Learning from the international experience

Ireland – where do we go from here

Brian Duncan
Chairperson, Combat Poverty
Chief Executive, Irish Pensions Trust

29 May 2008

30 Years on from the first Pensions Green Paper …

But some things have changed …

- Strong economic growth - greater resources and greater demands.
- Growth in value of social welfare benefits and easing of contribution requirements.
- Substantial growth in private pensions, with more recently a strong move from defined benefit to defined contribution and a much stronger (too strong?) compliance regime.
- Growing gap between public and private sector provisions.
- Some awareness of impact of demographic changes - ageing population and improved longevity.

Government commitments

- Increase basic state (social welfare) pension to €300 (at least) by 2012.
- Aim to secure a retirement income from all sources of 50% of pre-retirement earnings (at least).
- Work to develop flexible responses to retirement.

Comment: Commitment to 50% replacement looks okay except for low income groups; challenge is how much is mandatory and how much is voluntary.

Some key principles to underpin any "decisions"

- Build on existing arrangements.
- Focus on low income groups – the higher the income the more likely individual can make adequate arrangements.
- Consider impact on maintaining a competitive economy.
- Anticipate future changes in demographics and recognise the impact of improving longevity.
- Distinguish between pension provision and wealth creation.
- Minimise the gap between public sector and private sector provision.
- Address the position of those who opt out of the paid workforce to take on carer duties.
- Simplify the system.

The Pension Provision Chain

Low Income	Middle Income	High Income
Reliant on State benefits -unlikely to change	Combination of State benefits and private pension provision	Mainly wealth creation

Poverty after pension age (65)

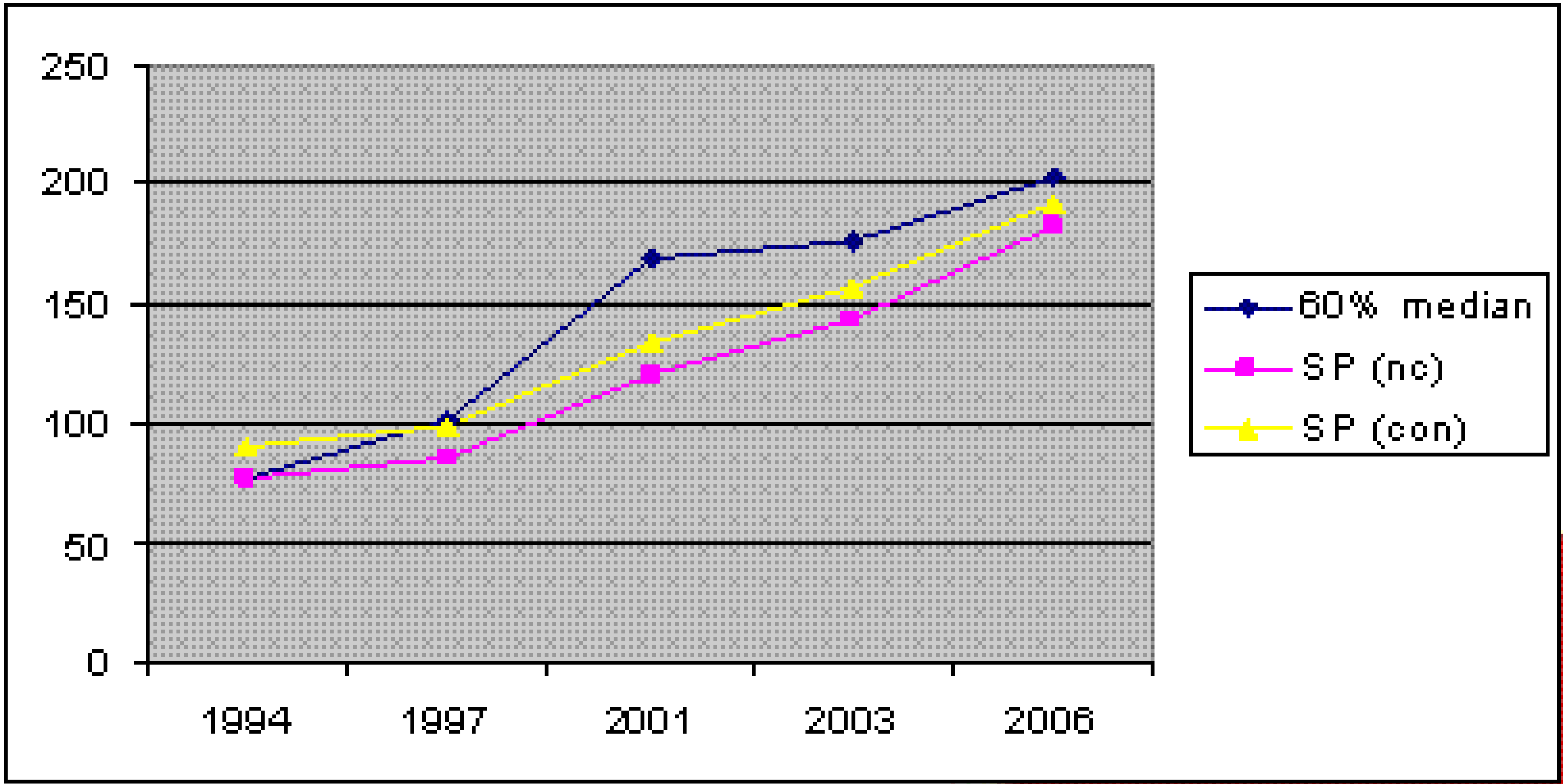
Relative Poverty: Income below 60% of national median

Consistent Poverty: Income below 60% of national median with lifestyle deprivation indicators

	Consistent Poverty		Relative Poverty	
	Male	**Female**	**Male**	**Female**
Population	6.9	7.0	16.6	17.4
Over 65's	2.4	1.9	13.6	13.7
Children under 16	11.2	10.7	19.7	20.9
Single parent	36.5	30.7	43.1	38.0

Source: EU – SILC 2006

The poverty threshold and the state pension, 1994-2006



The bad news – we are all living longer

- Life expectancy has improved significantly over the last 30 years and this improvement continues, probably at an accelerated rate.
- Life expectancy at age 65 has grown by around 50% over the last 30 years.

	Male	Female
1976	13.5	15.0
Now	20.2	23.1

- Coupled with changing demographics there is an urgent need to increase pension age
- Improved life expectancy and the changing demographics will give rise to other challenges, both economic and social.

Focus on pension provision

- The public sector has a clear distinction between pension and lump sum provision:
  - pension and lump sums are calculated separately
  - only pension is subject to Social Welfare offset (from 1995)
- By contrast private sector puts somewhat less emphasis on pensions:
  - lump sum is not related to amount of remaining pension.
  - values (commutation factors) do not recognise value of pension foregone.
  - focus on ARF’s is moving further away from pension provision.
- Perceived “poor value” when purchasing annuities is part of the issue and with improved life expectancy needs to be addressed.

Public service pensions

- Growing gap between public and private sector pension provision, and growing awareness of cost of public sector pensions.
- Some reforms, including adoption of flexible (later) retirement age and integration with social welfare (for new entrants from 1995).
- Pay parity is not guaranteed but is “expected”.
- Public sector benchmarking has attempted to address the issue by putting a value (12% to 15% of salary) on excess value of pensions
  - is this approach adequate and sustainable?
- Report details a number of options which must be explored in depth.

Mandatory earnings related pensions?

- Focusing on enhancing the basic (flat rate) social welfare pension is most cost effective and targets resources to the area of greatest need.
- However is there such pressures for some element of earnings related that the issue will not “go away”?
- The challenge with a compulsory earnings related element is to provide a meaningful addition to the basic flat rate social welfare pension while not eroding the opportunity for additional private provision.
- There is a very strong case that any mandatory earnings related element should be done through the established PRSI system to reduce collection, administration and compliance costs.
- The PRSI system could also be used as a default option for voluntary or soft mandatory provisions.

Basic strategy

- We can't predict the future so flexibility is needed.
- On the other hand as much certainty as possible is essential for individuals to plan for their future.
- In the Irish context flexibility is best achieved by a combination of the following:
  - Flat rate social welfare pension, funding on a pay as you go basis.
  - Mandatory earnings related money purchase scheme through the PRSI system, with some degree of opt out for "adequate cover".

If I were Minister for Social and Family Affairs I would …

- Increase the basic flat rate pension to 40% of average income, funded through a combination of:
  - Higher PRSI contributions
  - Gradually pushing out the pension age and
  - Some limited curtailment of private sector tax reliefs.
- Maintain the insurance related qualifying conditions for the basic pension but significantly simply the qualifying conditions and allow credits for those involved in caring.

And I also would …

- Introduce a mandatory earnings related money purchase scheme
  – 4%* employer and employee (minimum) contribution rates, applicable from age 25 (up to a salary of €50,000)
  – operating through PRSI system with State determining investment strategy
- Allow once-off option to opt out of earnings related scheme for those over 25; mandatory for those reaching 25 in the future.
  – There will be huge pressure to allow an opt out option on an on-going basis; can clear and cost effective criteria be devised?
- Introduce State guaranteed annuities up to a specified limit (related to level of contribution under mandatory scheme):
  – in conjunction with this limit restrict the availability of lump sums (and possibly ARFs).
- Consider impact of new structures on public sector pensions.

* To provide 50% pension for a male aged 25 on a salary of €45,000

Some final thoughts!

- Your future pension expectation…