Department of Social and Family Affairs

# Hewitt Green Paper Response

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Prepared for

Department of Social and Family Affairs

Prepared by

Hewitt Associates

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# Introduction

**About Hewitt**

Hewitt Associates Limited is an Irish registered company which is wholly owned by Hewitt Associates LLC (an Illinois USA Limited Liability Company).

Hewitt Associates LLC is owned by Hewitt Associates Inc., a global benefits consultancy which is a public quoted company whose shares are traded on the New York Stock Exchange. (HEW:NYSE)

In Ireland, Hewitt Associates Limited is a leader in the actuarial, administration, strategic benefits and investment consultancy business.

We work with many of Ireland's leading indigenous and multinational companies and organisations from our offices in Dublin and Cork.

As specialists in the management of pension schemes, we combine deep commitment and experience with leading edge systems to support our structured client servicing approach.

**Why we are responding**

Hewitt's client base in Ireland consists of large and small multinational and indigenous employers who have many hundreds of thousands of employees participating in the pension plans that they sponsor.

In this regard, it is important to us and our clients that Hewitt submits a response to the questions prompted by the Green Paper on Pensions.  In this report we have outlined our views on some key areas where we feel we can add value to the process.

**Key issues**

We have set out in the following pages, Hewitt's response to the Green Paper.

We have listed below, in order of importance, the issues that Hewitt are would like to see addressed in the immediate future:

1. Provision of a fair and adequate income in retirement.
2. Equalisation of the availability of Approved Retirement Funds for al DC members.
3. Simplification of the available pension options and surrounding legislation.
4. Flexibility in retirement.
5. Encouraging saving for retirement where it is affordable.
6. Financial education at school level.

**State vs Supplementary Provision**

Hewitt believe that higher pension provision should come from both an increase in the State provided benefit and supplementary provision where relevant.

People must be given the ability to save for retirement themselves and equally those who cannot afford to save for retirement should be entitled to a basic standard of living once they retire.

We understand the Government is committed to continuing to increase the level of state provision and we would propose that the amount which should be targeted should relate to a percentage of national average earnings.

Hewitt also suggest that providing more flexibility in the State Pension Age will go some way towards mitigating the cost of higher state pension provision.

**Soft mandatory/ mandatory**

Hewitt do not support this approach.

We are concerned that any form of mandatory provision would direct employers to fund to the lowest contribution rate required rather than considering the impact of contribution levels on the future retirement income of the individual'.

We would encourage the legislators to consider the following points to increase coverage:

- a simplification of the tax regime surrounding pensions in Ireland to look more similar to the SSIA approach
- allowing people to access a portion of their pension funds when key events occur in their lives

**Integrated Arrangements for DB Schemes**

Integrated pension schemes have operated very effectively as a vehicle for employers to assist employees in providing pension benefits and have stood the test of time where the employer was targeting total income.

The employer benefits if the government is generous and the employer funds the difference if the state benefit does not increase.

In the long term, we would expect the impact of offsetting the state pension will balance out. It is clear that lower earners have been adversely impacted by the recent changes in the state pension, making integrated pension schemes for low earners very difficult to justify. However, this may have enabled employers to continue to provide DB benefits because of funding requirements being lower.

To remove integration with no other change is not feasible as the cost to employers would be prohibitive and would lead to a further reduction in DB schemes.

Possible approaches to addressing this issue could be

- Mandate that pensionable salaries cannot reduce and follow a ratcheting system as in the UK.
- Redesign the scheme to incorporate a lower accrual rate but with no integration in the definition of pensionable salary.

**Savers Understanding**

Education and communication are the two key elements which need to be addressed at a younger age. Financial planning, including saving for pensions, should be part of the school curriculum so that young people understand early in life the impact of saving early for retirement and more importantly the impact of starting late.

People understood SSIAs.  The language used was simple. The industry and the government should simplify where possible all reference to pension provision.

Provision of personalised web enabled tools which project expected benefits at different retirement ages and simplifying benefit statements and projections would help individual understanding.

Individuals need to understand that unless their employer is providing a reasonable level of pension benefit, they will only have the State Pension on retirement which is unlikely to provide the retirement replacement incomes that they require and may expect.

It must be made easier for individuals to save for retirement by a combination of simplifying the choices available and the underlying legislation as well as improving the transferability of benefits between pension arrangements.  These factors are a serious frustration and deterrent for individuals trying to plan for retirement.

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**Scheme Protection Funds**

We do not consider that this approach is practical in Ireland given the size of the Irish market.

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**Funding Standard**

One of the difficulties with the funding standard is that it measures the funding position at a point in time and therefore by its very nature can produce very volatile results.

Furthermore, the value placed on benefits for actives and deferred members is very low compared with that on an ongoing basis, although for pensioner benefits the opposite is the case.

Coupled with both of these points is the inequity that exists between the wind up priorities where pensioner benefits are 100% secure and an individual 1 year from retirement is treated in the same way as a member 40 years off retirement (with considerably less time to make good any difference).

Hewitt believe that the wind up priorities should be changed to introduce a sliding scale prior to retirement. We would also recommend that the state look to change the annuity basis and/or reconsider some form of state annuity fund.

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**Should DC members be compelled to buy an annuity**

Hewitt believe that members of occupational DC plans should have the option, and not be compelled, to purchase an annuity at retirement, provided an appropriate level of regular income is available to the individual.  The current approach is not appropriate as:

- it is not equitable as other DC contributors are not required to do the same with their funds eg PRSA savers
- may require the purchase of an annuity at a time where they do not offer value for money
- reduces the attractiveness of investing through DC plans and possibly contributes to the low coverage rates.

This option must be made available subject to appropriate safeguards.

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| **State involvement in the Annuity Market** | Hewitt would welcome a greater involvement from the state in the annuity market particularly in the following situations:<br>■ Insolvency of a pension scheme on wind up<br>■ Small DC funds at retirement that would be very poor value for money if commercially required to purchase an annuity |
| **Annuity Market more competitive** | The market for inflation linked annuities would become more competitive if the Irish Government issued Irish-inflation linked bonds. |
| **Late Retirement** | Flexibility of retirement age will go some way to assist individuals in planning for retirement and ensure that the level of income receivable on retirement approaches expectations.<br>Partial retirement is an approach that we favour where an individual can draw retirement income and continue to work.<br>Should the state provide more flexibility around pension age, employers sponsoring DB schemes might have more scope to change the scheme retirement age and therefore help manage pension costs.<br>Any increase in the State Pension Age requires flexibility and careful design consideration. |
| **Deferral of Social Welfare** | Optional deferral of social welfare benefits should be made available but not at the expense of those retiring or at the expense of over complicating the existing system. |