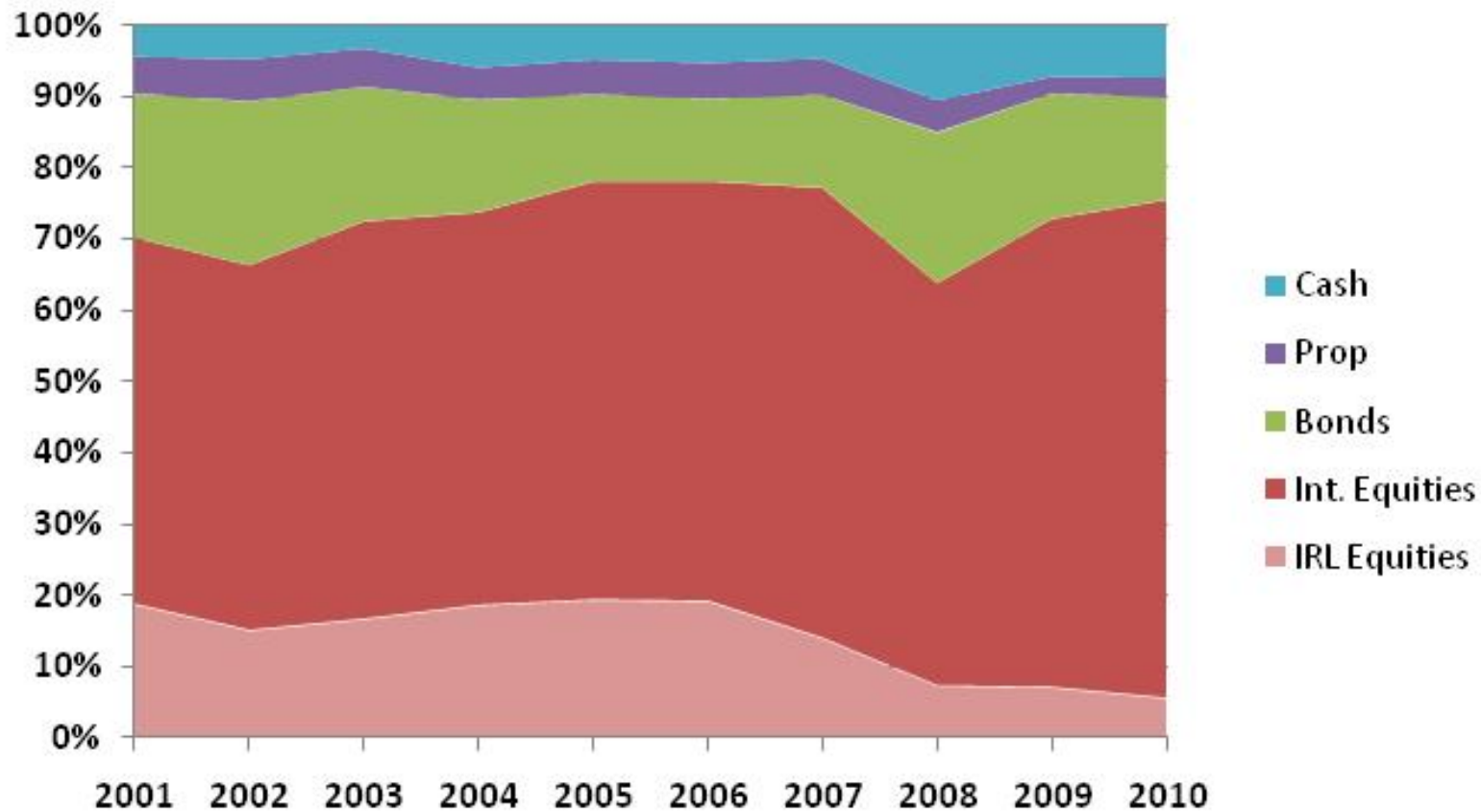
+ 1.6% pa

0.8% pa for
regular
contributor

Consumer switches

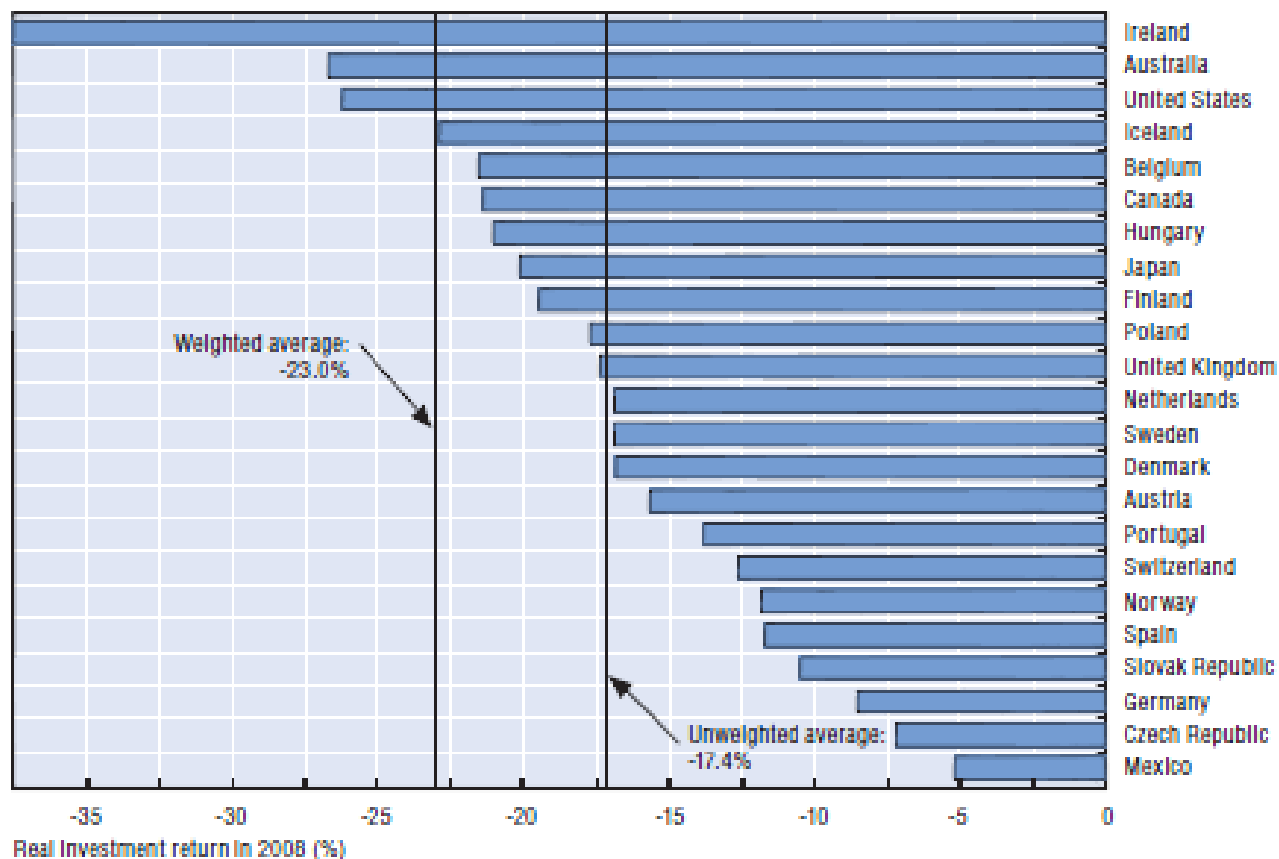


Consensus Managed Fund Asset Allocation



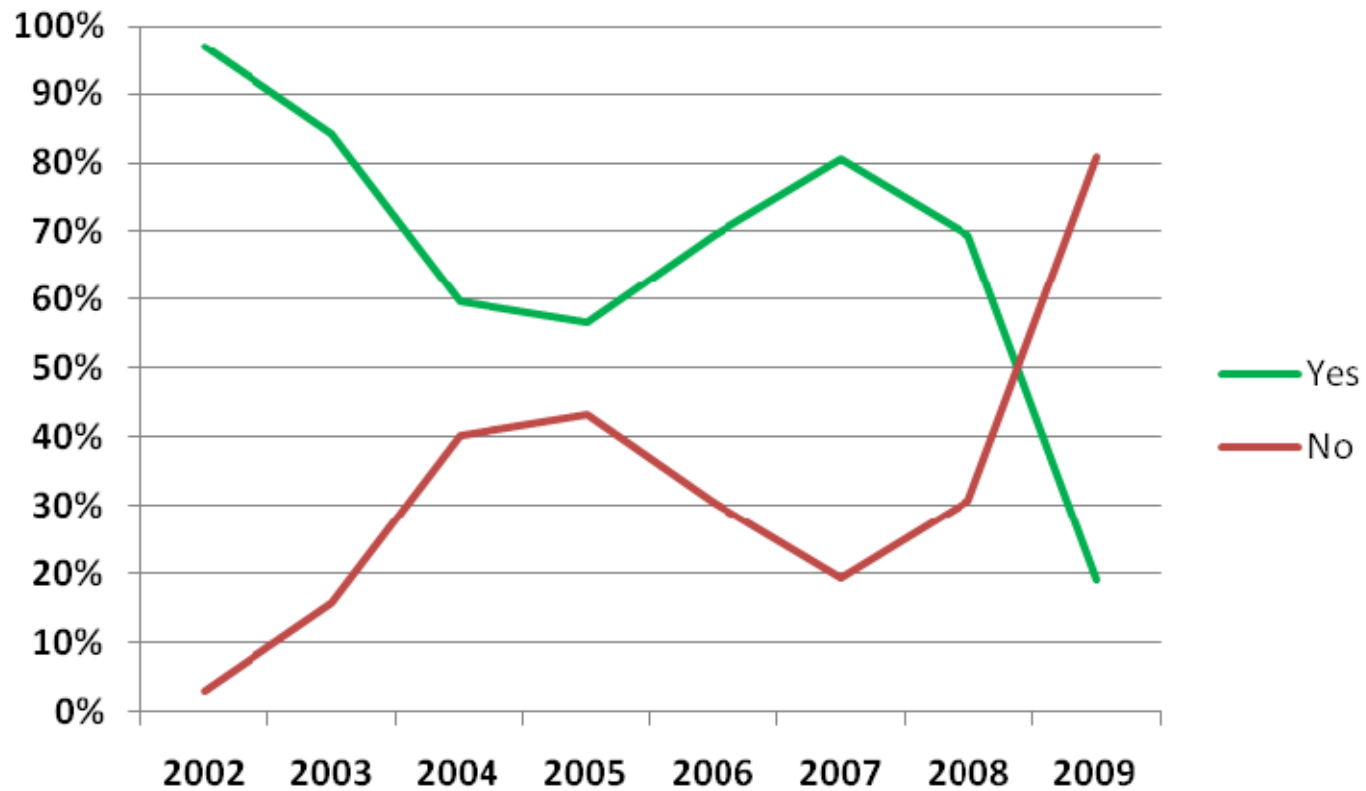
International

Figure 1.3. Pension funds' real investment returns, 2008



Source : OECD Pensions at a Glance 2009

DB schemes funding standard



PIPs

Sovereign
Annuities

Source : Pensions Board Annual Reports, 2002-09

Sovereign Annuities

"The trustees of a scheme may, at any time, not withstanding anything contained in the rules of the scheme and without the consent of the members... "

- *Buy a sovereign annuity to hold*
- *discharge liability to pensioner*

"... acted honestly and reasonably and that having regard to all of the circumstances of the case he or she ought fairly to be excused for the breach of trust, the court may relieve him or her in whole or in part from his or her liability ..."

Source : S.59 Pensions Act 1990

Sovereign Annuities

Turns pensioners into bondholders!



Restructuring DB schemes?

- Fixed contribution rates for members and employers;
- Because contribution rates are fixed, benefits must be flexible in the event of investment losses or other adverse experience; and
- The benefit design must accommodate increases in life expectancy.

Source : National Pensions Framework

Restructured DB design

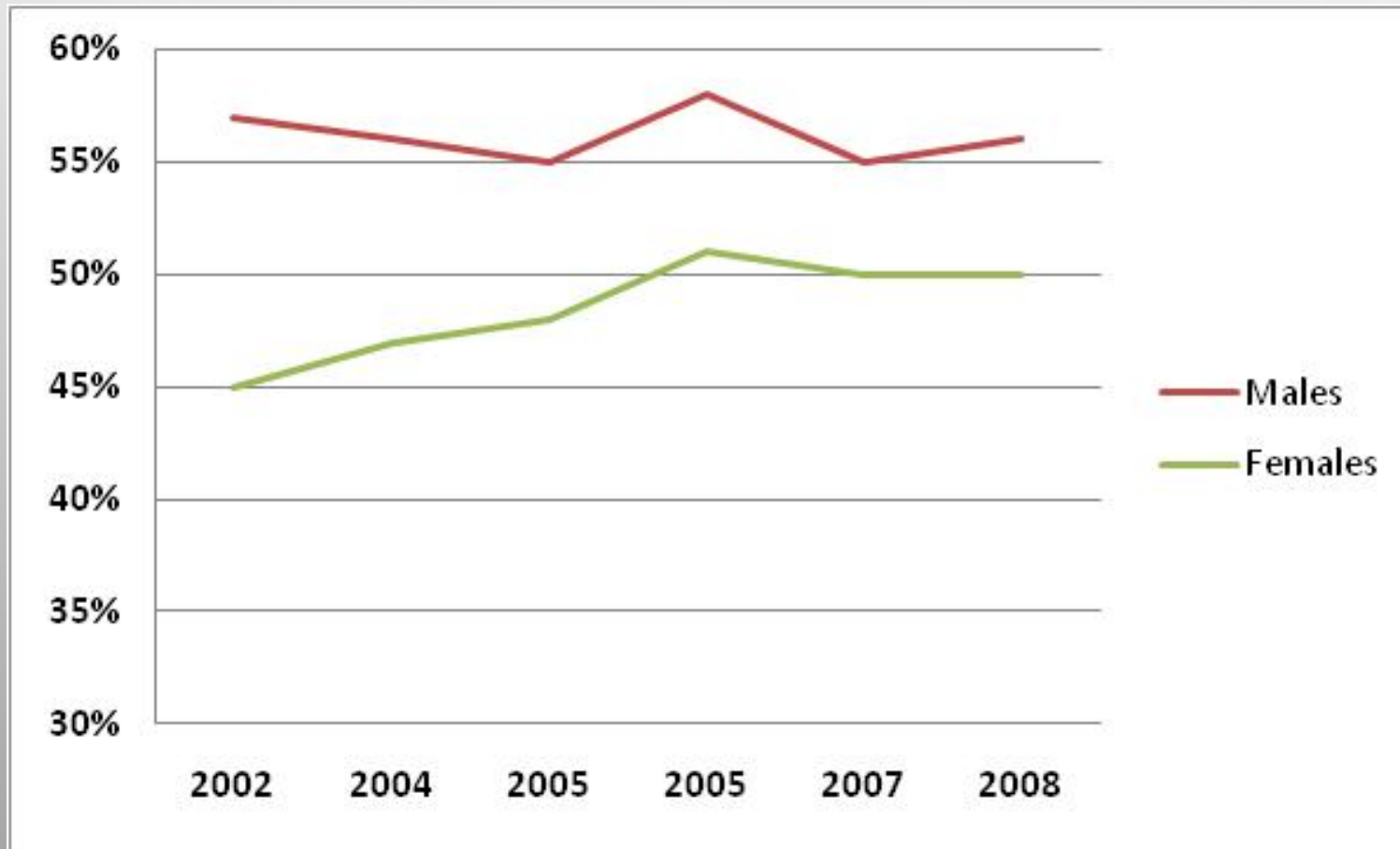
"... The promised level of benefits would be significantly lower than under a typical current DB scheme but on the other hand, they would be provided to a greater degree of certainty..."

*"... It also provides scheme members with a clearer understanding of the benefits that their scheme will provide them, and gives them a clearer basis for retirement planning.
..."*



Source : National Pensions Framework

Private pension coverage



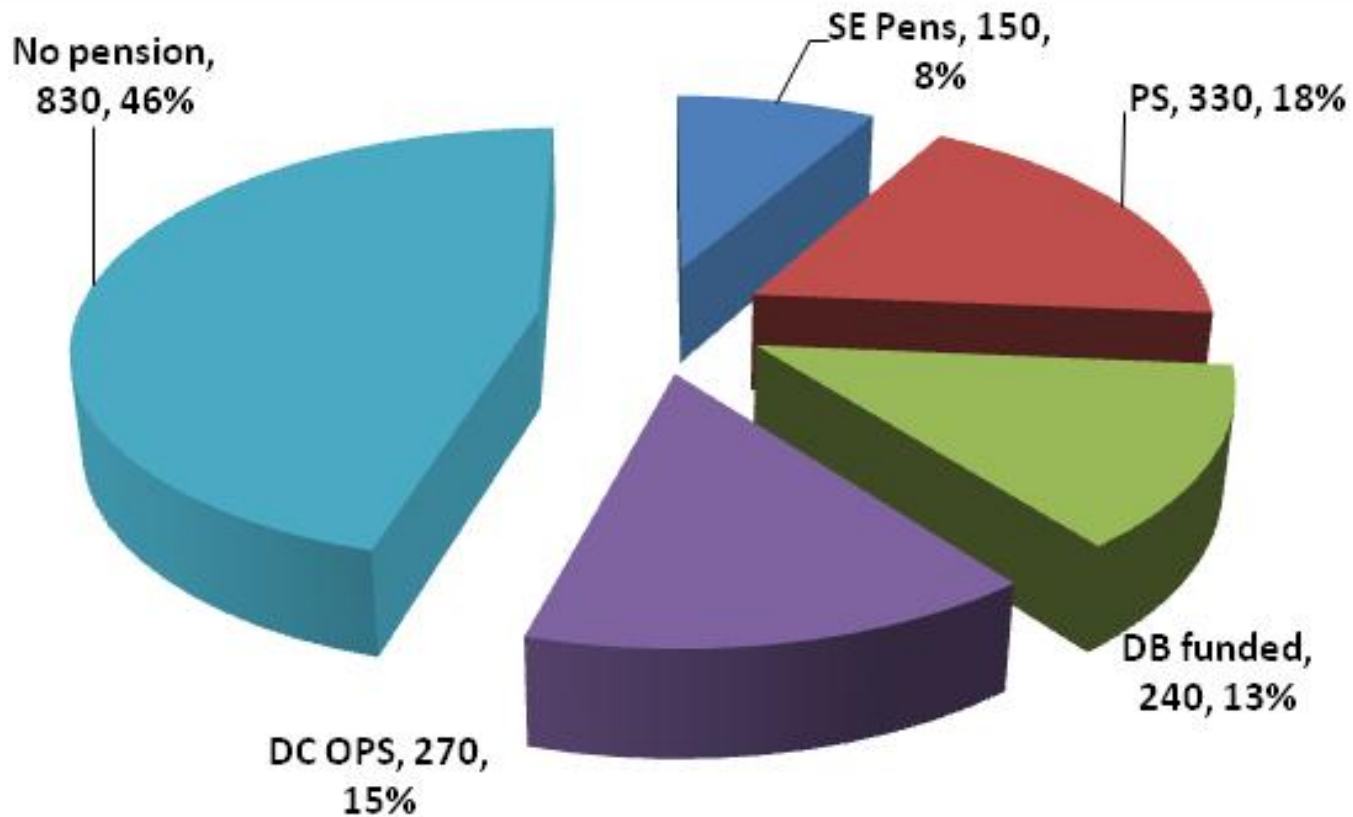
Source : CSO Quarterly National Household Survey, Pension Modules

Coverage

	DB (FS)	DB (PS)	DC OPS	Total
2009	254	332	267	853
Increase 2000-09	28	108	86	223
PRSA's 2003-2010				66
Labour force				+422

Sources : Pensions Board Annual Reports/ CSO

Makeup of Employed persons 1.8m



Auto enrolment scheme

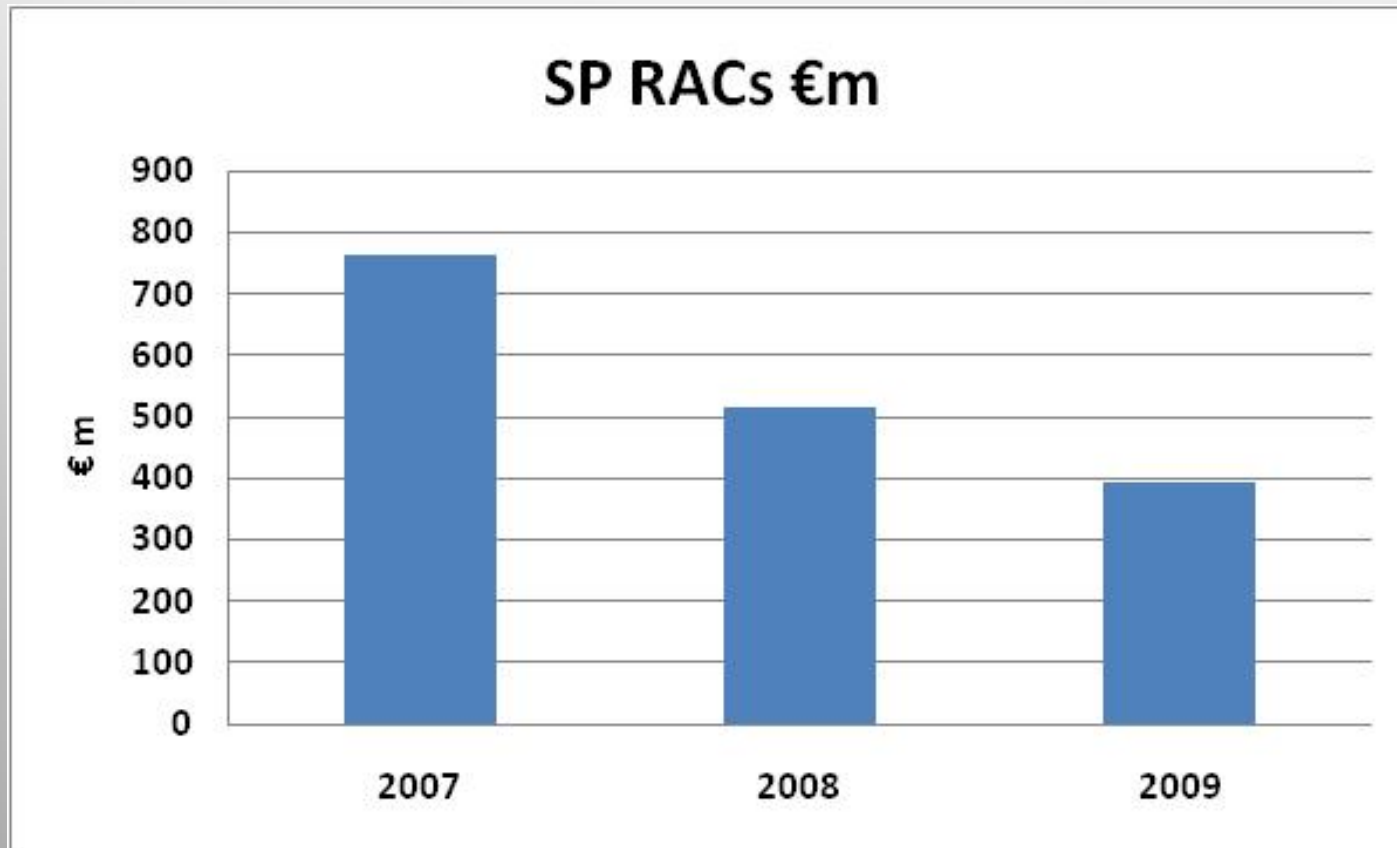
- **Automatic enrolment**
 - Voluntary opt out
- **Matching contributions**
 - 4% employee + 2% tax credit + 2% employer
 - Collected through PRSI system
- **Private investment funds**
- **Implementation 2014???**



Economic crisis

- **Falling earnings/profits**
- **Falling membership**
 - More redundancies
 - More retirements
 - Less new entrants
- **Ageing/maturing membership**
- **Reduced contribution flow**

Falling pension premiums



Programme for Government

"We will reform the pension system to progressively achieve universal coverage, with particular focus on lower-paid workers, to achieve better risk sharing, and to provide for greater flexibility for those who wish to retire on a phased basis."

Taxation of private pensions

2005 Review

INTERNAL REVIEW OF CERTAIN TAX SCHEMES

Section G:

Tax Relief for Pensions Provision
– Sections 770-790B of the Taxes Consolidation Act 1997

Contents

	Page
Executive Summary	G.2
I. Introduction.....	G.4
II. Pensions - Current Structure and Rules	G.6
III. Approved Retirement Funds Regime – Rules and Use of ARFs	G.16
IV. Conclusions & Options for Change	G.25

Source : Department of Finance, 2006

Context of 2005 Review

"the apparent ability of companies to make sizeable tax-exempt payments into the pension funds of their directors who could subsequently avail of changes made to the pensions regime since 1999 to place the funds into ARFs.

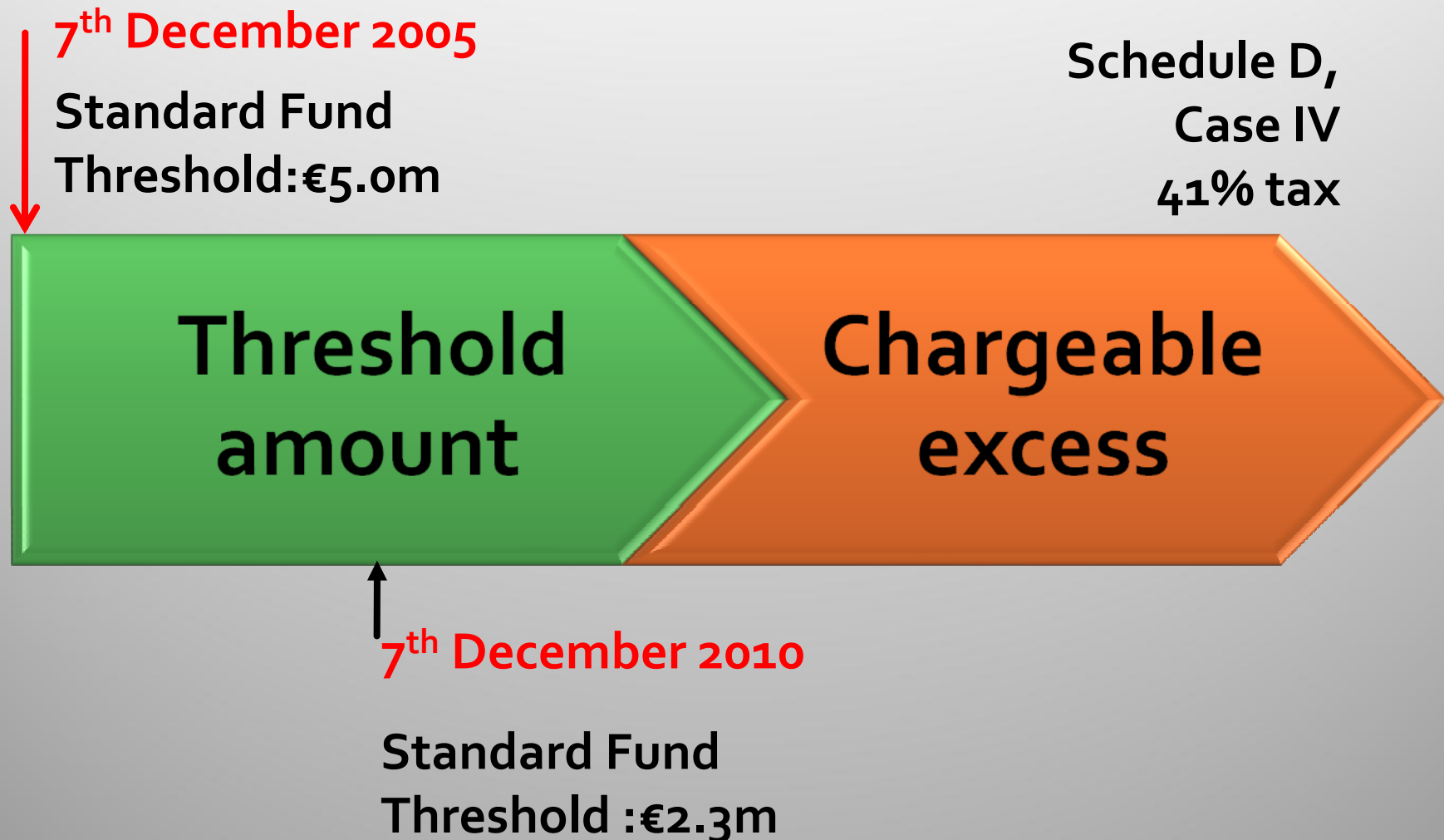
The ARF fund could then pass tax-free to a surviving spouse or pass to the next generation in a tax efficient manner.

... the favourable tax arrangements for private pension provision predominantly favours higher income taxpayers."

Options

1. Include employer contrib. in earnings cap
2. **Absolute cap on max value of tax relieved retirement fund ✓**
3. **Absolute cap on max tax free lump sum ✓**
4. Max final salary
5. Extend average remuneration to 10 years
6. Flat tax on ARFs
7. **Notional distribution on ARFs ✓**
8. Tax post death ARF transfers as income
9. Max transfer to ARF

Maximum tax relieved fund



Personal Fund Threshold (PFT)

- Value of 'uncrystallised' pension rights
 - 7th December 2005
 - 7th December 2010

Retiree example

Benefits	Value	
€150,000 pension	€150,000 X 20	€3,000,000
Gratuity	€350,000	€350,000
Total 'fund'		€3,350,000
Less		
Standard Fund Threshold		- €2,300,000
Chargeable excess		€1,050,000
Tax	@ 41%	€430,500

Tax on chargeable excess

- 'Administrator' and member have a 'joint and several' liability for tax
- Administrator options
 - Reduce benefits '*to fully reflect the amount of tax paid*', or
 - Member reimburses the administrator; or
 - Otherwise another '*chargeable excess*' and 69% increased tax liability!

Implications

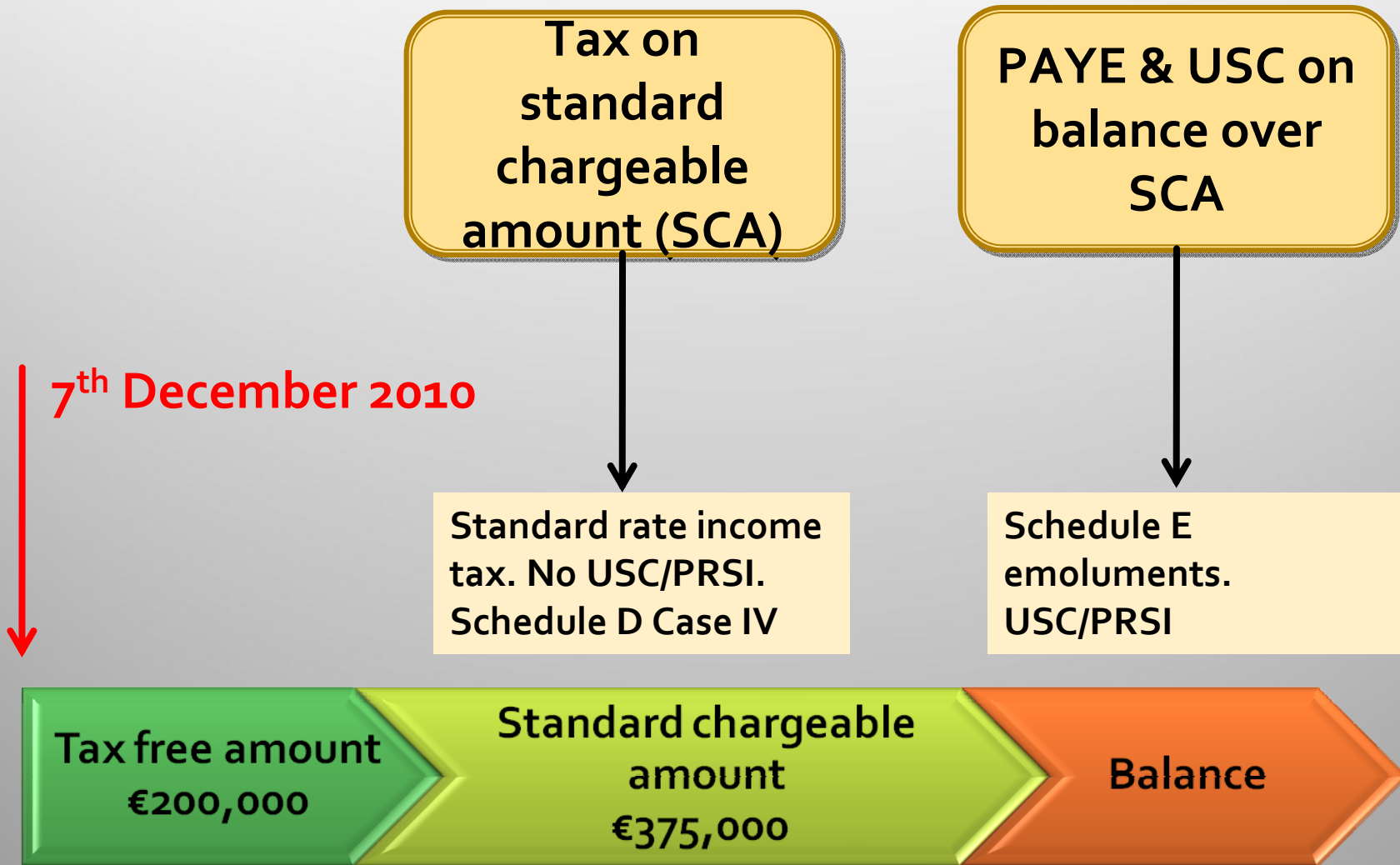
- **Accrual of retirement benefit beyond Threshold?**
 - $(1-41\%)*(1-48\%) = 30\%$
 - Alternative compensation structures?
- **DB schemes may have a cash liability at NRA for some retirees**
 - How to reduce '*rights*' to '*fully reflect the amount of tax so paid*'?
 - Need for scheme rule

Example

Benefits	Value	
€150,000 pension	€150,000 X 20	€3,000,000
Gratuity	€350,000	€350,000
Chargeable excess		€1,050,000
Tax	@ 41%	€430,500

Administrator has to pay €430,500 to the Revenue within 3 months, or €729,660 if member's benefits are not reduced.

Limit on tax free lump sums



Retiree example

Benefits	Value	Taxable
Gratuity	€350,000	
First	€200,000	nil
Next	€150,000	€150,000
Tax	@ 20%	€30,000

Anomalies

- **Pension lump sums subject to TWO taxes**
 - S790AA – lump sum
 - S787R – as chargeable excess
- **Liability on chargeable excess**
 - Public service : personal liability
 - Private funds : deduction from gross benefits

Cost of pension tax reliefs 2007

	<i>ESTIMATED COSTS</i>	<i>NUMBERS*</i>
	<i>€MILLION</i>	
EMPLOYEES' CONTRIBUTIONS TO APPROVED SUPERANNUATION SCHEMES	590	708,100
EMPLOYERS' CONTRIBUTIONS TO APPROVED SUPERANNUATION SCHEMES	150	385,100 **
ESTIMATED COST OF EXEMPTION OF EMPLOYERS' CONTRIBUTIONS FROM EMPLOYEE BIK	540	385,100
EXEMPTION OF INVESTMENT INCOME AND GAINS OF APPROVED SUPERANNUATION FUNDS	900	NOT AVAILABLE
RETIREMENT ANNUITY CONTRACTS (RACs)	420	123,900
PERSONAL RETIREMENT SAVINGS ACCOUNTS (PRSAs)	65	56,400
ESTIMATED COST OF TAX RELIEF ON "TAX-FREE" LUMP SUM PAYMENTS	130	
ESTIMATED COST OF PRSI AND HEALTH LEVY RELIEF ON EMPLOYEE AND EMPLOYER CONTRIBUTIONS	240	NOT AVAILABLE
GROSS COST OF TAX RELIEF	3,035	
ESTIMATED TAX YIELD FROM PAYMENT OF PENSION BENEFITS	410	
NET COST OF TAX RELIEF	2,625	

2,000
615
1,350

EET system is misunderstood

"Public discourse about the cost of pension tax relief has been ill-informed and tends to distort the expectations of the savings that could be delivered by adjusting these reliefs.

"The estimated cost of tax exemption on the accrued income and gains of pension funds is a "notional or imputed" cost. It is in effect deferred income tax – the fund rolls up gross to provide a higher pension value which is then taxed in the hands of the pensioners as the pension is paid .

Source : Govt 4 Year Plan

Finance Act 2011 measures

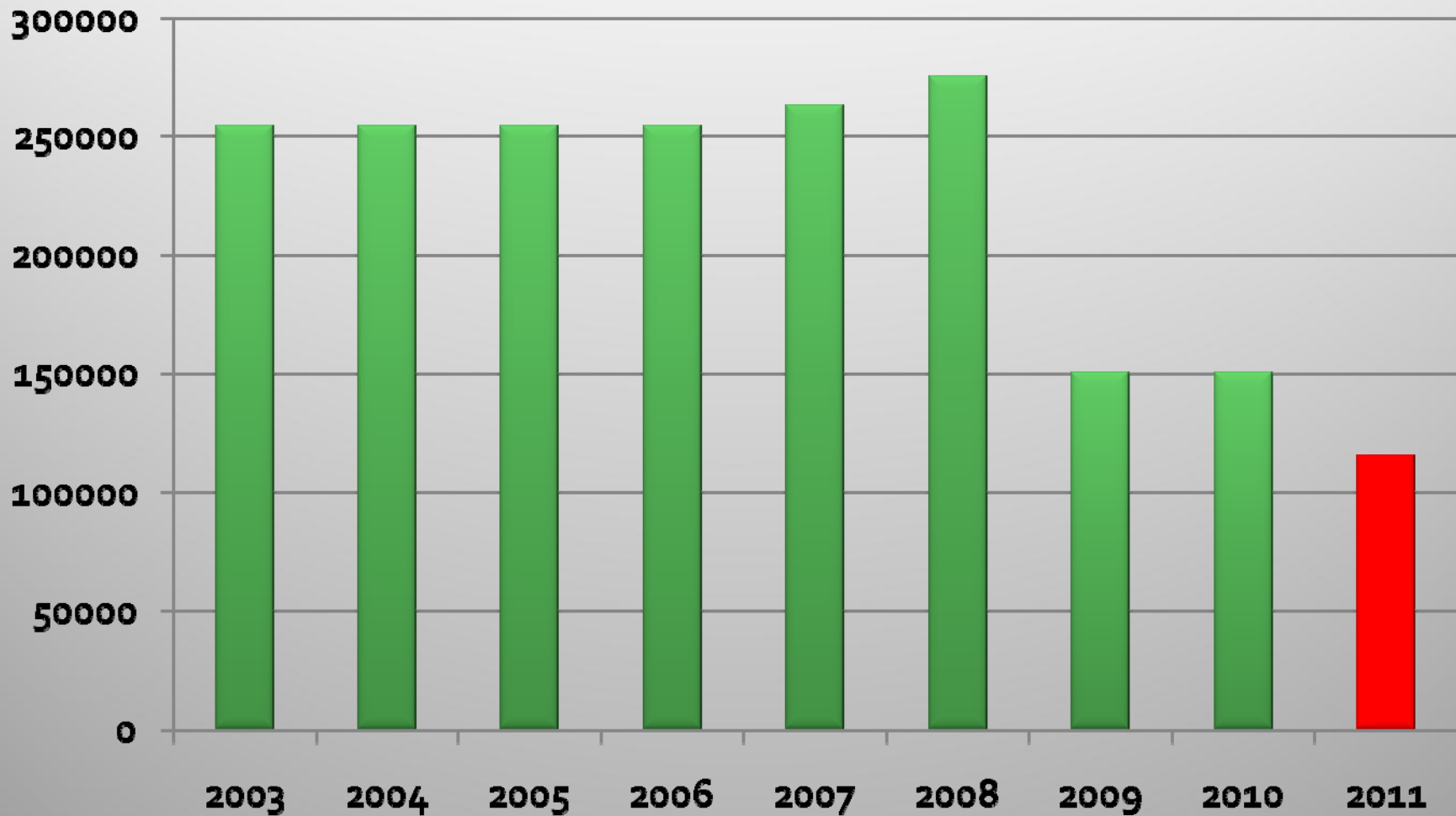
- Pensions earnings limit reduced to €115k
- Removal of PRSI/USC relief on ee contributions
- 50% loss of employer PRSI relief
- SFT reduced to €2.3m
- TFLS limit reduced to €200k
- ARF deemed distribution increased to 5%

€400m pa

Employee liability in respect of employer contribution

	OPS	PRSA
Income Tax BIK	No	Yes* (but relief can be claimed as personal contribution)
PRSI	No	Yes
USC	No	Yes

Earnings limit for tax relief



Tax relief ... are we already at the tipping point?

On the way in	On the way out
$1 - 41\% + 7\% \text{ USC} + 4\% \text{ PRSI}$ $= 70\%$	$25\% \text{ tax free} +$ $75\% * (1 - 40\%)$ $= 70\%$

Effective tax rate in retirement

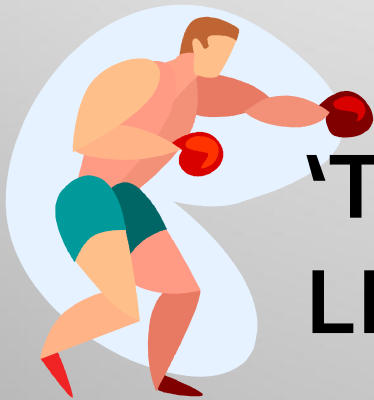


And more to come!

- Standard rating tax relief?
- 0.5% pa levy?
- Reduce SFT to €1.5m
- Cap pensions at €60,000 pa?

€500m pa more

Contest



**'TEMPORARY STANDARD
LEVY RATE
INCOME TAX
RELIEF**



Tax relief ... standard rating

On the way in		On the way out
1- 20% + 7% USC + 4% PRSI = 91%		25% tax free + 75% * (1- 12%) = 70%

Effective tax rate in retirement



Programme for Government

“We will cap taxpayers’ subsidies for all future pension schemes for politicians (and indeed for everybody) that deliver income in retirement of more than €60,000 pa.”

ARF option

- **New DC schemes after 6th February 2011**
- **Existing DC schemes**
 - Rule change
- **25% tax free lump sum**
- **AMRF/annuity set aside**
 - 10 x State Pension = €119,800
- **Specified income test**
 - 150% x State Pension : €18,000 pa

The 'AMRF' option?

	Traditional Benefit option	ARF option
Tax free lump sum	150% x final remuneration (max)	25%
Next €119,800	Annuity	AMRF/annuity
Balance	Annuity	ARF/annuity

Default investment options?

Need for financial advice? Who will pay?

Summary

Summary

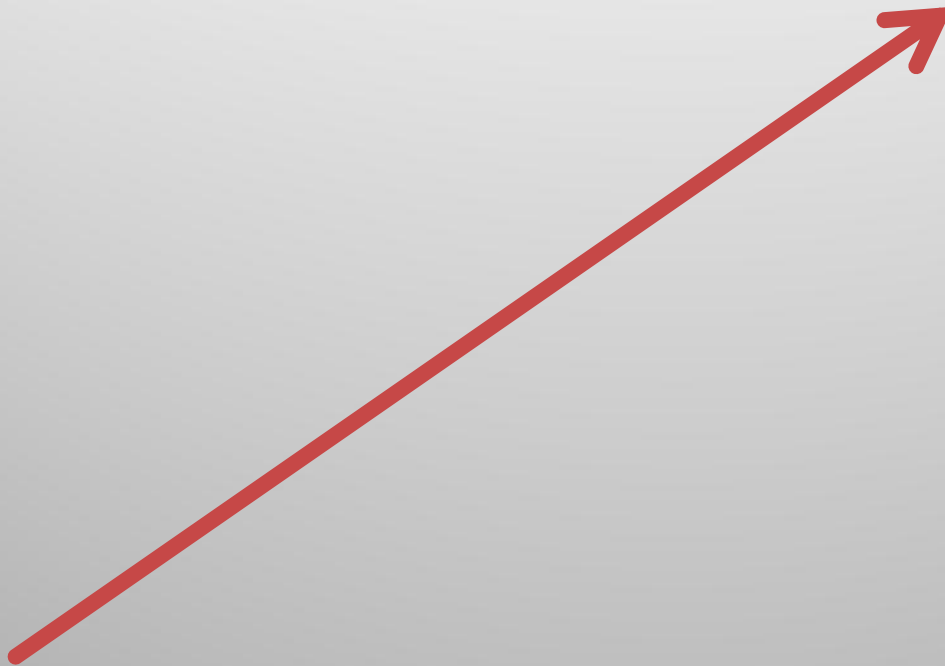
- **State & Public Service Pensions**
unsustainable in the short and long terms
- **Unpensioned are particularly vulnerable**
- **DB schemes ... a closed book**
- **All arrangements**
 - Falling membership
 - Lower contribution inflow
- **Alternative structures to save for retirement?**

Burn the pensioners!



Suggestion

The Promise



The Cost

Will the private pensions industry survive?

Tony Gilhawley FSAI FIIPM
Technical Guidance Ltd.