Society of Actuaries in Ireland

Review of Policy Options

to Expand Private Pensions Coverage in Ireland

Position Paper

February 2014

A. Purpose

In April 2013, the OECD published its comprehensive "Review of the Irish Pension System". While the review covered all components of the Irish pensions system, it was highlighted that only Ireland and New Zealand, among OECD countries, do not have a mandatory earnings-related pillar (a system of compulsory pension contributions) to complement the State pension.

During 2013, the Minister for Social Protection, Joan Burton, indicated that a mandatory or quasi-mandatory approach such as that envisaged by an auto-enrolment scheme could be introduced when the economic climate is appropriate.

In the meantime, the Government should decide whether the adoption of an auto-enrolment or mandatory regime provides a better fit with Ireland's long-term strategic plan for retirement pension provision. The Society of Actuaries in Ireland ("the Society") has undertaken its own research to assist policymakers and contribute to the debate. Following this research, the Society believes that – economic and political circumstances permitting – it is preferable to work towards the long-term target of a mandatory system.

The primary purpose of this paper is to set out the rationale for the Society's position of recommending the introduction of a mandatory system over other alternatives to increase pensions coverage in Ireland.

B. Contents

To ensure a holistic view of the topic, the paper includes the following sections:

C. Queries

Please direct any queries on this paper to Ms. Yvonne Lynch, Director of Professional Affairs, at the contact details at the end of the paper.

1. Executive Summary

In March 2013, the Society of Actuaries in Ireland set up a Working Party to form a view on whether a mandatory system was preferable to other potential approaches, such as auto-enrolment, for increasing pensions coverage and improving pensions adequacy for individuals in Ireland.

The interaction with the broader Irish pensions system must be considered when selecting the preferred regime (i.e. mandatory or auto-enrolment). The Society's key messages are set out below:

1. The Government should decide whether the adoption of an auto-enrolment or mandatory regime provides a better fit with Ireland's long-term strategic plan for retirement pension provision. **Following the research undertaken by the Society, we believe that – economic and political circumstances permitting – it is preferable to work towards the long-term target of a mandatory system, with the planning phase commencing now.**

   The Society is conscious that, in Ireland, auto-enrolment may appear more palatable than a mandatory system in the current economic environment. However, in our view a mandatory system is superior to an auto-enrolment regime for a number of reasons:

   a) The Society researched a range of international regimes and noted how the more successful of those regimes operated. Our research concluded that the introduction of a mandatory regime has led to better coverage across international examples. Intuitively this makes sense when the two key long-term objectives of increasing pensions coverage and adequacy are considered. **A mandatory regime clearly increases coverage** (subject to any exclusions made), **whereas auto-enrolment will be less effective by virtue of its "opt-out" features.** Some of the more successful auto-enrolment regimes of those reviewed (such as KiwiSaver) use financial incentives from the State, which is unlikely to be viable in Ireland in the near-term. In terms of improving adequacy over the longer term, the Society is of the view that both regimes should eventually serve this purpose, although auto-enrolment will only improve adequacy for those who have remained within the auto-enrolment regime.

   b) If exemptions are kept to a minimum, a mandatory system should be easier to run than an auto-enrolment regime, since opt-out and opt-in issues will not arise. This should make the collection of contributions, the administration of the system and compliance with the system easier. An auto-enrolment regime is hence more complex and more expensive to design and to subsequently implement and maintain.

   c) The Society considered auto-enrolment and mandatory regimes for Ireland in terms of affordability for individuals and employers, conscious that auto-enrolment might be politically more acceptable at the current time. We also considered whether it was possible to first establish an auto-enrolment system and then to subsequently introduce a mandatory system– an approach that could address any near-term affordability concerns. However, there does not appear to be a natural progression in developing a mandatory regime from an already-established auto-enrolment regime. In particular, we believe that first establishing the more complex system of auto-enrolment and subsequently introducing the simpler mandatory regime could potentially be a waste of resources. There would also be the risk that any planned later transition would simply not take place.

2. **Allow appropriate time to design the regime well**
   This should include all of the following:
   a. consider the full interaction with State benefits,
   b. identify the most appropriate regime,
   c. put the infrastructure / technology in place to support the regime being adopted,
   d. start the process of educating and winning acceptance from employers and individuals, and
   e. map out the contribution levels in advance (taking full account of potential knock-on impacts of setting contribution rates too low – see bullet 4 below).

3. **Keep the design and implementation of the new regime as simple as possible**
   It is a real challenge to ensure that the new system is kept simple. The Society recommends introducing measures to simplify the current Defined Contribution (DC) pensions landscape while planning the introduction of any new regime. Conditions and options (whether new or existing, e.g. extensive fund choice), will make the system more complex – to operate, communicate and for employers and individuals to understand the impact on them. Therefore, we strongly recommend limiting the options and introducing a mandatory regime from the outset with a simplified DC landscape as a foundation. Further thoughts on simplification of the DC landscape are set out in our October 2013 response to the Pensions Board consultation on the future of DC pensions[1].

4. **The approach adopted should be clearly defined, well in advance of being implemented**
   Initial contribution levels and how these will progress over specified time-frames need to be clearly set out in advance. If the contribution rates for the mandatory (or quasi-mandatory) system are set too low, coverage may be increased but the issue of adequacy will remain unaddressed. As with auto-enrolment, there is a concern that the mandatory level could be treated as the new 'default' level, leading to falling contributions where existing provision exceeds the default level. This highlights the need to set appropriate contribution rates at outset and/or to have a clear progression of contribution rates set out in advance.

5. **Mandatory System – desired features**
   The Society has identified a number of desired design features for a mandatory system including:
   - the introduction of individual accounts to increase transparency,
   - a system based on matching contributions rather than tax relief at the marginal rate, and
   - a system where access to funds is not an option or only allowable to a limited amount with tight rules involving a large burden of proof.

   These features should be considered when the implementation of the regime is being developed.

[1] This submission is available on the Society's website at https://web.actuaries.ie/sites/default/files/story/2013/10/131030%20Pensions%20Board%20DC%20Consultation%20-%20FINAL.pdf.

Conclusion

The Society believes that a mandatory regime is a better solution than an auto-enrolment regime for Ireland and recommends that it is introduced from outset, with the planning phase starting immediately. This decision is based on (a) the complexity of auto-enrolment, (b) the overall aims of increasing coverage immediately and improving adequacy over the longer-term and (c) the scale of the implementation effort that will be required.

2. Introduction

This paper sets out the research undertaken by the Society in forming a view that a mandatory pension regime is preferable to work towards than an auto-enrolment regime and other potential approaches for increasing pensions coverage in Ireland. However, the Government should decide on the main objective of any system introduced from outset and ensure that it is appropriately planned, designed and implemented.

In Ireland, some of the factors driving the apparent need for additional pension provision are as follows:

- Low level of pensions coverage - in 2009, 51% of workers aged between 20 and 69 years were enrolled in an occupational or personal pension[2]. This was a fall from 54% in 2008 and 52% in 2005. If public sector workers in unfunded schemes are excluded, coverage in 2009 falls to 41.3%[3]. For the self-employed, coverage in 2009 was lower again at 36%. Taking Personal Retirement Savings Accounts (PRSAs) as an example, the recent past has shown that giving choice to individuals to save for retirement has not led to increased coverage. The Society believes that the most effective method to increase pensions coverage is to implement a mandatory regime from outset.
- Concerns about the sustainability of current State pension levels into the future.
- Demographic factors such as the increasing number of pensioners relative to the number of working age population.

In Section 3, we provide an illustration of retirement savings for a given individual's earnings profile. This information is important to take into account when setting contribution rates for any new regime. If the contribution rates for the mandatory (or quasi mandatory) system are set too low, coverage may be increased but the issue of adequacy will remain unaddressed. There is also the potential for the contribution rates on existing private schemes to fall to the contribution rates introduced for the new regime (if lower), so careful consideration needs to be given to the setting of the initial contribution rates.

Further research is required to confirm sustainability concerns and substantiate the argument for additional retirement provision. The objective of this further research should be to assess how the supplementary system can be designed taking into account the State pension, other State benefits and the desired long-term retirement provision target for Ireland.

The form that any additional retirement provision would take in Ireland would most likely be either an auto-enrolment or mandatory regime. While the Society recommends a mandatory regime, consideration of how any new regime would interact with State benefits (now and in the future) is important and requires analysis. This is considered briefly in Section 4.

As part of the Society's research, several international regimes were reviewed (mandatory regimes in Australia, Chile, Switzerland and Sweden and auto-enrolment in New Zealand, the UK and Italy). Summary details are included in the appendices with preferred features of a mandatory regime set out in Section 5.

[2] Quarterly National Household Survey Quarter 4 2009

[3] OECD Review of the Irish Pension System 2013 page 48

Sections 6 & 7 explore the relative merits of auto-enrolment and mandatory regimes in an Irish context, including implementation aspects and other considerations. Section 8 sets out a potential road map for the implementation of a mandatory pension regime.

3. Retirement Savings and Setting the Initial Contribution Rates for a Mandatory System

In order to consider the setting of initial contribution rates for any new regime, the tables below show some possible required annual contribution rates for different ages starting to contribute to a pension now based on a set of assumptions (shown below) and the following parameters:

- Average earnings of €35,000 p.a.;
- Retirement age of 68 (which will be the State pension age from 2028).

Table A considers a target retirement pension of 50% of pre-retirement earnings and the current State pension (the State pension provides approximately one third of average earnings). This is an optimistic scenario in terms of the level of contributions needed.

Table A

Age	Balance to be funded (Target 50% less Current State Pension 33%) *(% pre-retirement income)*	Contribution Required after State Benefits *((% pre-retirement income)*
25	17%	7%
30	17%	8%
35	17%	9%
40	17%	11%
45	17%	14%
50	17%	19%

Table B considers a higher target retirement pension of 66% of pre-retirement earnings and a lower State pension. There has been a lot of discussion in Ireland about the sustainability of current State pension levels into the future, hence we have assumed for this pessimistic scenario that the State pension would fall to 25% of average earnings.

Table B

Age	Balance to be funded (Target 66% less State pension 25%) *(% pre- retirement income)*	Contribution Required after State Benefits *(% pre- retirement income)*
25	41%	16%
30	41%	19%
35	41%	22%
40	41%	27%
45	41%	34%
50	41%	45%

Assumptions used in the tables above: Inflation 2% p.a., salary increases of 3% p.a., investment return of 5% p.a., post retirement interest rate of 1%, mortality basis: 52% PNMA00.

Based on Table B, someone aged 25 and starting to contribute to a pension now would need to contribute c.16% p.a. of earnings in order to reach a target retirement pension of 66% of pre-retirement income. This is more than double the amount required in Table A.

The above tables highlight the importance of clarity in relation to the State pensions to allow individuals to plan for their retirement and also the requirement for individuals to decide on the level of retirement pension they need above the State benefits. Individuals need to recognise the trade-off between lower income now (i.e. foregoing income to contribute more to a pension) and reduced income in retirement.

All other things being equal, assuming lower State benefits leads to higher contribution requirements and assuming a lower overall pension target leads to a lower contribution requirement.

These numbers are for illustration purposes only. However, based on illustrative scenarios such as those set out above, indicative ranges could be communicated to people. For example, "if you earn roughly €35,000, are aged 40 and are only starting to contribute to your pension now, you most likely should be contributing between 11%-27% of your earnings to retirement provision".

As can be seen from the tables above, the additional contribution rates required (after State benefits) for an adequate pension range from 7%-45%, depending on the age at which pension contributions begin and the target pension at retirement (as a percentage of earnings). These numbers are provided to inform a decision on the level of contributions that should be introduced as part of any new regime.

There is a concern that the mandatory level could be treated as the new 'default' level, leading to falling contributions where existing provision exceeds the default level. This highlights the need to set appropriate contribution rates at outset and/or to have a clear progression of contribution rates set out in advance.

Factors to consider in deciding appropriate contribution rates for a mandatory system include:

- the appropriate target level of income replacement (and in particular, how much of this will come from the State pension);
- any phasing required to get to the ultimate contribution level (and what the ultimate contribution level should be);
- the breakdown of contributions between employer, employee and Government (whether through matching or tax-relief);
- whether contribution rates should be applied to total earnings or whether floors and caps on earnings should apply;
- whether tiering of contribution rates at different earning levels should be introduced.

The Society recommends that further research is undertaken by Government to confirm sustainability concerns, to quantify the retirement savings gap and substantiate the argument for some form of mandatory (/quasi-mandatory) retirement provision. The overall objective of this further research should be to assess how the supplementary system can be designed taking into account interactions between the supplementary system and State benefits. This is considered in the next section.

4. Interaction with State Benefits

It is crucial when considering the relative merits of an auto-enrolment / mandatory regime that the broader context of Ireland's overall retirement provision system is taken into account. The Society, therefore, considered the interaction of State benefits with both regimes to determine which combinations appear to be complementary (see below). This contributed to our recommendation of developing a mandatory system from the outset of any plan to implement compulsory pension provision in Ireland.

While each country reviewed in this paper has its own combination of pension systems, the common thread is that there is a basic State pension, supplemented by other pension benefits.

- The basic State pension can be either a means-tested benefit for low income individuals or a universal State pension irrespective of income. A universal State pension will still have eligibility conditions related to periods of residency in the country or periods of work.
- In relation to the supplementary pension systems, they can be broadly categorised as mandatory enrolment systems and auto-enrolment systems with a facility to opt out.
- Thus, various combinations of basic State pension and supplementary systems are possible as outlined in the following table along with the Society's observations:

Basic State Pension	Supplementary Pension	Observation
1. Means-tested State pension	**(a)** Mandatory enrolment	This combination can work well when the supplementary pension system becomes the main provider of retirement income, as individuals who do not have sufficient income - or who do not qualify for the supplementary system and have no other means - will receive a State pension.
	(b) Auto-enrolment	Under this combination, lower income workers may be better off opting out of the supplementary pension system and relying solely on the basic State pension. Accordingly this combination is not likely to result in increased retirement savings for low to middle income workers and as such the issue of increasing adequacy and coverage is not addressed.
2. Universal State pension	**(a)** Mandatory enrolment	All workers are entitled to the State pension under this combination and so the supplementary pension system needs to be structured so that it provides benefits for workers above a minimum level of income (related to the level of the State pension).
	(b) Auto-enrolment	This combination works quite well, but as for combination 2(a), all workers are entitled to the State pension and so the supplementary pension system needs to be structured so that it provides benefits for workers above a minimum level of income (related to level of the State pension).

Observations

Combination **1(a), i.e. a means-tested State pension combined with mandatory pension provision,** would lead to a phasing out of the State pension (Contributory) and it is likely that this could only be done over the longer-term. This would add to the complexity of the pension system during the phasing-out period. However, **when fully established it would be the most cost effective system**.

Combination **2(b), i.e. a universal State pension combined with an auto-enrolment regime,** would be the main alternative to combination 1(a). While there is a universal State pension under combination 2(b), the State pension (Non-Contributory) would need to be retained under this combination as some form of means-tested State benefits would be required for individuals who do not qualify for a universal State pension.

Given that combination 1(a) leads to the most cost-effective system for the State, we explore the preferred design features for a mandatory system in the next section.

5. Mandatory Regimes – Preferred Design Features

Following the comparison of international mandatory regimes researched and reviewed by the Society (see Appendix A), we have identified the following preferred design features for a mandatory regime. The Society's view is that a mandatory system with a low level of exemption should be the simplest system to develop and implement.

How

- If exemptions are kept to a minimum, a mandatory system should be easier to run than an auto-enrolment regime, since opt-out and opt-in issues will not arise. This should make the collection of contributions, the administration of the system and compliance with the system easier.
- However, a mandatory system, in particular with central collection of contributions, may be perceived as an extension of taxation. This can be mitigated somewhat by ensuring individual accounts are maintained to give personal ownership. Simple annual statements for individuals are crucial. This will ensure transparency for those who did not already have a pension and will encourage personal ownership and engagement.
- Central collection of contributions, perhaps through the PRSI system, would seem sensible for a mandatory system. However, as stated above, there is the risk that central collection might be perceived by the public as an "extension of taxation".

Eligibility

- Making the mandatory system as broad-based as possible is important. However, we would agree with excluding employees earning less than a certain level of income from this regime (with the limit being linked to the State pension level).
- The interaction with existing pension arrangements is important to consider and review. Employer schemes with contributions of at least the level required under the mandatory system could potentially be certified and therefore excluded. However, this would need to be considered further and would increase the monitoring required for the system and hence its complexity.

Contribution Levels

- A mandatory system could possibly allow for higher initial contribution levels than an auto-enrolment system, since the risk of high levels of opt-out is not an issue. However, this has to be balanced against the palatability and affordability of the system. On this basis, a mandatory system starting at a low level and building according to a pre-defined timetable would be preferable. Gradual increases over time have worked well in Australia – though admittedly under different economic circumstances than we are likely to see here in the foreseeable future.
- As with auto-enrolment, there is a concern that the mandatory level could be treated as the new 'default' level, leading to falling contributions where existing provision exceeds the default level. This highlights the need to set appropriate contribution rates at outset and/or to have a clear progression of contribution rates set out in advance.

Access to Funds

- Based on our research, this feature clearly has a large impact on public behaviour. For instance, access to funds for home purchase is credited to be partly responsible for the large uptake of auto-enrolment in New Zealand, while a lack of access to funds is seen to have hindered the uptake in Italy.

- In our view, allowing access to funds is counter-intuitive where the aim is to increase pension adequacy. Therefore access should not be allowed or at least should be limited with tight rules involving a large burden of proof.
- However, even in a mandatory system, individuals could be allowed access of up to 25% of the fund (to a certain maximum amount) on one occasion. This would be similar to allowing early access to the tax free lump sum and would allay fears regarding locking in funds for such prolonged periods.

Taxation

- From an individual's perspective, State aid in the form of matching contributions would be easier to understand and may be viewed as being more desirable than tax relief. This sort of incentive scheme worked well previously with SSIAs in Ireland. It was also a feature in the KiwiSaver scheme in New Zealand whereby an initial contribution was given by the State. The 2013 OECD "Review of the Irish Pension System" has flagged that tax incentives for pension provision should be reviewed. Subsidies and matching contributions appear to be preferred to tax relief at the marginal rate.

Who monitors?

As the State is mandating that individuals be part of this regime, there is an extra prudential burden on the State to ensure that the operation of the regime is appropriate and to monitor payments and providers. A clear governance framework must be adopted with the overall objective of monitoring the various parties operating and managing the system:

- Employers (to ensure timely payment of contributions);
- Providers (member record-keeping, technology, investment managers).

For completeness, the Society has also identified the preferred design features for an auto-enrolment regime – please see Appendix B.

Specific considerations on introducing a mandatory regime for Ireland are discussed in the next section.

6. Auto-enrolment v. Mandatory - Considerations for Ireland

As mentioned earlier, it is crucial for the auto-enrolment / mandatory debate to consider the broader context of Ireland's total retirement provision system.

The State pension was improved substantially in Ireland during the late 1990's and the first few years of this century. It currently stands at €230.30 per week, 33% of the latest average earnings of €695.80 per week. Thus, for many of the lowest paid members of the population, the State pension may be regarded as sufficient, especially when combined with other benefits provided to pensioners. The Government wishes to address the inadequate pension arrangements for the middle tranche of the private sector, where coverage is very uneven - especially in certain industries - and the decline of Defined Benefit pensions has also resulted in an adequacy problem even where supplementary pensions exist.

The 2013 OECD "Review of the Irish Pension System" notes that the issues with sustainability for the State pension in Ireland are much less critical than in many countries but suggests that the current system of entitlements is complex. The report recommends changing to a universal pension based only on residency or a means-tested system. The latter would only work if combined with a mandatory second tier pension, otherwise disincentives to save would be too strong. We are conscious that, in Ireland, auto-enrolment may appear more palatable than a mandatory system in the current economic environment. However**, the OECD report favours a mandatory system over auto-enrolment as this has led to better coverage across international examples and we concur with the OECD in this regard.**

Meeting the Key Objectives

In considering auto-enrolment or mandatory regimes for Ireland specifically, the Society looked at certain international regimes and noted how the more successful of those regimes operated. Bearing in mind the two key long-term objectives of increasing coverage and adequacy, a mandatory regime clearly increases coverage (subject to any exclusions made), whereas auto-enrolment will be less effective by virtue of its "opt-out" features. Some of the more successful auto-enrolment regimes of those we considered (such as KiwiSaver) use financial incentives from the State, which we felt would not be viable in Ireland in the near-term. In terms of improving adequacy, over the longer term we felt that both regimes should eventually serve this purpose, although auto-enrolment will only improve adequacy for those who have remained within the auto-enrolment regime.

Affordability for Individuals/Employers

The Society also considered auto-enrolment and mandatory regimes for Ireland in terms of affordability for individuals and employers, conscious that auto-enrolment might be politically more acceptable at the current time. Additional thought was given to whether Ireland's supplementary regime could or should first start as an auto-enrolment regime and then move to a mandatory regime over the longer-term – an approach that could address any near-term affordability concerns. However, after some consideration of what that phased approach might entail, it became evident that auto-enrolment and mandatory regimes are sufficiently different that a significant upfront investment to design each regime would be required. Also, there is no obvious 'natural progression' from an auto-enrolment to mandatory regime. In particular, we believe that first establishing the more complex system of auto-enrolment and subsequently introducing the simpler mandatory regime could potentially be a waste of resources. There would also be the risk that any planned later transition would simply not take place.

Recommendation of a Mandatory Regime

Overall, the Society believes that the introduction of a well-designed mandatory system when the economy improves is preferable, given the complexity involved in designing an auto-enrolment system. This would also avoid some of the potential manipulation of the system which is possible under an auto-enrolment regime.

The next section sets out the implementation factors that would need to be considered when introducing a mandatory regime in Ireland.

7. Implementation Factors for a Mandatory Regime in Ireland

This section highlights some of the key aspects to be considered when designing a mandatory regime for Ireland. It is worth noting that many of the same challenges set out below would arise if designing an auto-enrolment regime.

Who will the system cover?

While the aim is to get coverage as high as possible, a number of issues arise with this:

- Are employees earning under a certain threshold exempt as they would be provided for using a basic State pension?
- How can self-employed coverage be achieved?
- Should the system be for both the public and private sector?
- Are part-time workers or those not in the workforce assumed to be covered by the basic State pension?

A system aimed to keep exemptions to a minimum would be easier to run but might be seen as unfair to those on low-incomes.

What sort of structure will the system be?

The structure of the mandatory regime would need to be considered in detail and further research is required. Initial thoughts/questions on the structure include:

- While a defined contribution structure would appear obvious, a structure that gives some form of "minimum" benefit would be popular. This, however, leads to the question of who would underwrite/guarantee the minimum benefit. The likelihood is the State would need to guarantee any minimum benefit.
- An individual account structure would seem most logical as it provides accountability, transparency and a greater feeling of ownership to the individual.
- What would the structure in retirement be, i.e. annuity, fund or some hybrid?

Who will run the system?

The choice for running the system would appear to be either a State body or the private sector or some combination of both. Existing bodies or new bodies could be considered. The interaction of each of the elements below would impact the choices available. Whichever system is chosen, the following structural aspects need to be decided upon:

1. Collection of Contributions (e.g. similar to payroll schemes or PRSI collection)
2. Fund / Asset Management
3. Member Record Keeping
4. Benefit payment
5. Regulation / Compliance
6. Fund ring-fencing
7. Charges

Who runs / investments / member record-keeping?

- The Irish market is not large enough for economies of scale to be achieved if investment and administration are allocated to multiple providers.

Regulations

- The governance requirements for Governments are higher with a mandatory system. Regulation to ensure full compliance with the minimum contributions would not be insignificant. However, the regulatory requirements under an auto-enrolment system would also be significant.
- Safeguarding contributions, asset management, payment of benefits, and product / provider regulation are requirements that would exist under both systems. Safeguards are needed for contribution payments and there must be monitoring and checking of employers, with penalties where employers do not pay.

Certainty – Enabling employers and employees to plan and prepare

As well as simplicity, a well-planned mandatory system should limit future changes as much as possible. This would provide greater confidence to all stakeholders – in particular, in terms of how they prepare for the introduction of the new regime. Details to consider include:

- Certainty of contributions, retirement benefit options, investment options, exemptions etc are all important.
- A central fund to hold contributions (even if ring-fenced) could be perceived to be subject to future changes and would not provide the same confidence to individuals that individual accounts would.
- Long-term certainty in terms of taxation, limits, thresholds and charges / levies is also important to generate confidence and acceptability for any new regime.

What will the investment structure be?

Questions to consider when developing the investment structure of the mandatory regime include:

- Will individuals be given investment choices and if so, how many? Increasing choice leads to additional cost and complexity (and advice may be required).
- Who would choose the asset mix, the potential "lifestyling" structure, the eligible assets etc? Should there be target investment returns and volatility levels? What investment strategies would be permissible?

What is the impact on existing arrangements?

The impact on existing pension contributions and arrangements would have to be considered, focusing on employees, employers and existing pension providers. Worries that the introduction of the new system would result in reversion to the lowest possible contribution level for existing schemes would need to be examined. Exemptions for existing scheme members and the future of existing Defined Benefit schemes should be considered, along with the future role of existing pension providers.

Options / Features to exclude certain groups / Opting-out – how would these work?

There is a trade-off between flexibility within the system (and hence attractiveness to the public) and managing the complexity and cost of the system. Options such as opt-ins, opt-outs, contribution holidays etc would need to be considered. The technology, administration and potential moral hazards related to these features would need to be studied in detail and taken into account.

Other issues for consideration

- Should early access to funds be allowable? The Government needs to weigh up the cost, added complexity and impact on adequacy of allowing early access to funds against the flexibility and attractiveness such an option gives to the public.
- Taxation: is tax harmonisation possible with existing rules? Could this be achieved through a Government contribution to the individual's fund rather than through tax-relief?

8. Potential Roadmap for the Introduction of a Mandatory Regime

Whichever system is ultimately introduced by the State, the Society believes that it is an important part of the communication process to set out a pre-defined progression of contribution rates, participation and development over time. This gives employers and individuals time to plan and prepare for the new regime. Appendix D includes some examples of the gradual progression of contribution levels from the UK auto-enrolment regime and from the Australian mandatory regime.

Proposed Roadmap

The following table sets out what we consider to be the stages involved in targeting a mandatory regime starting from 2014:

Steps	3 – 5 year lead-in period
2014	- Government to verify future retirement savings gaps and sustainability issues - Agree whether coverage or adequacy is to be targeted first (this feeds into the contribution levels and regime decision)
2014-2015	Explore form of future long-term social pension provision strategy
By mid-2015	Decide between an auto-enrolment and a mandatory regime
2015-2018	- Design regime, apply preferred features, governance structure, advance preparation for introduction of system, technology, providers and communications programme - Development/appointments required to build technology and structure and to operate the system
2017-2019	- Communicate to individuals - Set out pre-defined progression of contribution rates in future – gradual, fixed increases that will be applied automatically, without State discretion - Introduce low level of employee contribution rate - Include all workers, other than those earning under a certain minimum income level
Thereafter	Governance Function reviews and monitors

Appendix A - Comparison of the mandatory regimes reviewed

Table C: Comparison of the mandatory regimes reviewed by the working party

Comparison of Mandatory Regimes	Switzerland	Chile	Australia	Sweden
Key Design Elements	Individual accounts, with fixed contribution. Guaranteed "annuity" rate on retirement	Individual Defined Contribution Accounts that are managed by private Pension Fund Administrators.	Individual accounts Very gradual introduction No requirement to buy annuity at retirement	Contributions collected as part of Social Security tax
Stated main objective of that regime	Increase adequacy and supplement State pension	Increase coverage and adequacy	Increase coverage	Supplement state and occupational pensions
State benefits	Good, linked to career-earnings to a maximum level. Funded through a direct tax: 10% of salary (50/50 split)	Basic pension for poorest people plus means tested top up for those falling short.	Means tested age-related State pension	Pay related State pension
Taxation of contributions, investment return, benefits	EET (i.e. Exempt, Exempt, Taxed)	EET	TTE*	EET
Pros - what worked well	Very simple system, with contributions a percentage of salary. Pension c7% of accrued pot on retirement is very attractive	- Competition measures introduced -Government guarantee -Special measures for younger workers or those in heavy work	Supportive economic conditions over the last 15 years. Tripartite agreement between state, employers and trade unions to start from1992.	Central collection agency for contributions
Cons - what worked less well	Self-employed need to make their own arrangements	-Self-employed exempt -Parents at home and informal labour markets not covered	Excludes self-employed Upper age limit of 70 years was later removed Employees do not have to contribute, which leads to less ownership.	Too many investment options
Has coverage improved / addressed over longer-term?	Yes – employed coverage excellent.	Yes – although still areas to improve	Yes	Yes
Will adequacy be improved / addressed over longer-term?	Adequacy achieved through high contribution rate: 10% to basic State pension and up to 18% to Compulsory Occupational	Yes – but this will take time as the system matures	Yes – but slowly, small contribution rate increases have been mapped out in advance	Yes but contribution rate still at low level

**The taxation treatment shown is for a member who is retired and over 60 years of age.*

Appendix B - Auto-enrolment Regimes – Preferred Design Features

Following the comparison of international auto-enrolment regimes researched and reviewed by the Society (see Appendix C), we have identified the following preferred design features for an auto-enrolment regime:

How

- ***"True" auto-enrolment,*** where contributors are actually enrolled and must opt out of the system, is preferred. The KiwiSaver system adopts such an approach; where contributions must be made for a minimum period (2 to 8 weeks) and can then be refunded if you opt out. Only your own contributions would be refunded to you, not those from employers or the state.
- ***Collection of contributions:*** Contributions could be collected through the PRSI system (however, central collection through the PRSI system could be perceived as an extension of taxation by the public). This may be favoured if the intention is to implement a mandatory system in the future. If a mandatory system is not the final goal, then existing systems and structures (most likely private sector, e.g. large group arrangements) could be used for an auto-enrolment regime to reduce costs.
- ***Simple annual member statements are vital to give individuals personal ownership***. Support for the Australian (mandatory) system increased post implementation, once individuals received annual statements showing their personal account information. We acknowledge that annual statements are already received by members of pension schemes. However, engagement continues to be a challenge. Therefore, further work would need to be done to identify how member statements can encourage engagement/personal ownership.

Who

- The collection of contributions, management of funds and payment of benefits could be managed separately or together. These elements could be managed by the state or privately.
- Contributions could be collected along with PRSI or could alternatively be taken from payroll and paid to private companies (as is currently done for a lot of private pension provision).
- A central fund could deliver economies of scale and lower fund charges. On the other hand, availing of the structures already in place within the existing pensions industry might help the state to avoid / reduce implementation costs.
- Benefits could be paid by the State or by private companies. **Security of the benefits is paramount.**
- Supervision of the scheme would be required to ensure compliance from employers and employees. The costs and organisation of this element would not be insignificant. This could perhaps fall under the remit of the Pensions Board.
- Any auto-enrolment regime should aim to cover as much of the population (including the public sector) as possible. Exemptions will generally hamper the effectiveness of the regime as was seen in Chile (self-employed people were not covered) and Italy (small companies were exempted).
- Exemptions could be allowed for those who have occupational pension schemes or existing pension provision with contribution rates of at least the level required under the auto-enrolment regime.

Taxation

- From an individual's perspective, State aid in the form of matching contributions would be easier to understand and may be viewed more desirable than tax relief. This sort of incentive scheme worked well previously with SSIAs in Ireland. It was also a feature in the KiwiSaver scheme in New Zealand whereby an initial contribution was given by the State. The 2013 OECD "Review of the Irish Pension System" has flagged that tax incentives for pension provision should be reviewed. Subsidies and matching contributions appear to be preferred to tax relief at the marginal rate.

Contribution Levels

- Setting initially low contribution levels could be used as a route to increase coverage at outset and adequacy of provision could then be addressed later by increasing contribution levels.
- It is hard to select the correct contribution level to encourage people not to opt out while providing adequate coverage. Perhaps the system could have a default contribution percentage but could also include further options and/or information that the default level of contributions is not appropriate in all cases. For example, there could be "Bronze, Silver and Gold" contribution levels.
- The Society has concerns that individuals or companies who are currently making contributions at a level above the default setting of any auto-enrolment regime could be encouraged to reduce contributions to this level.
- The National Pensions Framework published by the Government in March 2010 discussed a possible contribution rate of 8% of income (split 4% for employees, 2% for employers and 2% from the exchequer). From our analysis above, this level of contributions is likely to be suitable for an employee joining the workforce in their twenties and for someone targeting a relatively low retirement pension.

Access to funds?

- Based on our research, this feature clearly has a large impact on public behaviour. For instance, access to funds for home purchase is credited to be partly responsible for the large uptake in New Zealand, while a lack of access to funds is seen to have hindered the uptake in Italy.
- In our view, allowing access to funds is counter-intuitive where the aim is to increase pension adequacy. Therefore access should not be allowed or at least should be limited with tight rules involving a large burden of proof.
- However, individuals could be allowed access of up to 25% of the fund (to a certain maximum amount) on one occasion. This would be similar to allowing early access to the tax free lump sum and would allay fears regarding locking in funds for such prolonged periods. While pension adequacy would be reduced due to this feature, it is possible that allowing access to funds would increase pension coverage in an auto-enrolment regime, i.e. fewer people would opt-out if they thought they could access funds in certain circumstances.

Appendix C - Comparison of the auto-enrolment regimes reviewed

Table D: Comparison of the auto-enrolment regimes reviewed by the working party

<table>
<tr><th>Comparison of Auto-enrolment Regimes</th><th>Italy[1]</th><th>New Zealand</th><th>UK</th></tr>
<tr><td>Key Design Elements</td><td>Auto-enrol contributions from Trattamento di fine raporto (TFR) into pension provision</td><td>$1,000 incentive to join; Limited opt-out opportunity</td><td>Auto enrols at start & every 3 yrs.
Scope – employees not in a qualifying scheme aged 22 or over who earn more than £9,440 per annum.
Contributions rates:<table><tr><th>Timing</th><th>ER</th><th>EE</th><th>Total</th></tr><tr><td>Oct 2012-Sept 2017</td><td>1%</td><td>1%</td><td>2%</td></tr><tr><td>Oct 2017-Sept 2018</td><td>2%</td><td>3%</td><td>5%</td></tr><tr><td>1.10.2018 onwards</td><td>3%</td><td>5%</td><td>8%</td></tr></table></td></tr>
<tr><td>Stated main objective of that regime</td><td>Increase private pension provision.</td><td>Supplement basic State pension</td><td>Post retirement income replacement of 45% of income in work as minimum target for median earners[3]</td></tr>
<tr><td>State benefits</td><td>High levels</td><td>Universal basic State pension</td><td>A single tier State pension of £144 per week is being introduced, with the second State pension and contracting out being removed.</td></tr>
<tr><td>Taxation of contributions, investment return, benefits</td><td>Public – Exempt, Exempt, Taxed.
Private – Exempt, Taxed[2], Taxed or Exempt</td><td>TTE (i.e. Taxed, Taxed, Exempt)</td><td>EET</td></tr>
<tr><td>Pros - what worked well</td><td>Good structures in place</td><td>Incentive to join; all pay included</td><td>National Employment Savings Trust (NEST) has been set up so that all UK employers have access to a suitable pension scheme.
The OECD have commented that the introduction of auto-enrolment shows good progress but recommend that further efforts are made to improve the design of DC pension plans in line with the OECD “Roadmap for the Good Design of DC Pension Plans”</td></tr>
<tr><td>Cons - what worked less well</td><td>-Less access
-No guaranteed roll-up
-Rushed implementation</td><td>Reduction in occupational schemes</td><td>Employer awareness of auto-enrolment obligations is relatively low with concerns over there being enough capacity in the market to advise employers</td></tr>
<tr><td>Has coverage improved / addressed over longer-term?</td><td>Somewhat, but not sufficiently</td><td>Coverage greatly improved</td><td>Too soon to tell as auto-enrolment is being introduced in phases over October 2012 and April 2017</td></tr>
<tr><td>Will adequacy be improved / addressed over longer-term?</td><td>Somewhat, but not sufficiently</td><td>Needs increase in contribution rates to improve adequacy</td><td>Estimated impact of auto-enrolment in the UK:
- between 5m and 9m new savers or saving more in pensions
- 50 to 70% of the additional savings generated will represent additional household savings[4].</td></tr>
</table>

[1] This considers the Auto-enrolment section of the Italian regime only, relating to the Trattamento di fine raporto (TFR) which is a kind of severance pay that already exists in Italy.

[2] Returns are taxed at a reduced rate.

[3] Pensions Commission, Pensions: Challenges and Choices: The First Report of the Pensions Commission, October 2004, p142. The replacement rate is income after retirement as a percentage of income before retirement

[4] Pensions Bill 2011 – Impacts Annex B: Workplace pension reform, p45; Hawksworth J, 2006, *Review of research relevant to assessing the impact of the proposed National Pensions Savings Scheme on household savings,* DWP Research Report No 373

Appendix D – Pre-defined Progression of Contribution Rates: International Examples

We have included examples of regimes which have pre-defined how contribution rates will evolve over time, which enables better planning and preparation.

1. Progression of contribution rates under the UK auto-enrolment regime

- Automatic enrolment at the start and every 3 years
- Scope – employees not in a qualifying scheme aged 22 or over who earn more than £9,440 per annum
- Contributions levels are as shown below:

Timing	Employer	Employee	Total
1.10.2012-30.09.2017	1%	1%	2%
1.10.2017-30.09.2018	2%	3%	5%
1.10.2018 onwards	3%	5%	8%

2. Progression of contribution rates under the Australian mandatory regime

Timing	Employer*
At outset in 1992	3%
July 2002	9%
0.25% increments from July 2013 to July 2014	
July 2013	9.25%
July 2014	9.5%
July 2015	10%
Long term target (to be reached by 2019)	12%

*Employees can contribute, but are not obliged to do so.