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Financial Regulator Submission on the Government Green Paper On Pensions

The Financial Regulator and its role

The Financial Regulator welcomes the publication of the Green Paper on Pensions and supports the work that Government proposes to undertake to address the potential challenges that lie ahead across the entire pensions system.

The Financial Regulator was established on 1 May 2003, and holds a statutory consumer protection mandate. Our purpose is to help consumers make informed decisions in a market which is both safe and fair and to foster sound dynamic financial institutions in Ireland. This includes monitoring the solvency of Irish financial firms, developing and enforcing consumer protection rules and providing consumer information to raise awareness of the costs, risks and benefits of financial services. We believe strongly in transparency, competition and choice for the consumer.

Our role involves the supervision and monitoring of financial services providers. Our statutory code of conduct for financial services providers, the Consumer Protection Code (the Code), governs the way in which products are sold to consumers. The Code, fully effective since 1 July 2007, is a legally binding document. Under one of the key principles of the Code, financial services providers are required to act honestly, fairly and professionally in the best interests of consumers and the integrity of the market.

The Code imposes a further obligation on financial services providers to gather and record sufficient information about a consumer in order to provide products and services that are suitable to the consumer. The level of information gathered should be appropriate to the nature and complexity of the product or service being sought by the consumer, and must be to a level that allows the provider

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to provide a professional service. This requirement is particularly pertinent to the provision of private pension products, PRSAs and AVC facilities by regulated financial services providers to consumers.

Our information role includes a dedicated consumer information service (helpline, website and walk-in Information Centre), consumer guides and other publications on various financial products. We also publish cost comparisons on commonly purchased financial products with the aim of raising awareness among consumers about the features and costs of similar financial products provided by different firms. This also encourages the demand side of competition by highlighting to consumers that they can use their buying power to achieve a better deal. With regard to pension products, we have a dedicated section relating to planning for retirement and pensions on our website www.itsyourmoney.ie and we have issued a number of pension-related publications since our establishment, such as '*Your choices at retirement*' and '*Pensions made easy*'. We consult with the Pensions Board regarding these.

Having regard to our statutory consumer protection role in the area of financial services regulation, we would encourage consultation by Government with the Financial Regulator at an early stage, which would allow us to become aware, at the outset, of the policy decisions taken and the options selected to address the pensions challenge. Ongoing communication and consultation between the parties would enable the regulatory regime to respond to a changing pensions environment and to evolve in tandem with any market developments that may occur as a result of future Government proposals; thereby ensuring that consumer confidence in the pensions system is preserved. Furthermore, it may be useful if all key stakeholders sought to develop and sustain a collaborative approach to the implementation of measures proposed by Government to address the issues raised in the consultation paper. Such an approach could, in the longer term, contribute towards ensuring that the solutions proposed are implemented in a cohesive and consistent way across the pensions system and that negative, unintended consequences are avoided.

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Some specific comments

Market related

These comments relate solely to non-public service and non social welfare pensions.

We suggest that if the policy option of some form of mandatory pension arrangement (with perhaps the possibility of an opt-out) is to be explored further, then a number of key issues must be considered:

1. Product transparency

The design of the mandatory pension scheme must be such that the contribution mechanism, investment policy, costs and benefits are as simple as possible and are capable of being understood by consumers with no expertise in financial matters. As such, it should be a low-cost product. There is no obvious need for a more complex version (such as the non-standard PRSA), there are already plenty of complex pension products in the market-place. An analysis of the reasons why SSIAs model succeeded in terms of its simplicity of structure and clarity of benefits might help in this regard.

2. Market transparency

If some form of mandatory pension scheme is considered, and if the pensions industry is to have a role in relation to the management/administration of this scheme, then this would effectively be requiring that consumers purchase a product from the industry. In the only other similar example of a 'compulsory' product, i.e. motor insurance, it has been considered appropriate to put in place a significant number of accompanying provisions to ensure that the market operates in a transparent manner. A similar approach might be warranted if a universal pension scheme is to be introduced.

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3. Portability and Switching

Any mandatory or soft mandatory pension scheme should be fully portable from one employment to another, and the consumer should also be free to switch from one product provider to another. Formal (though not necessarily statutory) portability and switching codes should be considered.

4. Financial Capability

The Financial Regulator's research into the financial capability of Irish consumers will be published towards the end of 2008. This is the first exercise of this kind in Ireland and it will provide an evidential basis for policymaking in the whole area of financial consumer protection and education. The output of this study would seem to be of obvious relevance to the subject of this Green Paper. We would be happy to share the relevant sections upon publication.

5. Regulatory Structures

It is possible that, in order to determine the appropriate regulatory structures needed to oversee the implementation of any new measures in the area of pensions policy, a further consultation paper examining the regulatory impact of any measures and the merits/demerits (including a costs/benefits analysis) of each policy option will be needed.

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Product related comments

Annuities and Approved Retirement Funds (ARFs).

Annuity contracts have had a long association within the pensions area. They have an advantage of providing a guaranteed stream of income to a pensioner at a time when such monitory guarantees could be valuable when an individual is adjusting to a changed financial position. However, annuities are generally perceived as giving poor value. In addition, upon the demise of the pensioner, depending on the type of annuity chosen, the income ceases or a reduced amount would be paid to any surviving spouse. This can be viewed negatively in a situation where a pensioner dies shortly after retirement.

ARFs on the other hand give greater options to an individual as to how their pension fund at retirement is invested (with the associated risks). This fund can be used to give an income stream, or alternatively held to be eventually passed to dependants. A downside however, is that the pensioner may draw too much in the early years with the potentially disastrous consequences of the fund being depleted entirely.

Most members of defined contribution schemes are obliged to avail of the annuity route when they reach retirement. This can be perceived as negative. Other pension plans such as PRSAs, provide the policyholder with additional options at retirement, such as an ARF or AMRF.

Incentives for retirement savings

At present individual contributions to private pensions arrangements and occupational pension schemes attract tax relief at the individual's marginal or highest rate of tax. In addition, contributions are deductible for PRSI and Health Levy for income from non-pensionable employment. Employers' contributions (if any) are allowable as a company business expense. Any gains within an approved pension fund are exempt from taxes. At retirement a tax-free lump sum is an available option to individuals.

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Overall the tax reduction incentives provided are considerable for those making contributions to private pension arrangements. However many pension contributors are not fully informed or sufficiently aware of the extensive tax incentives attaching to pension schemes.

Compare this to the Special Savings Incentive Accounts (SSIAs). Many people found the incentive of €1 for every €4 saved, easy to understand. This clarity and simplicity undoubtedly was one of the factors in the success of the SSIA scheme.

Notwithstanding that the incentives for pension contributions are often considerably more generous than those attaching to the previous SSIA scheme, nevertheless this point is often lost when people are contributing to a pension plan or considering the commencement of a pension.

It is suggested that consumers need to be more aware of the tax incentives that are available and that these need to be very clearly explained to them.

Future Research

Indications are that an increasing number of people have been making arrangements for retirement outside what would be considered the normal formal route of private or occupational pension schemes.

Additionally in recent times an increasing number of people have invested in residential property in Ireland and overseas. These property investments are in addition to their principal private residence, and are purchased with a view to disposal at retirement, in order to provide a retirement income. Whether or not disposal of the property will provide a sufficient retirement income is not material to this submission.

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However it is suggested that future research of pension coverage address whether interviewees have what they might perceive as “alternative” pension arrangements or other investments. This could provide greater clarity and be relevant to the debate on pension coverage throughout Ireland.

The possible implications for pension arrangements of changing work patterns and more flexible working arrangements might also be considered (e.g. career breaks, part-time working, leaving the workforce early) as well as those concerning changing demographics.