

# GREEN PAPER ON PENSIONS

## EXECUTIVE SUMMARY



Department of Social and Family Affairs

An Roinn Gnóthaí Sóisialacha agus Teaghlaigh

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# Green Paper on Pensions

## Executive Summary



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## Government Foreword



**Bertie Ahern, T.D.**  
Taoiseach



**Brian Cowen, T.D.**  
Tánaiste and Minister  
for Finance



**Martin Cullen, T.D.**  
Minister for Social and  
Family Affairs

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The Government is proud of its record of achievements for older people and greatly values the contribution this group has made to our economic success and continued prosperity. This success and prosperity has generated the resources to enable the Government to provide significant increases in the State Pension and other supports, resulting in consistent improvements in the standard of living for all older people over many years.

We will continue to make improvements for older people a key priority and have set out a wide range of commitments in the Programme for Government, including: increasing the basic State Pension to at least €300 per week by 2012; aiming to secure a retirement income from all sources of at least 50% of pre-retirement earnings; and working to develop flexible responses to retirement.

Reflecting awareness of the fact that our population is ageing, the issue of pensions has moved closer to the top of the public agenda in recent years. The social and economic implications of this trend are emerging and we need to assess our ability to ensure the protection of all our pensioners, both now and in the future. As has been the case with many developed countries, we know that there are significant challenges ahead. We are living longer, and in better health, which is a wonderful achievement. However, while Ireland currently has a younger population than most European countries, over the longer term the impact of population ageing in this country will be considerable. According to new data in this Green Paper, the number of people

of working age for each person age 65 and over will fall from 6 in 2006 to 2 in 2050. Taking account of the fact that a proportion of those of working age will not be in employment, the ratio of workers to people aged 65 and over in 2050 will be 1.5 to 1. This demographic change will be a challenge for the sustainability of the pension system because of the expected substantial increase in age-related expenditure in the decades ahead. This issue needs to be considered in the context of our aims to increase supplementary pension coverage and to enable people in retirement to have adequate replacement incomes.

We now have a 'window of opportunity' in which to address these concerns. Thus, the objective of this Green Paper on Pensions is to carefully consider the issues involved, before making appropriate decisions for ourselves and future generations. We must decide what sort of retirement we want for ourselves and our children and what choices we as a society are prepared to make to secure that future. Good pension provision costs, whether it is done through a system of private provision and personal contributions or through the State by way of taxes and social insurance contributions.

The Green Paper sets out the wide and complex range of issues involved. It addresses specific issues in relation to Social Welfare pensions, occupational and public sector pensions, and incentives for supplementary pension saving. In addition, it examines issues regarding defined benefit and defined contribution schemes, and the

role of regulation. It also sets out some key issues related to work flexibility in older age and barriers to older people working longer, including possible approaches to flexibility in retirement age.

The essential purpose of this Green Paper is to stimulate debate. Key questions for consideration are posed and some possible approaches to pension development are set out. We wish to thank the social partners and the many individuals, groups and organisations who have engaged in this process to date. We also wish to thank the officials across a number of Government Departments who contributed to the development of the Green Paper.

The consultation process that will follow the publication of this document will allow all stakeholders to contribute towards shaping a framework for addressing the pensions challenge over the longer term. The Government looks forward to engaging in these discussions and invites all stakeholders to participate in working towards achieving an affordable, sustainable and modern pension system to meet the individual needs of those currently in retirement and which also secures the same objective for younger generations.



## Chapter 1: The Current System and its Overall Philosophy

This Green Paper on Pensions is published in fulfilment of the commitment in the social partnership agreement, *Towards 2016*. It builds upon two major reports from the Pensions Board - the 'National Pensions Review' (2006) and 'Special Savings for Retirement' (2006). These two reports built on the earlier report of the Board on the National Pensions Policy Initiative (1998).

The pensions system in Ireland comprises two main elements. The first is the State-run Social Welfare system and the second comprises voluntary supplementary pensions provided through a variety of arrangements and regulated by the State. The overall objective of our pensions system is to provide an adequate basic standard of living through direct State supports and to encourage people to make supplementary pension provision so that they may have an adequate income in retirement.

It is an objective of the Social Welfare pension system to provide income and other supports at an adequate level. Pension **adequacy** is also about the maintenance of a level of retirement income which is adequately related to pre-retirement income.

In common with many other countries, Ireland is experiencing demographic changes which increasingly, over time, will add considerably to the cost of pension provision. Therefore, along with the focus on adequate income in retirement, a key objective of our pension system is **sustainability**.

**Modernisation** of the Irish pension system is an ongoing process. In order to provide adequate pensions and to remain sustainable, a pensions system must move in tandem with changes in the labour market. This has particular implications for women.

The current pensions system can be described as a tripartite arrangement between the State, employers and individuals. Different views on the appropriate respective roles of each of these stakeholders are held within society.

In the current environment, many people are not making adequate supplementary pension provision. Changes may be needed to address this. The

Green Paper is intended to continue the debate on the most appropriate form of any new direction on pensions and to outline various options for the most appropriate way forward.

## Chapter 2: The Demographic Challenge

There is a wide range of population projections for Ireland based on various demographic assumptions, which reflects the difficulty in making long term forecasts. However, the scale of the transition from a lower to higher old age dependency ratio has been highlighted in a number of recent reports on the long-term demographic pressures facing Ireland.

Net **migration** has been the most volatile component of Ireland's population change since the foundation of the State. Migration patterns in Ireland have changed materially in recent years. Future levels of migration are extremely difficult to predict with any degree of certainty. Demographic assumptions in this chapter take account of the actual migration experience of recent years.

Future expected levels of **mortality** within the population and the labour force are also important in determining the number of people requiring pension income in the future and the length of time for which they will require it. Projections suggest that, by 2061, life expectancy at age 65 will increase by 6.4 years for men and 6.3 years for women over the current position.

The **fertility** rate recovered somewhat between 1994 and 2004, and is at a very high level relative to most other European countries. Projections suggest that, while decreasing, the fertility rate will remain high by international standards.

The population aged 65 and over will increase by 59% to 2021 and by a further 142% to 2061. There will be a relatively rapid and severe decline in the Pensioner Support Ratio (PSR - the ratio of the number of people of working age to the number of people over pension age) from 5.6 in 2006 to 1.8 in 2061. The analysis of sustainability in Chapter 3 is based on other demographic projections which show the same pattern of changing dependency.



Increases in the retirement age were found to have a significant impact on the 'real' PSR (the ratio of people in employment to those aged over 65). We would require high sustained net inward migration to reverse the underlying trend of falling PSRs. Increased female participation in the labour force will bring about a temporary increase in the real PSR.

The age structure of the Irish population is different to most other countries in the EU, and our demographic situation is relatively favourable over the medium term. The Irish working age population is projected to peak in 2041 at around 29% higher than its current level and to fall back thereafter. Older workers are eventually projected to form a significant part of the labour force.

### Chapter 3: A Modern and Sustainable Pension System

A key objective of pension policy design is to ensure the sustainability of the system over the longer term. For many countries, including Ireland, a growing concern in this respect is demographic change.

The projected ageing of the population will give rise to a substantial increase in age-related expenditure, of which pension provision is expected to be the single largest component. Recent projections indicate that spending on this age-related aggregate will increase from roughly 5% of GDP today to 13% by 2050. This is the equivalent of a €12 billion increase in 2007 present value terms.

A further consequence of demographic change is that the task of financing increasing pension spending will fall to a diminishing share of the population. By 2050, it is projected that there will be fewer than two workers per pensioner.

Taken together, these changes in the composition of the population imply a mismatch between the spending demands facing the public pension system and its ability to meet these demands (notwithstanding the accumulation of assets in the National Pensions Reserve Fund). In short, the existing system is not sustainable on the basis of current projections, without adjustments to the overall policy mix.

To safeguard the pension system into the future, a combination of measures aimed at financing and reducing the size of the projected funding gap will be required. In broad terms, the available options are:

- Increasing Exchequer savings (raising taxes or reducing spending elsewhere) and / or private savings;
- Easing upward spending pressures;
- Raising the retirement age;
- Increasing the share of the population at work;
- Improving the economy's productive capacity and overall competitiveness.

Meeting future challenges will clearly require major policy choices on our part. In making these choices, it will be important to recognise the trade-offs that exist, and to take advantage of the current 'window of opportunity', so as to put in place an appropriate and timely policy mix. This should aim to secure the financial and social sustainability of the pension system, with minimum disruption to the wider economy.

### Chapter 4: Maintaining Income Adequacy in Retirement

The average net income for single pensioners and pensioner couples in 2005 was €327.55 per week, compared to net average weekly incomes for all households in the population of €776.11. Social Welfare pensions are the main source of income for Irish pensioners. Age, gender and household composition factors affect pensioners' incomes. Around 32% of pensioner units have income from occupational or personal pensions, but relatively few pensioners in the bottom two-fifths of incomes have income from these sources.

50% of people at work expect that supplementary pensions, rather than Social Welfare pensions, will be their main retirement income source. While over 50% of workers are scheme members, Social Welfare pensions are likely to be the main retirement income source for many of this group based on current contribution levels to occupational schemes. Savings and investments are seen as an important additional source of income but are not widely expected to be the main income source.

Based on the official consistent poverty indicator, older people are in a better position than the rest of the population (3.7% for those over 65, compared to 7% overall). The risk of income poverty indicator is at approximately the same level for both groups.

The limited evidence available would suggest that some pensioners are not attaining the replacement income target suggested by the National Pensions Policy Initiative/National Pensions Review. There is also evidence that many PRSA contributors are under-saving for retirement, based on the same target.

A relatively low percentage of workers without pension coverage had either investment income or a second home. The majority of those with investment income or second homes also had pensions. Around 23% of workers without a pension had an SSIA, compared to around 46% of those with pensions.

Non-cash benefits, including the household benefits package, are an important support for pensioners' living standards.

Coverage surveys conducted in 1995 and 2002 were not directly comparable, and the best conclusion that can be drawn is that there was no change in pension coverage over the period. Pension coverage increased from 51% in 2002 to 55% in 2005. The supplementary pension coverage target suggested by NPPI/NPR is 70% of the working population between age 30 and 65 from 2013. Current coverage for this group is 62%. Despite this improvement, certain groups remain hard to reach through supplementary pensions. These groups include part-time workers, workers in sectors with traditionally low coverage, women, and groups outside the labour market.

The risk of income poverty for older people in Ireland is relatively high by international standards. Replacement income provided by the Social Welfare pension for middle and high income groups is also low by international standards.

## Chapter 5: The Social Welfare Pension in Ireland

This chapter identifies and discusses the main issues which have arisen in relation to the Social Welfare pension system. In the main, the issues identified have arisen because of the limited coverage of the

social insurance system up until the late 1980s and early 1990s, and societal norms which applied until the early 1970s. The manner in which the qualifying conditions for pensions are designed, particularly the average contribution test, can give rise to difficulties and there are also issues in relation to the use of means testing in relation to contributory payments. The appropriateness of the rates of payment, vis-à-vis the objectives of the Social Welfare system, is also an area which could be looked at. Possible approaches to the future development of the system are set out in the next chapter.

## Chapter 6: The Social Welfare Pension: Reform Options

This chapter sets out a range of approaches, including pros and cons, that could be considered to deal with the issues set out in Chapter 5. The approaches are not mutually exclusive. Reform options discussed are:

### “Reform” A: Maintain the Current Arrangements

The gaps in pension coverage are mainly the result of the structure of our social insurance system in the past and societal norms which existed through to the 1970s. Over the years, a range of measures has been introduced to deal with issues within the existing contributory and means-tested structure. While the impact of our earlier social insurance structures and societal norms will reduce in the years ahead, maintaining the status quo would mean that, in the short to medium term, about 47,000 people (mainly retired public servants and self-employed people) would remain outside the Social Welfare pensions system.

### Reform B: Universal Pensions

This pension could take a number of forms, including a standard rate of payment to all on reaching pension age; a minimum payment to those without any existing welfare entitlement; or a minimum age-related payment to those without any existing welfare entitlement. A universal payment would, however, be a radical departure from the present system - but it would deal with many of the societal and equality issues associated with the current system.

### **Reform C: Reforming and Backdating the Homemaker's Scheme**

One of the main issues relating to the Social Welfare pensions system is the treatment of those who left employment to care for children or sick or incapacitated people. Issues continue to be raised regarding those who left employment before 1994, when the Homemaker's Scheme was introduced. This reform examines options for changes to the Homemaker's Scheme, including: changing the period covered by the scheme, replacing disregards with credits, and backdating the Homemaker's Scheme.

### **Reform D: Replacing the Average Contribution Test with a Total Contributions Approach**

A change to a system of qualifications based on total contributions, allied to a more comprehensive rate structure, would be a more equitable and transparent way of awarding pensions. In deciding on an appropriate structure and, in particular the contributions for maximum and minimum pensions, this should also have regard to the potential people now have to make social insurance contributions. Having examined the implications, it may be considered that it would be prudent to postpone a move towards a total contributions approach because of the varying levels of contribution which people qualifying for pension today have on their records. This will improve in future as improved social insurance coverage feeds into the system and brings more consistency into the insurance records of those applying for a pension.

### **Reform E: Miscellaneous issues relating to Social Welfare pensions**

This reform examined issues relating to the indexation of Social Welfare pensions, the existence of two contributory schemes, the role of the Living Alone Increase, and social insurance for spouses of farmers and self-employed people.

### **Reform F: Approaches to address sustainability**

There is a significant projected rise in the cost of the Social Welfare pension system, arising from demographic change, improvements in social insurance coverage, and ongoing improvements in pension rates. In a Social Welfare context, if it was decided that savings were required, these may be achieved by one or a combination of the following: introduce an indexing arrangement which would limit the growth in costs; increase social insurance contributions; defer payments by increasing Social Welfare pension age; introduce means-testing for Social Welfare pensions.

### **Questions for Consideration**

In view of the issues and challenges facing the Social Welfare pensions system and the approaches to reform discussed in this chapter, the key questions include:

1. In the light of the reforms to the Social Welfare system undertaken in the 1970s, 80s and 90s which will, in future, see most people qualifying for contributory pensions, are there implications for people who are at present not receiving support through the Social Welfare pension system?
2. Is the introduction of a universal pension arrangement a desirable and feasible option?
3. If universal provisions are not considered appropriate, then what groups, if any, currently outside the Social Welfare pensions system should be targeted for action?
4. Policy in relation to pensions has, for many years, concentrated on improving the position of all pensioners. Is this the most appropriate way of improving pensioner incomes or should there be a more targeted approach using measures such as the Living Alone Increase?
5. If the basis of qualification for contributory pensions was changed from average contributions made, to one based on total contributions, what would be an appropriate level of contribution a person should be required to have to receive a full pension?
6. Should a formal indexing arrangement linking pensions to some level of prices, earnings or risk of poverty threshold be introduced? How would a formal indexation mechanism be operated having regard to the overall budgetary and economic position?
7. Given the issues raised in this chapter, in Chapter 3, and in the Green Paper in general in relation to the long-term affordability of existing arrangements, how can the challenge of the growing cost of Social Welfare pensions be addressed?

## Chapter 7: Supplementary Pensions - Incentives for Retirement Saving

This Chapter details the current tax arrangements for investment in supplementary pensions. These arrangements involve tax relief on amounts contributed by employers and employees to approved pension schemes and on the investment income and capital gains of the pension funds. Pension benefits payable on or after retirement are taxable subject to an entitlement to a tax-free lump-sum cash benefit.

The Chapter also discusses issues surrounding the estimated cost of these tax incentives. It also discusses value for money and equity issues relating to the current tax relief arrangements. In this context, the potential factors militating against an improvement in supplementary pension coverage are outlined, notwithstanding the tax incentives on offer. The arguments made for tax incentives to be better targeted for those on lower incomes in a cost effective way are considered.

Changes made since 1999 introduced more flexibility and control for certain individuals in relation to their pension arrangements, including the option of investing pension funds in an Approved Retirement Fund (ARF). The Chapter considers the case being made for a general extension of the availability of these flexible options including the arguments for and against such an extension.

Finally, the Chapter discusses various options for change to the existing tax incentive regime and for some forms of mandatory pension schemes for those without supplementary pensions which were previously raised by the Pensions Board. The advantages and disadvantages of these various options are considered, including estimates of the costs involved.

### Questions for Consideration

1. Can tax incentives be better targeted to encourage improved coverage in a cost-effective way?
2. Should the over-riding principle be coverage or equity and should incentives be offered at the marginal, standard or a hybrid rate?

3. Should pension arrangements (e.g. the ARF option) differentiate between individuals or be open to all on the same basis? Where is the proper balance to be struck between the competing calls for equitable treatment of all pensioners, appropriate protection for vulnerable pensioners and the costs involved?

## Chapter 8: Possible Approaches to Pensions Development

The Chapter looks at possible approaches, any of which could, in combination with elements selected from the options discussed previously or others which might emerge over time, provide the framework within which pensions policy might be developed in Ireland. They are presented for illustrative purposes and to encourage the national pensions debate.

In that context, the models for supplementary pension reforms discussed are based on either enhancing the existing system of voluntary provision or on introducing mandatory or soft mandatory approaches. As an alternative to reforms based on supplementary pensions, a rise in the social insurance pension combined with an increase in the statutory retirement age is also considered.

These four approaches (voluntary, mandatory, soft mandatory and enhanced Social Welfare) need to be compared to the current system across a range of criteria. The main criteria that facilitate comparisons of the five approaches are coverage, adequacy, cost, competitiveness, modernisation and redistribution. These criteria apply both to the level of pensions provided under the system and to the means of delivery.

Decisions on the adoption and implementation of any particular approach would have to take full account of its likely impact on the economy and of the need to maintain budgetary stability in the light of the analysis presented in Chapter 3. A decision to adopt any particular approach would need to recognise that it would take effect over a long period and that an early and complete commitment to any one approach could restrict the options in relation to other proposals later on.

### Questions for Consideration

1. In light of the discussion in this Chapter, and giving consideration to the sustainability concerns raised in Chapter 3, is the current system of retirement provision, based on a combination of State provision through the social insurance system, and voluntary provision through occupational and other supplementary pension arrangements, appropriate? If the current system requires to be enhanced, should higher pensions be provided through social insurance or through supplementary provision or both?
2. If an enhanced supplementary pension approach to coverage and adequacy is preferred, should it be addressed through changes in the current voluntary system, or by way of soft mandatory or mandatory provision?
3. Can either a “soft” or “hybrid” mandatory pension scheme be designed to ensure that it would not operate to the detriment of the existing voluntary pension arrangements, for example by encouraging movement out of existing systems (which may be potentially better from the member’s point of view) into any new mandatory arrangement?
4. How can the extra costs of enhanced provision be financed? Are improvements in pension coverage and adequacy through enhancement of the social insurance system and/or the introduction of a system of soft mandatory or mandatory pensions provision outweighed by the likely costs and economic impacts?
5. Is the introduction of either a “soft” or “hybrid” mandatory scheme a desirable option given the economic, financial and competitiveness implications of such systems?

## Chapter 9: Issues Regarding Defined Benefit and Defined Contribution Pension Schemes

Almost all schemes in Ireland are either defined benefit (DB) or defined contribution (DC), though the development of hybrid schemes is gathering momentum.

A number of issues arise which are particularly related to the nature of DB. These issues include:

**The impact of the funding standard** (which is dealt with in detail in Chapter 10).

**The growth of DC.** While the number of DB schemes is remaining constant, the majority of new schemes are DC. DB schemes are an important part of Irish pension provision and DB scheme members currently outnumber DC scheme members by a ratio of about 2:1, down from 4.5:1 in 1996. While DC schemes can provide certain advantages, the main concerns about the declining proportion of DB membership include: i) that retirement benefits are too low, given the contribution rates for DC schemes and; ii) a change in the allocation of risks from employers to employees.

**The integration of DB pensions with Social Welfare pension.** An integrated scheme is a scheme, usually DB, where the contribution and benefits are calculated net of the Social Welfare retirement benefit. A frequent criticism of these schemes is that if Social Welfare retirement benefits increase rapidly in the years before retirement, the benefits paid by the scheme, particularly for the lower paid, can be lower than expected.

The main issue which arises in relation to DC is the **adequacy of the pension benefit** payable on retirement. Most DC members are unlikely to have a retirement income equal to, or greater than, the NPPI target. The level of contribution into a DC scheme is an essential factor in this regard.

Issues that are common to both DB and DC include:

**Guarantees.** People save to provide for the future.

In allocating assets towards a long-term target, the acceptable level of risk and return will vary, depending on the objective. However no-one, including the State, can give long term absolute guarantees.

**The security of the pensions benefit.** Security of pension benefit as it relates to DC is concerned with the security of what was expected from the investment.

From time to time, a DB scheme may have a shortfall, i.e. the value of the assets of the scheme may be less than the calculated value of the future benefits of the scheme. Usually the shortfall is made up by additional contributions into the scheme. A shortfall becomes important in two circumstances; where future contributions are not sufficient to cover the shortfall and where the scheme is being wound up and there is an uncovered shortfall.

In Ireland, the security of benefits of members of DB schemes depends on the assets already accumulated in the pension fund, and on the willingness of the employer to continue to make contributions.

In some countries, there are mechanisms to provide additional security for scheme members in the event that the scheme has an unmanageable asset shortfall, including obligations on employers to make contributions and/or to take responsibility for fund shortfalls and insurance or similar arrangements to meet part or all of any shortfalls that may arise.

### Questions for Consideration

1. Are there problems with the current integration arrangements for DB schemes?
 

If so, what are the possible solutions?

  - a. prohibit integration?
  - b. restrict a reduction in pensionable pay in last, say, 3 or 5 years?
  - c. have a different integration formula for lower earners, as is the case in the public sector?
2. How can we ensure that savers understand that the level of contributions, the length of time the contributions will be made, and the return on investments will influence the level of benefits in a DC scheme?

3. What would be considered appropriate security of pension benefits? Does this exist at present?
4. Are people sufficiently aware of the trade-off between risk and the return on investments, i.e. usually the higher the potential return, the greater the risk?
5. What could be done to enhance guarantees of pension benefit? Do guarantees justify the associated costs and risks?
6. In some countries, there are arrangements to meet at least part of a shortfall in the event of a scheme shortfall. Some of these arrangements include the Pension Protection Fund in the UK, the Pension Benefit Guarantee Corporation (PBGC) in the USA and the German Pensions-Sicherungs-Verein. These arrangements can run into considerable difficulties, with the experience of the PBGC, which is currently experiencing large deficits, being a particular case in point. Having considered the discussion, would you be in favour of any of these arrangements, having regard to the pros and cons outlined in this chapter?

## Chapter 10: The Funding Standard

The funding standard was introduced in 1991 in order to set out the minimum assets that a defined benefit scheme must hold and what steps must be taken if the assets of the scheme fall below this minimum. Before 2000, very few schemes failed the funding standard because of high investment returns and low revaluation liabilities. However, between 2000 and 2004, many schemes failed the standard due to a fall in investment returns and a sharp decline in long-term interest rates. There has been an improvement in the situation recently, reflecting the progress of equity markets since 2003.

There is now a divergence of views about the standard: some believe that the number of schemes failing the standard is a sign that the standard is too high: others believe that the standard is appropriate or even too low, and that schemes' failure to meet the standard is a result of increases in longevity and lower expected future yields.

The operation of the current funding standard comprises two elements: (i) the preparation of an Actuarial Funding Certificate (AFC), which compares assets of the scheme with the liabilities, calculated on a specified basis, and, (ii) if the AFC shows a shortfall, the preparation of a funding proposal, designed to eliminate the shortfall over an agreed period.

The funding standard does not determine the cost of a DB scheme. This cost is determined by the benefits provided by the scheme, the investment returns earned and the experience of the scheme in terms of the actual salary of the member at retirement; the rate of price inflation during the course of pension payment (if payments are inflation linked); demographics, i.e. how long will the member live while in retirement and, if there is a spouse's pension, how long the spouse will live and the fact that pension funds have acquired much higher commitments on wind-up. Schemes are also faced with higher annuity costs. The cost is also determined by the impact of the FRS17 accounting standard (which obliges employers to show the amount of their pension commitments (liabilities) compared to the amount of the scheme assets (fund) and to disclose the net difference in their annual accounts).

The funding standard as a wind-up standard obliges schemes to aim to hold assets that would be enough if the scheme wound up to meet the scheme's accrued liabilities. There is an issue in relation to the priority given to pensioners and non-pensioners in a wind-up situation.

Options include:

1. Make no change to the funding standard;
2. Base the funding standard on long-term expected returns, but leave the current wind-up entitlements unchanged;
- 2.1 A variation of this scheme has been suggested which is to change the funding standard for large DB scheme members; and
3. Change the wind-up entitlements for DB scheme members. This would result in the funding standard being reduced.

Finally, the Pensions Board has been asked by the Minister for Social and Family Affairs to examine the operation of the funding standard and plans to submit a report to the Minister in 2007.

### Questions for Consideration

1. Are there any particular difficulties with the funding standard? If so, what are these difficulties and what implications do they have in your opinion?
2. Should the funding standard be based on long-term expected returns, but leaving the current wind-up entitlements unchanged?
3. Should the link between the funding standard and wind-up entitlements be broken?
4. Should the funding standard remain unchanged?
5. Should the benefit entitlements underlying the funding standard be reduced in value, thereby reducing member entitlements in the event of a wind-up happening, as compared with the current standard?
6. Should the funding standard be changed for large DB schemes only?

## Chapter 11: Annuities and Related Issues

This Chapter considers the operation of the annuity market, the factors determining the price of annuities and the role of annuities in the supplementary pension system.

Annuities provide a secure means of converting pension savings into pension income and avoid the danger that pensioners could exhaust their pension savings before dying. Despite their advantages, there has been debate as to whether the market for annuities is operating efficiently and effectively.

There are reasons to expect that demand for annuities will grow in the future, though this is highly sensitive to policy developments, particularly in relation to any extension of the option to invest in an Approved Retirement Fund (ARF). Certain groups are required to use their retirement funds to buy an annuity while others are allowed the option to convert their pension savings into an ARF. There have been calls for more flexibility in relation to the options available to those obliged to purchase an annuity.



In choosing between an ARF and an annuity, many factors need to be considered including price, charges, control and risks. Many would likely prefer to retain control over their funds by means of an ARF rather than buying an annuity. However with an ARF there is the risk of outliving one's pension assets since life expectancy generally tends to be underestimated by individuals. Prospective returns from ARFs may also be overestimated. ARFs may be particularly unsuited to holders of small pension funds in view of their likely inability to cope with fluctuations in income and capital deriving from investment performance.

The Chapter also outlines the role of annuities in relation to defined benefit occupational pension schemes and considers suggestions that the State should become a provider of annuities in certain circumstances. It cautions that the broader implications of a 'State Annuity' deserve careful attention and critical examination and questions whether it would be appropriate in view of the State's existing exposure to longevity risk within the economy. Finally, some questions are raised in relation to the State's potential role in improving the functioning of the market for both providers and purchasers of annuities.

### Questions for Consideration

1. Do annuities offer value for money?
2. Should DC holders continue to be compelled to buy an annuity at the precise moment of retirement or should they be allowed some flexibility in timing? Should PRSA and other personal fund holders continue to be allowed to avoid annuitisation and to continue to hold their retirement funds until death?
3. Should the State be more involved in the annuity market and, if so, in what way? Is it appropriate that the State takes on the additional risk involved in the form of a State Annuity Fund?
4. What measures could be introduced to assist individuals to recognise annuity terms that they may find satisfactory? For example:
  - Are there steps which could be taken to better inform customers in relation to the comparative cost of annuities?
  - Should providers be obliged to inform a prospective purchaser that their annuity can be bought from a different provider?

- Should measures be introduced to encourage people to look at alternatives to fixed single life annuities?
5. How can the market for annuities be encouraged to diversify and become more competitive? Can measures be taken to encourage new entrants to enter the market?
  6. In what ways can employers and trade unions be more proactive? Can more information be provided about annuities and the options available when employees are coming up to the point of retirement?

## Chapter 12: The Role of Regulation

This main reason the State establishes systems of regulation in any area of activity is to provide confidence and stability in that system. The State may also intervene where markets are not operating efficiently. As pensions saving involves providers investing other people's money on their behalf, it is important that those people can be confident that the system is secure and that their own savings are secure.

The State ensures that sufficient levels of confidence and security exist in the pensions system by intervening through legislation or other means to ensure standards are put in place and monitored. The State has established bodies to monitor those standards.

This Chapter sets out the State's regulatory objectives in relation to pensions. These include:

- ensuring that savers receive the benefits to which they are entitled;
- giving those saving enough information to assess the adequacy of their provision;
- ensuring that pension contributions are not misappropriated and are accounted for;
- ensuring that people have enough information to make investment decisions, where relevant;
- ensuring that tax reliefs are used appropriately;
- providing pension savers with enough information to decide whether or not to use that vehicle for retirement saving, particularly in respect of value for money;
- providing pension savers with the information needed to make specific decisions, for example, at retirement or on leaving employment.



The number of occupational pension schemes in existence creates particular regulatory challenges.

Information on pensions is essential to heighten pension awareness, safeguard the rights of scheme members and to ensure that people have sufficient information to make appropriate financial decisions. The overall approach to pension regulation continues to evolve to address, proactively, challenges of a changing environment. In order to address these challenges, the Pensions Board is undertaking an operational review, with the intention of moving towards a risk-based approach. This will ensure that the Board is structured and skilled to ensure confidence and stability in the occupational pension system as far as possible.

Finally, the Chapter outlines options for streamlining some aspects of regulation of PRSAs, while deepening other aspects of regulation, in particular issues in relation to information and charges.

### Charges

Funded supplementary pension arrangements are subject to both explicit and implicit charges, depending on the nature of the arrangement and services required.

Employers may also incur their own costs in operating funded supplementary pension arrangements in relation to the deduction and submission of employee contributions, providing various administration services (e.g. record keeping), providing information and advice to employees and making annual returns of certain information to Revenue.

Only PRSAs are currently subject to statutory control over the type and level of explicit charges; there is no readily available central source of information on the level of explicit third party charges made to funded supplementary pension arrangements. This makes it difficult to compare different arrangements or know whether value for money is being received.

For defined contribution arrangements, high charges can reduce the individual's retirement fund. For defined benefit arrangements, higher charges increase the cost of providing the promised benefit. A perception of high charges can act as a disincentive to employers and individuals alike to start and contribute to a voluntary pension arrangement.

The key issue in relation to charges is the lack of detailed knowledge and the Chapter outlines options that may address this information deficit. Options are also outlined in relation to controlling charges for supplementary pension schemes.

There are impacts attached to each of these options and any change in the regulatory approach would need to have regard to the principles of better regulation and undergo a regulatory impact analysis.

### Questions for Consideration

1. Is the overall approach to the regulation of pensions appropriate to ensure confidence and security in the system?
2. Are the regulatory objectives appropriate?
3. Is the level of regulation appropriate to the regulatory objectives we are trying to achieve?
4. Are there measures that could be taken to introduce transparency in relation to pension fund charges?

## Chapter 13: Public Service Pensions

This Chapter details the defining features of public service pensions and the significant reforms that have been implemented in this area in recent years. It shows that pension coverage is close to 100% across the public service and that most public service pension schemes are contributory, *pay as you go*, defined benefit schemes.

It gives details on the programme of reform which was based largely on the recommendations of the Commission on Public Service Pensions. The key cost containment aspect in this programme was the raising in 2004 of the minimum pension age for new entrants to the public service from 60 to 65. The mandatory retirement age of 65 years was abolished for most new entrants at this time also.

The Chapter also considers the cost of public service pensions, which are set to rise significantly in the medium-term (mainly because of increases in the number of public servants and improved life expectancy), notwithstanding implementation of the reform programme.

The Chapter outlines a number of further reform options which the Government intends to research and consider in respect of future appointees to the public service to address demographic and other developments since the Commission reported in 2000. These include:

- raising the minimum public service pension age
- increasing the rate of pension contributions
- modifying the 'pay parity' basis for post-retirement increases in pensions
- removal of fast accrual terms
- abolition of certain notional added years arrangements
- options for accounting for pension costs
- a slower accrual rate in respect of retirement pension and lump sum
- moving to calculation of pensions on the basis of 'career average' earnings.

At present, the Public Service Benchmarking Body and the Review Body on Higher Remuneration in the Public Sector are carrying out reviews of the appropriate level of remuneration of the categories of public service grades coming within their respective remits. The terms of reference of the Benchmarking Body state that:

"the body should have regard to the differences between the public service and the private sector and between the various public service groups within its remit in working conditions, the organization of work, perquisites, and conditions of employment and other relevant benefits, including security of tenure and *superannuation benefits*".

### Questions for Consideration

1. How should the cost of funding public service pensions be met?
2. Which individual reform options offer the most realistic potential?

## Chapter 14: Work Flexibility in Older Age: A New Approach to Retirement

With people living longer and fitter lives, the costs of pensions increasing, and younger workers seeking to increase their current living standards, growing numbers of people want to work, or feel a need to work, beyond the State pension age. Sustainability considerations may mean that the idea of increasing retirement age should play a central role in our pensions strategy.

Government policy is to facilitate those who wish to extend their working lives. The average exit age from the labour force in Ireland was 64.1 years in 2005, compared to the average EU25 age of 60.9 years. The current employment rate for older people (55-64) is over 53%. The OECD has commented, however, that population ageing in Ireland could have a profound socio-economic impact if Ireland's potential labour supply is not mobilised more effectively.

There are a wide range of viewpoints held by both individuals and employers on an increase in retirement age. While recent legislative change has improved the possibilities for people to work into older age if they wish, there is a view that a change of mindset needs to be promoted among both employees and employers to encourage older workers to remain in employment.

Flexibility in pension arrangements and working conditions may assist in removing some structural barriers to working longer. In addition, more flexibility may be needed in the Social Welfare pension system. Attention might also be given to the alignment of other policies to support any change in retirement age, including continuing to create the conditions for economic growth and competitiveness, narrowing health inequalities, and adapting HR processes and practices.

Allowing people to postpone retirement and to improve their Social Welfare benefits through further employment would be in keeping with EU policy in this area.

While the primary argument in favour of increasing retirement age is financial, a further argument is on the grounds of intergenerational equity. There are nevertheless some obstacles which would have to be overcome and issues to be addressed if the State retirement age were to be increased.

The Actuarial Review of the Social Insurance Fund presents a number of methods for phasing in retirement age increases. It is clear that increasing the retirement age has the potential to contain, to some degree, the extent of the projected rise in benefit expenditure. A balance will need to be achieved between maintaining the stability of the Social Welfare pension system, supporting the voluntary nature of occupational pension provision and intergenerational fairness.

Given that Ireland is seen to be in a position of strength relative to other developed economies in terms of retirement age, properly designed, imaginative incentives which allow a flexible approach to employment in later life may bring the results needed.

### Questions for Consideration

1. Should measures be put in place to encourage later retirement? Should measures be put in place to encourage employers to retain older workers? What form should such measures take?
2. Should a system allowing for voluntary deferral of the Social Welfare pension be introduced? How should this operate?
3. Should other incentives be introduced to encourage people to work beyond normal retirement age?
4. In order to encourage later retirement, should employers be prohibited from setting a retirement age below a certain age? Should they be prohibited from setting any retirement age?
5. In order to contain costs and reflect increased life expectancy, should a change be made to the retirement age for Social Welfare pensions? How should such a change be implemented?

## Consultation Process

The Government is publishing the Green Paper on Pensions in order to stimulate debate on the challenges and options for the future development of pensions in Ireland. The Government would like all interested individuals and organisations to give their views and we welcome comments on any aspect. Your contribution will help to inform us in making appropriate decisions for ourselves and future generations.

The Government appreciates that issues in relation to pensions can be wide-ranging and complex. Accordingly, in order to ensure that adequate time is allowed for reflection and debate, the consultation process will extend to mid-2008. This will ensure that the consultation is both thorough and inclusive.

To assist you in formulating your response, key questions for consideration are set out at the end of each chapter – these are also repeated in the executive summary.

When making a submission, please state whether you are responding as an individual or representing the views of an organisation. Submissions received will be published on the website.

An electronic version of the Green Paper is available at the website:

**[www.pensionsgreenpaper.ie](http://www.pensionsgreenpaper.ie)**

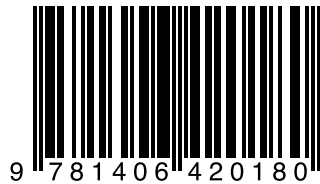
You can make your submission using this website. Alternatively, a written response may be submitted by email, letter or fax to:

**Green Paper Consultation  
Pensions Policy Unit  
Department of Social and Family Affairs  
Áras Mhic Dhiarmada  
Store Street  
Dublin 1**

**email: [pensionsgreenpaper@welfare.ie](mailto:pensionsgreenpaper@welfare.ie)**

**Fax: 01-7043457**

[www.pensionsgreenpaper.ie](http://www.pensionsgreenpaper.ie)



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