IBEC SUBMISSION

GREEN PAPER ON PENSIONS

MAY 2008

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Introduction

IBEC welcomes the publication of the Government's Green Paper on Pensions and views it against a background of ongoing pension's policy review and development. This submission to the Green Paper incorporates our previous submission to the 2006 National Pensions Review undertaken by the Pensions Board which is attached as an appendix hereto.

It is increasingly clear in recent years that our pension provision, both as a nation and for individuals, is inadequate to meet the demands of future retirees. Planned and careful action now will gradually address this situation and ensure adequate and sustainable retirement pensions into the future. The problems we face with our current pension structures have the capacity, if left unchanged, to impact negatively on other areas of social policy such as care of the aged, health, housing, mental wellbeing, inter-generational supports, taxation, employment, consumer spending and lifestyle.

By promoting and implementing a structure, which is more equitable and demographically appropriate, we will not only negate the potential adverse consequences but can also plan to take advantage of those changing demographics in a way which will benefit business and society. This could impact positively on working patterns in older years, promotion of volunteerism post retirement, better mental wellbeing and health, and improved spending power, which in itself will promote consumer spending and economic activity.

Background

Our current pension system with its mix of a State pension aimed at poverty proofing, and a voluntary supplementary pension system has generally served us well. However, demographic changes along with lower mortality levels and rising immigration levels will add to the social and economic cost of pension provision. The State spend on pensions is low by international standards, standards of living have risen considerably, and the poverty proofing mechanism which the State pension delivers is no longer adequate or matched to current lifestyle requirements. Indeed a recent Pensions Board survey indicates that 80% of respondents say they wouldn't be able to live off the State pension.

Voluntary supplementary pensions have developed in tandem with the state pension system. However, where the contribution of the first pillar State pension is eroded in terms of adequacy, this adds to the pressure on the supplementary pension system to compensate. Some commentators have asserted that the supplementary system should compensate for the inadequacy of the State system which, IBEC argues, is an inherently flawed and unacceptable approach.

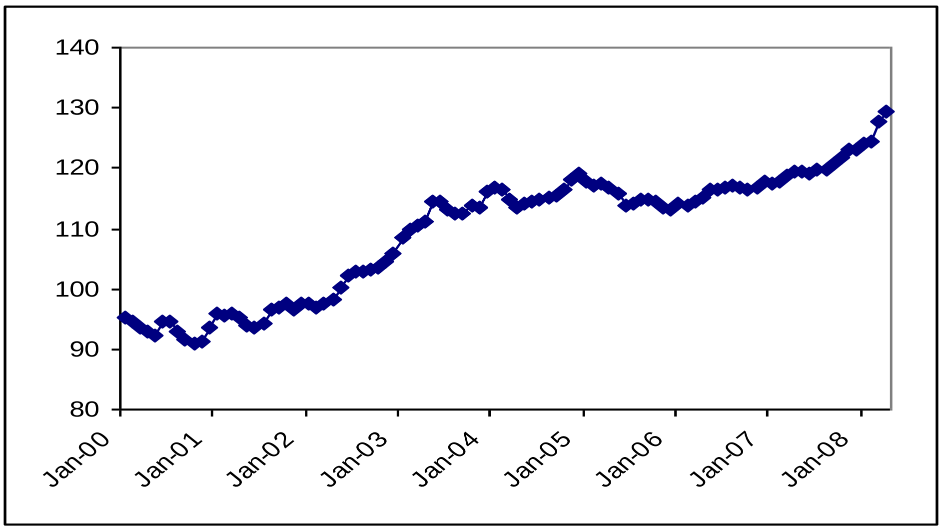
The supplementary voluntary system cannot compensate for the inadequacy for the State system, nor can it be structured to do so as this would transfer a substantial part of the State obligation on to individuals and/or employers. While the current system correctly seeks to promote individual responsibility, there is a limit to the capacity of many individuals, particularly those in lower paid employments, to provide for their own retirement. For those with such income constraints impeding their retirement savings, a series of negative consequences then follow not just for those individuals, but also for the employer and for society. Clearly, there is difficulty for the individual having inadequate savings but there is also the frustration of unmet income expectations from those savings and the resulting cost implications for the State through compensatory interventions and support.

These are, similarly, constraints to rising employer pension costs and their impacts on business competitiveness.

Economic Context

The competitiveness of Irish business has been substantially eroded in recent years because of pay and non-pay costs rising faster than our trading partners and through a significant deterioration in the trade-weighted exchange rate. While various international sentiment rankings provide some indication of competitiveness trends, the most accurate quantitative measure is the Real Harmonised Index of Competitiveness produced by the Central Bank (Figure 1). An increase in the index illustrates a loss of Irish competitiveness against trading partners. The index has risen sharply since the end of 2000 and by early 2008 had increased by 36%. This indicates that Irish exporters are in general 36% less cost competitive against their trading partners than they were at the start of the decade.

Figure 1 Real Harmonised Index of Competitiveness, Jan. 2000-March 2008.



Source: Central Bank.

Over this period, pay costs in the Irish economy have increased by twice the average across the Euro Area and Ireland is now a high waged economy. Average earnings in 2007 were 17% higher than the Euro Area average and take-home earnings in Ireland are now the second highest in the EU. Non-pay costs have also increased well ahead of those in our trading partners. In particular, Irish companies have experienced substantial increases in fuel and electricity costs. Due to an over-reliance on imported energy sources, Irish business has suffered more than that in other countries because of rapidly rising global energy prices. A range of other non-pay cost increases in areas such as environmental services, office rents and professional services have also dented the competitiveness of Irish business.

Much of the more recent competitiveness loss emanating from the severe currency adjustments of the past 12 months will probably not manifest itself in job losses for some time yet. Nevertheless, the steady competitiveness loss of previous years has already left its mark. Ireland has lost about 10% of total manufacturing employment over the past six years, while redundancies across all sectors of the economy in the first four months of 2008 are up 30%.

A combination of weakening global demand and a sharp housing induced correction in the domestic economy will result in the most challenging economic conditions in two decades, over the next year or two.

It is imperative that Government addresses the competitiveness challenges facing Irish business. In particular, it must ensure that nothing is done to add to what has become an unsustainably high cost business structure in the Irish economy.

State Funding - Adequacy

There is a requirement for the State to underpin the retirement income of individuals who are unable to fund an adequate retirement pot for themselves. While people must be encouraged to put disposable income aside for pension provision, if they are obliged to do so it could well be at the expense of other necessary expenditures including that of health, education, nutrition and housing, childcare and clothing. People need to earn an adequate income for their current needs before they are required to save for their future retirement. It is appropriate that the State provides a pension to poverty proof income levels in retirement but it is also increasingly necessary for the State to fund beyond the basic poverty proofing level in place at present.

The intent of the current social welfare system is to provide an adequate basic standard of living. Accordingly, the level to which this State system should provide cover is of fundamental importance. IBEC believes a detailed review of what this future level should be is required in order to properly assess the implications for the State and the taxpayer for the future.

In 2005 social welfare pensions accounted for 54% of the overall gross income of Irish pensioners with supplementary pensions providing just over 24% of income. However, these figures mask the fact that our system is relatively young, both in terms of the State pension and the occupational sector pension provision. Most private sector occupational pension schemes have come into existence since the 1980's and as such, current retirees from the private sector in particular will generally have accumulated less pensionable service than their public sector counterparts. Consequently private sector workers are more likely to rely on the social welfare system at the moment. That is likely to change from 2020 onwards as we see more private sector retirees with full pensionable service earned based on their working lives rather than a proportionate of it.

The State pension is inadequate and becomes increasingly so as inflation erodes its value and as standards of living improve generally. A percentage of gross average industrial earnings as an indicator is also flawed, partly due to the difficulties of defining what precisely gross average industrial earnings are and partly because of rising service sector employment.

In summary it is clear that increasing the social welfare pension is the first step towards building on better pension provision

State Funding - What pension income should the State provide?

IBEC believes it is necessary to set the proportion of retirement income, which ideally should be provided by the State, as well as the proportion of retirement income which should be provided privately. This would help alleviate the present ad hoc approach to pensions planning. Currently the State pension is set as a percentage of gross average industrial earnings (which is variously measured) and currently the state pension covers 34% of the average industrial wage. The Pensions Board have recommended that that would increase to 40% of the gross average industrial wage. However, this measure is becoming less relevant giving the increasing level of service employment within overall employment levels. The more appropriate approach may be to determine, and periodically review, what percentage of average retirement replacement income (rather than a percentage of direct average earnings) should be provided by the State. This would have the benefit of incorporating tax incentive spends and would ensure a more equitable spread of incentives between the lower paid and those on higher incomes who are better placed to save.

The replacement rate of income in retirement provides a means of establishing what a person earned prior to retirement and what they should expect to have as pension income post retirement. In Luxembourg the replacement rate per worker actually exceeds 100% while in most other European countries the replacement rate is generally between 50% and 70%. Ireland has the lowest replacement rate of average earnings in not just Europe but in the OECD, at less than 30%. Workers on average earnings in OECD countries can generally expect their post tax pension to be worth just under 70% of earnings.

IBEC would support an increase in the social welfare pension, however is mindful of the significant cost which the State would incur in so doing. Such an approach must take account of the sustainability of the public finances and the avoidance of any increased costs being passed back to current employers and employees through direct/indirect taxation.

IBEC proposes:

- ***A re examination of the basis on which the State pension is funded with a view to establishing an alternative benchmark for adequate retirement income.***

- ***That consideration is given to a more equitable redistribution of the current tax take to include tax relief for all on savings for retirement at a uniform rate of 41%.***
- ***the additional funding necessary to support a higher level of first pillar State pension provision could partially be sourced from a redistribution of tax incentives, the National Pensions Reserve Fund and major public service pensions reform.***

In IBEC's opinion, these measures are prerequisites to establishing what level of support the State should offer its citizenship in retirement.

Principles of Pension Provision

We believe that in developing future pension's policy it is necessary to adopt some set principles on which to judge the newly evolving system. We would recommend the establishment of some key principles of reform based on the better regulation model.

We suggest those principles should include:

1. ***adequate retirement income for all,***
2. ***individual responsibility,***
3. ***sustainability,***
4. ***equitable incentivising,***
5. ***simplicity,***
6. ***affordability and cost effectiveness,***
7. ***cross party political backing to ensure long term sustainability.***

It is important that Ireland avoid the mistakes inherent in the UK system whereby a series of reforms have made more complex an already ailing pensions system. Any reform of the Irish system needs to be planned and well thought out. It needs to be developed and proactively reviewed so as to avoid reactive amendments, which may be incompatible with long-term sustainability. For that reason, structured reviews to the system should be undertaken every five or seven years.

Independent Pensions Review Body

Again, structural reviews should encompass the basic core principles with a clear and unequivocal rationale. Our pension system is complicated with many moving parts, and simplification must be a core policy objective. Regular systems review would minimise the potential for the pensions system becoming politically captive to diverse political interests. Such an approach could be conducted separate and independent from the operational role of the Pensions Board as regulator.

A core principle for determining pension's policy must be ensuring credibility in the system. Setting up an independent structure to review, monitor and develop pensions policy will help bring credibility to the pensions system provided it is independent of the political process. Such a system will require a high degree of transparency and be evidenced based.

The remit of such a body should encompass both public and private pensions and should be charged with independently examining the policy issues for both for the next fifty years.

An example of an existing structure internationally is the New Zealand Retirement Commission. The New Zealand system includes a principled based pension system and it ensures long term and sustainable policy development.

In summary, IBEC is reluctant to encourage the establishment of more State agencies. However, in this instance, we believe that an effort should be made to establish a separate independent pension's advisory body, as proposed.

Demographics

The demographic challenge is one which has been widely debated   It is difficult to forecast with any accuracy what mortality rates will be in the next fifty years.
There is little doubt however, that the current mortality assumptions are a huge increase on levels of twenty years ago and could not have been forecast with any degree of accuracy at that time.

In addition to the uncertain science of forecasting mortality levels, there are a range of other demographic factors to take account of such as immigration levels, fertility rates, working life span and the degree of reliance on pensions for retirement income. Given all of these factors, it is difficult to forecast accurately for the future. Hence, our projections should be for the medium term and be subject to regular review to enable appropriate adjustments to be made.

In addition to demographics, employment patterns also remain unpredictable. Increased mobility of employment, a narrowing work life span and multiple career/occupation changes during working lives all contribute to the need for a flexible structure for pensions and pension savings. Our current structure is more reflective of a workforce profile that is less mobile, works for forty years, and possesses the skills acquired in early life. We have a significant increase in the number of women working and in the number of atypical workers. Again, the pension demands of these groups are more difficult to reconcile within existing structures. This demands flexibility not only for contributions and benefits but also in respect of transferring retirement savings, allowing for contribution holidays and drawing down if required. Given improving mortality levels, it is reasonable to assume that we will be working longer and that normal retirement ages will increase from sixty-five thus enabling the continuation of pension contributions and the productive capacity of older workers.

The primary reforms must focus on flexibility and adaptability. IBEC believes that better and more targeted incentivisation of the current supplementary pensions system can encourage both.

Job Mobility

The importance of job mobility to pension provision arises in a number of contexts. The provision of occupational pensions and the type and difference of those pension systems together with ease of transfer, accumulated and preserved rights and pension charges are all issues which can be complex, costly and which can hinder the proper provision of private pension savings in particular.

On average a European worker stays with an employer for about ten years. However, there are distinct patterns of mobility throughout the European Union which are largely dependent on job flexibility. Ireland scores high on the job flexibility ratio and has a higher than average job mobility ratio.

Nevertheless, the pattern amongst the younger age groups is more important in framing future reforms. In Ireland, 33% percent of workers have been with their current employer for less than two years while 30% have been there for ten years or more. In all, 47% of Irish workers are in jobs that they have held for less than four years. We clearly have high mobility and that presents us with particular problems in framing occupational pension provision in a way which maximises the efficiency of pension savings.

Obviously high mobility between schemes increases costs, particularly where those schemes are small schemes to begin with. Ireland also has to deal with the level of international job mobility of our workforce. We have a unique position in Europe in that a very high percentage (18%) of the population has lived abroad. This adds complexity to the challenge of occupational pension provision and reinforces the need for flexible improvements. It also reinforces the importance of having regular reviews of national pension's strategy.

Retirement Ages

Given that pensions must now fund a longer period of healthier retirement than was ever envisioned, later retirement becomes an inevitability. The UK is moving from a normal retirement age of 65 to one of 68. Germany has moved from age 60 to 65 as a normal retirement age for women, and Sweden has moved from age 65 to 67. In each case, this lessens the burden of pension provision given the future projected costs of larger retirement communities. A further measure, which reduces the cost of provision and postpones increasing the retirement age, is to increase the number of contributions required before being entitled to the state contributory pension.

The simplest most cost-effective and productive means of reining in a state's pension liability is to increase the retirement age. Active ageing has become somewhat of a by-word in social policy due to its association with voluntary work and leisure time activity. However, in the context of pensions, it is a positive and healthy development and can be used constructively to reduce the burden on the State of pension provision. In the first five years of this century, the average retirement age throughout Europe has risen by about one-and-a-half years. That trend will continue and this needs to form part of Irish pension planning. This will also strengthen personal pension provision over and above that provided for by the first and second pillars. As third pillar pension provision has been seen largely as the preserve of the better off in society it is likely that given later retirement ages, the importance of personal pension provision will rise.

IBEC supports the phased increase of retirement ages by voluntary agreement between employers and employees. IBEC also supports the deferment of the State pension in favour of a later and enhanced State pension.

Enhanced State Pensions

IBEC submits that the State should provide retirement income for its citizens to a level comfortably above the 'risk of poverty' measure. Achieving this could be linked to inducements to further voluntary savings. By allowing a link between basic poverty proofing and an adequate retirement income, not only does the State ensure that its pensioner's income do not deviate significantly from that of the working population, but it also allows income adequacy and a lifestyle that will encourage both a healthier and more productive old age.

The State should also enable people who are of working age to save for pensions at a low cost, and that cost needs to be capped. This could involve the State setting up a public or private pension fund as an enabling vehicle, into which individuals can invest at reasonably low charges. However, IBEC recognises that this would become a complicated exercise as the offset of charges forgone on profit could well be diluted by the risk of bureaucratic administrative sructures.

In exchange for the State providing a State pension at a rate comfortably above poverty proofing, there could be a basic minimum threshold of social insurance contributions required over a set period of years. As an alternative, individuals who did not reach such thresholds could be enabled to purchase the enhanced State pension. This would allow individuals who had other forms of wealth such as equity and housing or other investments to use those investments to purchase the enhanced State pension.

We know that public spending on pensions is set to rise by more than 6 percentage points of GDP by 2050, more than in most other EU countries. The current cost to the state of social welfare pensions is 4.6% of GDP. On an adjusted basis allowing for future population trends this rises to 10% of GDP by 2050 or an additional €12bn, in 2007 terms. Accordingly, the sustainability of the escalating cost of the state social welfare pensions is a growing concern, in light of rapidly changing life expectancy trends. This will require substantial changes in the overall composition of public spending, in taxation or in the pension system.

There may be some opportunity to address the States own funding provision of pensions for the lower paid. This can be addressed with the delivery of improved infrastructure and as a smaller percentage of national income is spent on infrastructural deficits over coming decades**.**

Pension Saving Issues

Retirement under-saving, higher standards of living and increasing expectations of retirement all feed into an unstable pensions picture. The ‘Celtic Tiger’ has undoubtedly enhanced national wealth. However, with mortality improvement that wealth needs to last individuals for longer. In the UK total net worth rose by about 60% in real terms between 1997 and 2006. However, at the same time the number of people saving for pensions declined. The numbers of Irish pension’s savers have stayed relatively stable. However, we would have expected to see a considerable increase in the numbers of people saving for pensions given the increased economic circumstances of recent years. Whether, therefore, in a more uncertain economic climate, people are willing to save for pensions or whether they are more likely to build up other investments for retirement purposes is unclear. For that reason, wealth statistics need to show where people are prepared to save and where that can be attuned to the advantage of retirement savings policies.

The lack of retirement savings is not a uniquely Irish phenomenon. The percentage of US employees not in pension schemes has been increasing in the last twenty years and this in turn has led to an increased poverty rate amongst retirees (over 20%). Yet American occupational pension savings are huge (93% of GDP). As more Irish employers seek to contain the rising cost of defined benefit schemes, we are seeing an increase in the defined contribution provision at the expense of defined benefits or as the only viable alternative to no occupational pension provision at all. This is also having the effect of reducing the monies invested overall despite the fact that employer contributions doubled between 2000 and 2005 into such DB schemes. Although it is undoubtedly the case that the State must also place limits on its pension liabilities, it cannot follow that private sector employers should pick up the extra cost of occupational provision. It is imperative therefore to incentivise individual responsibility as well as improving targeted state pension provision.

Pensions are a complex subject and do not lend themselves to ease of understanding. They are rarely simple and there are many influencing factors about how much to save, how to save and manage those savings, and how to manage the benefit payments. Being so reliant on changing demographics, economic circumstances, state provision, types of occupational vehicle (if at all), tax incentives, and a host of other issues, the man in the street generally does not want to know or to engage on the issues. It is important, therefore, that pensions are simplified and that this is a priority for all stakeholders other than this just being the preserve of the pension's industry and the Regulator. While the current Pensions Board media campaign has many merits, it can only get across the broad messages on pensions such as the need to save and the need to start saving early. It cannot, deal with the intricacies of what suits particular individuals and that is best dealt with by independent and well-informed third parties. These are scarce and expensive and while Trustees fill the vacuum in many cases, it is not appropriate that Trustees give individual advices as their obligation is towards all members of the scheme rather than to individuals who may have conflicting interests.

This could be encouraged by the Department by making available funding support to reputable organisations with proven pensions knowledge to deliver training in the area. This should only be a short to medium-term option with the long-term aim to simplify pensions. IBEC believes the Regulator, in this case the Pensions Board, should manage this drive for simplification

We believe that the Department ought to make available support to trade unions, employer bodies, employers and all other independent stakeholders to assist them in both understanding and advising their constituencies of the best pension options.

Public Service Pensions

Public sector pensioners enjoy indexation increases linked to existing salaries rather than CPI, as is the norm in the private sector. This means that the value and cost of the public sector pension is increasing at a time when private sector employers are trying to manage and contain their own pension provision costs. The cost of public service pensions is ultimately borne by the private sector and the tax payer. The disparity in provision between both public and private is becoming increasingly problematic.

Our public service pension bill is running well in excess of originally forecast by the Commission for Public Service Pensions, but a true picture is still difficult to ascertain. It remains largely a pay as you go system and as such pre-funding requirements are not in place that would clearly indicate the provision cost to the State. It should be acknowledged that those joining the civil service since 1995 now make a direct contribution to their pensions, in the region of 6% of salary, and that those joining the public sector since 2004 enjoy less favourable early retirement options. However, those civil servants who now contribute to their own pensions are actually reimbursed for this in the form of a higher gross salary, fully paid for by the public purse. Despite very modest reforms in recent years, these are a far cry from the changes introduced in the private sector and about 60% of public sector workers continue to enjoy the more generous pre-1995 pension benefits.

IBEC remains very concerned in relation to the rapidly increasing liability associated with public sector pensions. The Department of Finances's own estimate of €75 billion shows this liability at about double the national debt of €37 billion. The scale of these liabilities could even prove to be underestimated; a recent UK study has shown that public sector pension liabilities there are double the official Government estimates.

These liabilities need to be capped here and more radical reforms introduced. Indeed most public servants are unaware of the value of their pension scheme and the massive increased financial investment needed by government to maintain it. The conclusion of the benchmarking processes both for the higher public servants and the general grades has for the first time recognised the value (to some extent at least) of the premium which public servants enjoy compared to their counterparts in the private sector.

As a matter of urgency Government should publish a detailed actuarial analysis of public sector pension liabilities. The ongoing benefit of pay-parity which links public sector pensions to current pay trends has become unsustainable and must be reviewed. This reinforces the case being advanced by IBEC in the debate on the sustainability of public service pensions and to place a limit on public sector pension liabilities. This current approach to up-rating public service pensions in payment should be reconsidered.

IBEC believes it is imperative that each government department and agency must do the costing of public service pension liabilities annually and the separate departmental and composite annual funding costs should be published.

IBEC believes that the idea of a national pensions reserve fund to fund for future pension liabilities is a good one. However, we believe there needs to be transparency about how that fund will be allocated to the state's pension commitments and believe that the greatest share of it should be used to fund social welfare pensions rather than public service pensioners, at least until such time as the state has examined its spending on pensions and how best to improve it equitably.

IBEC believes that no one individual reform option will solve the problem of escalating public service pensions. We believe that a combination of major reforms is necessary which could include:

- ***The Government should set a contribution rate cap beyond which employees would have to fund any pension liabilities on an equal basis.***
- ***All public servants should be required to contribute towards the cost of funding retirement benefits, which, in the majority of cases currently link the pension payable to the salary scale of the employee's former role. By increasing the rate of pension contributions from public servants e.g. in the case of public servants after a middle range income threshold, this would ensure that those who can best afford to save for their own pensions will do so.***
- ***The Government should move quickly to complete and publish a detailed actuarial analysis of the pension liabilities for public sector employees.***
- ***The costing of public service pension liabilities must be done annually by each government department and agency and the separate departmental and composite annual funding costs should be published.***
- ***Public sector workers should be aware of the value of their pensions. Payslips should record the indicative value of pension contribution rates.***
- ***Raise the retirement for many categories of public servants currently enjoying an early retirement age.***
- ***Pension increases should be indexed to a capped maximum level (e.g. CPI)***
- ***Calculation of public service pensions on a career average basis. This will help to stem the cost of late promotions.***
- ***Ensuring that pension benefits are taken into account in any examination of public service remuneration in the future.***
- ***Adopt a fundamental repositioning of the public service pension for new entrants away from defined benefit provision to a defined contribution with a state guarantee of certain minimum investment returns.***
- ***There needs to be close monitoring of public service numbers and a commitment to a reduction in public service numbers from current levels which will assist in capping the state's future pension liabilities.***

Profile of Occupational Pensions

It is important to recognize that the pension's coverage rate of those in employment aged 30 to 65 has over recent years increased by 4% to 62%, a significant advance towards the 70% target set in the NPPI for this age cohort after 2013. The European Commission survey of pensions throughout Europe published in 2007 also describes the topology of Irish pension schemes. It notes that 35% of defined pension schemes were opened before 2005 and 26% of defined benefit schemes were closed after 2005 with 56% of DB Schemes survey respondents having closed to new entrants. There is undoubtedly structural change developing in Irish occupational pension schemes away from the traditional defined pension schemes and towards either the defined contribution or hybrid schemes. 19% of defined contribution schemes were opened to new entrants either in or after 2005 which demonstrates that continuing shift. Given that we are subject to a statutory vesting period of not more than two years, individuals gain the entitlement to a preserved pension benefit after just two years. This places potentially high administration costs on schemes and attracting high pension charges where there is a highly mobile workforce.

The Commission survey also indicates that Irish employers are less likely than other countries surveyed to change their pension's policy within the next three years. On average about 22% of European companies were planning pension policy changes in the next three years whereas only about 9% of Irish organisations were doing so. This indicates a level of stability in Irish occupational pensions that is a lot higher than the European norm. For the most part, however, the geographic scope of our pension policy is Ireland based with a smaller proportion based either at European or global level. That coupled with our currently more favourable demographics may explain the difference in the stability level. ***Either way it indicates a robust Irish occupational pensions system that does not need radical change***.

Ireland has a highly mobile and flexible workforce and is above the European ratings in relation to both. Any reforms of occupational pension provision must take account of and adapt to this pro competitive labour force profile.

Ireland is a relatively small country with a large number of small pension schemes. This means that complexity must be minimised as such schemes attract relatively high pension charges, which increase proportionately depending on their complexities.

We also have a high number of atypical and part-time employees many of who are women. Part-time workers form a large proportion of the lower paid segment of the workforce, a cohort of the working population that is already poorly covered by supplementary private pensions.

It is likely that people's expectations of these schemes are probably greater than what the schemes themselves can yield given the relatively low rates of contribution. Quite often charges will be disproportionately higher for smaller schemes and the need for close supervision by the regulator will be important. This inevitably is an extra cost to the State despite the fact that there is no direct state contribution to these private sector schemes.

The Pensions Board introduced PRSAs some years ago to meet this particular market segment and the take-up has been somewhat slow and un-dynamic. The PRSA is over-regulated and when one also considers that charges are capped along with the relatively small amounts being put into PRSAs they are neither a lucrative marketing opportunity for financial outlets nor are they likely to be adequate to provide a decent top-up pension for the lower paid in particular. There is, therefore, a need to capture that market segment and ensure that decent retirement income is available to it. Given the difficulties in private sector provision, and the costs associated with it, it is IBEC's position that the state pension should be increased to provide income retirement to the lower paid without requiring disposable income at that level to be captured by pension savings.

Currently the state pension covers 34% of the average industrial wage. The Pensions Board have recommended that that would increase to 40% of the gross average industrial wage and IBEC would be broadly supportive of such a proposal pending a revision of the basis on which retirement income adequacy is assessed and provided the cost is absorbed within the current system

It is also noted that the continuing credit crunch diminishes to some degree the credibility of some financial products, not least of all pensions' products. To what extent the state can provide an investment option for savers that would provide them with a guaranteed pension is something IBEC would like to see further explored.

We believe the state has both the opportunity and the expertise to develop a state investment fund into which individuals could invest for a guaranteed or enhanced state pension.

DB versus DC Schemes

There are some inherent issues in DB schemes that make them unsuitable for long retirements, as is increasingly becoming the case with increased longevity. Longevity risk is increasingly difficult to forecast and as it increases so too do the costs to providing for it. For instance, in 1980 the average male life expectancy at age 65 was estimated at being 12 years and so defined benefit schemes planned for that length of retirement. By 2006 it had risen to 20 years and continues to do so.

The difficulty in estimating future needs in retirement and then trying to fund to those additional needs, weighs heavily on many DB sponsors. If the estimates of longevity are wrong, there could be significant future cost implications for sponsoring companies. Where sponsoring companies are also subject to 'FRS17' they must disclose the deficit in their company accounts. This is an uncertainty that many companies are unwilling to take on into the future. The UK estimates that if mortality assumptions are off by just one year, the average cost increase to a scheme is 3% and that this rises to 13% if the scheme's mortality assumptions are off by five years. This is a considerable risk and one that most defined benefits' sponsors are reluctant to carry.

Most employers have been concerned in recent years at the level of investment returns that schemes have been earning which shows no signs of abating. This too will lead employer sponsors to reconsider continued defined benefit provision. A CBI Mercer study in 2006 showed that three-quarters of firms of DB schemes reported that rising pension costs had significantly reduced company profits. This was mirrored in a similar IBEC survey in 2007, although the proportion of companies here reporting a significant reduction in company profits as a result of pension losses was less, given the robustness of the Irish economy over preceding years and the performance of Irish equities. We are increasingly likely to see employers report reduced profits due to pension costs as the economy loses elasticity. The biggest potential threat to defined benefit schemes remains the insolvency of the sponsoring employer.

One other factor in the demise of the DB schemes is its relative inflexibility in the event of a merger or take-over occurring. Any deficit in the pension scheme will be a liability that may tell against the company in its efforts to merge or sell on. From data produced by Mercer we know that another solution that DB schemes have used to survive is to modify benefits: 22% of the schemes have done so in the last two years alone.

Contributions into defined benefit schemes have been increasing but disproportionately between employers and employees with employers carrying the lions share. Between 2000 and 2005, average Irish employer contributions to defined benefit schemes doubled while there was a relatively marginal increase in contributions by employees.

This imbalance has been a major factor behind the growth in Irish employer interests in hybrid arrangements, albeit this has been most prominent in the financial services sector. In this way, employers are seeking to reduce the deficit in the scheme while capping liabilities into the future and capping its own exposure to those liabilities. This usually involves some element of risk sharing by a part-conversion of the scheme to defined contribution. The risk of the employer having to make good any future deficits is thereby minimized.

Funding Standard

IBEC is very concerned about the cost, employment and competitiveness implications of pension's reform. Employer contributions have risen significantly in many companies in recent years to the extent that pension costs in the case of defined benefit schemes are often seen as a 'bottomless pit'. Frequently this is due to our strict discontinuance funding standard, which imposes an overly restrictive solvency requirement on companies providing defined benefit schemes. As many as a third of DB pension schemes did not meet the funding standard in 2007. This is continuing and will undoubtedly increase further with the recent falls in asset values. In the light of recent market falls and continuing cost pressures, the continued viability of many DB schemes will be problematic for many employers. The funding standard for defined benefit schemes demands a high solvency standard and should be revisited to enable schemes to survive without unduly requiring additional scheme funding.

The DB funding standard has been problematic in recent years largely because of a confluence of factors including equity market falls, tied to a low interest rate environment and the fact that the standard itself was based on a hypothetical moment in time winding up scenario. While IBEC accepts the need for ensuring the viability of schemes and flagging difficulties in them at as early a stage as is possible to rectify, the funding standard has in many instances operated against continued occupational pension provision rather than support it.

IBEC believes that a solution needs to be found given in particular the current economic difficulties, the cost of annuity purchase, and the ageing profile of defined benefit schemes particularly those now closed to new entrants. If companies have to again revisit their pension costs because of the funding standard forcing them yet again top up the scheme, then this will lead to a further decline in defined benefit occupational provision.

We believe there are alternatives. The key issue is the protection of the fund and ensuring that there is enough available to retirees as they retire. This suggests that the scheme solvency requirement should be one of an 'on-going' nature rather than being judged against a moment in time wind-up standard. However, we acknowledge that there could be cost and administrative burdens associated with moving the standard to an on-going standard and requiring both the regulator and the employer to ascertain and support the credit-worthiness of the scheme. This will require a forensic assessment of the scheme and may attract additional actuarial costs, which, all things being equal need to be avoided.

We propose the following alternative. Where a company scheme has a difficulty meeting the actuarial funding requirement and where the sponsor employer is prepared to offer to sustain the scheme in the event that a short-fall occurs, then that employer covenant should be accepted by the Regulator without the need for further immediate funding. This would require the company to verify the credit-worthiness of such a covenant and invariably would mean that solvent employers would be able to continue their defined benefit scheme without on occasion meeting the actuarial funding standard. The employer covenant would then rank in priority with other employment costs in the event that the employer did wind up.

Where a scheme sponsor, however, is in a less certain state of solvency, then there will be a continued danger, given the current wind-up standard, that the defined benefit scheme's survival may be compromised. In such circumstances the employer would be unlikely to be able to offer such a covenant but also we believe may be likely to close the scheme entirely or reduce the benefits in order to keep the business afloat. In such circumstances, while we would encourage the Regulator to work with the company. We believe the employer should be in a position to explore other pensions' options with his or her staff. Ultimately, if the cost of defined benefits proves costly for employers, then those schemes may no longer be appropriate and jeopardise the viability of the business. IBEC is aware that many employers have found that the increased pension costs in recent years, associated with DB schemes to be unsustainable in the long term. Given that we are now in more difficult economic circumstances, employers will continue to examine the balance of pension costs. We believe that continuing the current wind-up standard will only hasten the flight from DB provision.

In summary we propose that where a company scheme has a difficulty meeting the actuarial funding requirement and where the sponsor employer is prepared to offer to sustain the scheme in the event that a short-fall occurs, then that employer covenant should be accepted by the Regulator without the need for further immediate funding

Pensions Security

IBEC does not believe a pension protection fund, such as has existed in the UK and the US, is appropriate. Ireland is a small country, such a protection fund could be costly and difficult to administer, and the costs could fall disproportionately on well-managed schemes that would then effectively be vehicle for propping up ailing and in many cases badly managed schemes. Ultimately the best guarantee is a well-regulated system and pensions industry.

We believe before any further consideration is given to this issue that there should be a full cost benefit analysis done of any such proposal.

The Role of the State

In examining how best to develop pensions policy to meet the challenges of the next fifty years it is vital to get the basics right. This involves defining the roles of the various stakeholders clearly and building an approach that adapts to and builds upon those roles. The role of the State is central but how far should that role extend?

It is clear that the State's role as pension provider in order to keep the aged out of poverty trap is a clear and unequivocal one. However, in an increasingly individualistic world the responsibly of the individual also comes sharply into focus. With better living standards, better quality of education, better earning power and better awareness of rights and responsibilities the State is less willing to shoulder the increasing cost burden. The former paternalistic role of the State therefore has ebbed away somewhat in favour of individual responsibility. However, the demands on the State to provide the necessary regulation and support for pension structures remain.

A central role of the State must be to help overcome the information deficiency around pensions and provide a credible system to foster commitment. As individual citizens we must take responsibility for providing for our own retirement. Yet the lack of understanding amongst the general public about the true cost of providing for their retirement remains staggering, notwithstanding the excellent work of the Pensions Board to promote awareness from modest resources.

IBEC believe that this definition of the State's role and desired input to pension's savings would help provide for a more stable pensions policy and would help to delineate responsibilities more clearly.

State Pension Investment Fund

The issue of whether the State should provide a State backed investment fund into which individuals can invest their pension savings in the secure knowledge that the State will mind, nurture and grow those funds has been debated for some time. Providing such a fund would undoubtedly incentivise pension savings. The National Treasury Management Agency could be called upon to manage and develop the fund and to target low to middle-income earners who currently have poor pension planning and provision. By the State putting such a fund in place, it would reduce the charges implicit in the multitude of smaller schemes, which populate the Irish pension industry. Charges within small schemes can be disproportionately high to the level of investment and so denude the value of those investments. By putting in place an effectively large umbrella fund owned, managed and run by the State many of those difficulties would be alleviated.

IBEC sees merit in examining such a proposal and weighing the cost and benefits for that specific cohort of relatively small savers who fall between the basic poverty proofing State pension and the capacity to save a decent supplementary pension. We believe this potentially would be a better alternative to mandatory pension savings.

Auto Enrolment

The key to incentivising and improving pension's provision on the part of employers must be based on an equal choice for employers and employees to opt out of pension or supplementary pension provision should they so wish. Forcing companies into compulsory pension contributions would be a retrograde step and would penalise the labour intensive sectors in particular and could also impact negatively on our foreign direct investment as that would then be a fixed cost which any company investing in Ireland would have to meet as part of its overall pay and conditions package. Given escalating pension costs, this may in many instances be the difference between locating in this country and elsewhere. We cannot afford that level of inflexibility at a time of economic uncertainty.

Savings behaviour is ultimately about behavioural responses. The notion that auto enrolment would provide certainty is to wishfully ignore the dynamics of a competitive and internationally trading economy. Many people already provide for their retirement through means other than that of pensions savings. Faced with uncertainty but with time still on our side, now is the time to learn the lessons over the coming years of pension experiments in other countries and the lessons provided by the success of the SSIAs .

Firstly we would endorse the main thrust of the National Pension Review Group's recommendations on the need for individuals to be incentivised to direct savings towards their own pension provision through the use of a supplementary pension to complement the universal state pension.

The incentives to save for the future are especially inviting in the Irish context both because of the success of the SSIA model, and the soundness of our current pension system. It is not a time for radical reform to a system that is well regarded both nationally and internationally.

We already have a high savings rate nationally and we should be building on that rather than moving prematurely into compulsory savings territory. Our national savings rate is well above the European average at 11.8% of GNP and as a nation we've shown our willingness to save where incentives are marketed simply and clearly as in the case of SSIAs. It is a pity to miss the window of opportunity now afforded us to capitalise on that savings habit. While accepting that budgetary changes have delivered some incentives in this area over recent years they are quite limited and should be expanded upon for maximum take-up.

Secondly, IBEC considers that greater encouragement is needed for the development of sectoral umbrella schemes. These would have a far greater impact on both the quality and level of pension take up rather than forcing employers into contributions, which will encourage a trend towards minimum provision.

Thirdly, auto enrolment is a new and uncertain system and is largely untested. Auto-enrolment began in New Zealand with the Kiwi Saver on 1st July 2007. The UK auto-enrolment scheme will build up gradually over the three-year period to 2012 with employers being obliged to contribute 1% per year rising to 3% by 2012. Employees will contribute further with the State contributing 1%.

IBEC believes the system in both the UK and New Zealand needs to be monitored and evaluated over the next few years as part of a continuous assessment of policy options. We cannot support such a radical and untested change to our current system when further options to maximise take up under the current voluntary system have not been fully exploited. The implications for the economy could be substantial.

Furthermore, such a system would require radical reforms of the current pension system in order to accommodate it. Regulation of pensions would, of necessity change and would inevitably become more cumbersome and costly. These charges invariably are passed to the consumer and given that the level of small pension's schemes is already high in Ireland, the relative value of the investments in those funds in the context of the charges taken from them maybe disproportionate and unjustified.

Other fundamental issues need to be considered in evaluating the option of auto enrolment over the medium and longer term to inform future debate. These include:

- the impact of auto enrolment on pension savings in the Irish economy given that savings generally are high here.
- the impact on existing occupational pensions schemes and the risk that it could encourage a race to minimum provision.
- the potential level of non-compliance and implications for enforcement.
- the implications for the National Pensions Reserve Fund
- the implications for public service pensions
- the operation of such a scheme without employers being obliged to contribute
- if employer contributions were to be encouraged how this could be done - through tax incentivisation rather than compulsion?
- would there be equal rights for both the employer and the employee to opt out voluntarily?
- the implications for those changing employment and for those seeking access to funds?

- how could such a system guarantee that employee contribution levels would not artificially inflate wages nor depress individual disposable income or take home pay?

Forecasts prepared in the UK on auto enrolment show that about 15% of private sector employers may be offered schemes that are more generous than the minimum auto enrolment contribution, which employers will be required to pay there. The remaining 85% of private sector employers either did not contribute to a pension scheme or contributed three per cent or less to those schemes. The Irish picture is much healthier with approximately 50% of private sector employers contributing to pension schemes with most of those contributing at least three per cent. ***The need therefore for auto enrolment in this jurisdiction is less severe than it is in the UK and the case for it is more robust there than it is here***.

Fourthly, whatever the outcome of the DB/DC comparison there is little doubt DC schemes will continue to increase both in number and in membership while DB schemes will continue to decline. Pension regulation will need to take greater account of the growing proportion of DC schemes. This shift in emphasis may entail a greater regulatory oversight of investment choices than is currently the case, so as to protect the initial investment and the individual from fraud or miselling. This will increase costs for sponsors of occupational schemes and will impose greater costs on the State in seeking to regulate and protect such schemes. It is important that such regulation is credible and robust enough to support any future policy decisions.

IBEC is not in favour of mandatory employer contributions and is against the idea of auto enrolment for the following reasons:

1. ***Auto enrolment forces people to save where they may already prefer to provide for their pensions through alternative means.***
2. ***It absolves the State largely of the responsibility of funding pensions for the population cohort on the edge of the lower income to middle-income groups.***

3. ***By forcing people in lower income brackets to save for a pension it reduces their potential to provide mortgage repayments and reduces their choice in how they use their disposable income.***
4. ***Forcing employees to provide for their own pensions indirectly raises the cost of labour as the demand for wage compensation to subsume the pension savings will invariably follow.***
5. ***Any further cost pressure costs on employers in the current and foreseeable economic environment would only serve to undermine competitiveness.***

Summary and Conclusion

Overall, IBEC is against radical change to the current system without clear and compelling reasons for so doing. Investing in the current voluntary supplementary system using the legacy of the historically strong economic performance of the last decade and high savings levels would be a "no regrets" policy option. The State may be paternalistic with regard to pensions, but ultimately it must do so as a libertarian. Freedom to choose applies to both employees and employers. Compulsion should be the last resort and is always a second best option which brings with it the problem of unintended consequences.

The idea of auto enrolment would not be universally popular and may not find cross party support. What the popular reaction to auto enrolment and compulsory pension's savings might be is also open to question. With employees struggling with higher mortgage and childcare costs the willingness of people to accept compulsory pension savings, even with an opt-out, is questionable. This could well result in such a system being short lived, thus causing serious potential damage to pension provision in the long term. There is also the very real risk of serious damage to the existing reputable system of voluntary pension provision, which is underpinned by the first pillar mandatory State system. This could undermine the future of Irish pension provision very significantly.

We believe that a fundamental review is needed in advance of any reform of how to set an appropriate State target for retirement income provision, taking account of what level of wealth exists in the country, recognising that many people already provide for their retirement through means other than that of pensions savings and assessing what effect that should have on pension provision. We also recommend that reform be carried out against a set of pension principles and with the assistance of an independent review body charged with monitoring and reviewing pension's policy as it evolves.

We believe however that a number of other reforms are worthwhile and need to be initiated. IBEC recognises that individuals need to be incentivised to direct savings towards their own pension provision with a supplementary pension to complement the universal state pension. Savings for pensions should be made easier but they should not be compelled.

In motivating further private pensions savings, we may need stronger governance mechanisms and a greater degree of oversight of investment management. Good governance is linked to strong performance and indeed the Clarke and Erwin study 2007 of large pension funds concluded that superior performance is linked to strong governance.

The incentives to save for the future are especially inviting in the Irish context because of our savings record and the soundness of our current pension system. These include improving the State pension, giving tax relief to all at 41%, further incentivisation of supplementary pension provision, reform of the defined benefit funding standard, improving education and awareness of the need for a pension, and reducing the States public service pension bill through radical reform.

IBEC advocates incremental improvements to the existing supplementary pensions system rather than dismantling it in favour of other more radical and largely untested reforms.

Appendix

IBEC SUBMISSION TO THE NATIONAL PENSIONS REVIEW

INTRODUCTION

Pension provision is worryingly costly for employers at present. Nevertheless pension provision remains inadequate in this country and unless tackled promptly the situation will get worse. The State pension is low at 32% of average industrial earnings. Similarly, occupational pension provision is patchy and low and has become increasingly costly. Meanwhile defined benefit schemes are proving unsustainable for the majority of employers All this is happening at a time when our population is ageing and our workforce to pensioners ratio rising.

This means that we have a window of opportunity for pension reform. IBEC believes the already heavy reliance on occupational pensions in this country needs to be rebalanced so that occupational entitlements act as a top up to a decent State pension and not as a replacement to it. However, individual responsibility for retirement planning is paramount and ultimately pensions reform will only succeed where individual choice is exercised in favour of postponing disposable income to pension saving. IBEC believes pension reform must be based on incentivising pension's savings through choice rather than obligation.

ISSUES

There are a number of problems to be considered in looking at how best to improve pension provision in this country. These are:

1. The level of state expenditure on pensions
2. The disproportionate reliance on the private sector for pension provision

3. The huge cost to the private sector of providing pensions and in particular to continuing defined benefit schemes
4. The inconsistency in tax relief rates granted for pension purposes across income tax brackets
5. The mounting cost to the State of its own occupational pensions and the lack of valuation of the ongoing cost of provision by individual government departments and agencies
6. The growing disparity of pension provision and benefit becoming apparent between the private and public sectors. We estimate the cost of public sector pension provision and benefit as being well in excess of an additional wage cost of 40%+ of pensionable salary
7. How long the private sector can continue to sustain the current cost and standard of public sector pensions, particularly at a time when private sector pensions are in themselves proving very expensive and subject to stringent and excessive regulatory requirements
8. The choices being made by individuals in respect of their expenditure priorities and the failure to prioritise pension savings
9. The mismatch between the expectations of individuals for decent pensions and the savings choices made by them
10. The lack of awareness of the value of pensions and in particular the lack of awareness of the value of occupationally provided pensions, both in the private and public sectors

Employee contributions to occupational pension schemes in the private and public sectors is also an issue to be grappled with as employers come under increasing cost pressure. We are already seeing a significant drift away from defined benefit schemes towards defined contribution schemes. This effectively contains the cost for employers against otherwise escalating and uncertain defined benefit costs.

Whether or not the retirement age needs to be raised is an important issue, which has far reaching consequences. There are important issues for the individual, the employer, the

State and the economy in any such debate. No decision should be made simply within the narrow context of the mounting pension crisis.

FUNDAMENTALS

The National Pension Review incorporates, as a fundamental building block, a review of key targets and progress towards these targets to date. There were a number of key targets set out in the original NPPI Report in 1998 and those targets were decided on the basis of particular assumptions information available to the Board at that time.

The targets include:

1. A replacement income target of 50% in retirement
2. 70% coverage for employees over the age of 30
3. Social welfare provision to be set at 34% of average industrial earnings

The targets in the 1993 Report were set using the information available on:

- average industrial earnings
- average household income
- poverty in retirement
- gross income after retirement
- net replacement rates of income

The NPPI Report is vague on the analysis used to support the targets set and so it is difficult to establish how well the targets have been met in 2005. However, there are a number of fundamental factors that must be taken into account in attempting to draw an accurate assessment of progress to date. These include:

1. Average incomes have risen considerably since 1998
2. Average industrial earnings have risen by approximately 35% in the years 2000-2004 in real terms

3. Disparity between social welfare payments and income levels has widened considerably despite social welfare improvements.
4. Replacement income rates in 2004 are considerably higher relative to replacement income rates looked at in 1998. Therefore transposing the 1998 targets to 2005 is problematic

As incomes have risen considerably since 1998 in real terms, so too has the amount of money put aside by occupational pension schemes to meet their promises. This has contributed in large part to the huge cost increases that employers have faced in recent years on pension provision and must be factored into any consideration of the continued appropriateness of the targets set by the NPPI in 1998.

LEVEL OF STATE PENSION PROVISION

A fundamental reassessment of the State's own obligations needs to be undertaken before looking at what contribution second pillar pensions are required to yield. The Irish State spend on pensions is the lowest in Europe and pensioner poverty in Ireland is the highest in Europe. The Irish spend is at just under 5% of GDP whereas the average in Europe is almost three times that. Ireland relies more heavily on occupational pension provision as a proportion of overall pension provision than do any of our European counterparts. It is both unfair and inappropriate to expect second pillar pensions to compensate for inadequacies in State provision.

The replacement rate of income in retirement provides a means of establishing what a person earned prior to retirement and what they should expect to have as pension income post retirement. In Luxembourg the replacement rate per worker actually exceeds 100% while in most other European countries the replacement rate is generally between 50% and 70%. Ireland has the lowest replacement rate at average earnings in not just Europe but in the OECD, at less than 30%. Workers on average earnings in OECD countries can generally expect their post tax pension to be worth just under 70% of earnings.

The OECD states on Ireland: "Not surprisingly Ireland – which has only basic and targeted pensions and no earnings related scheme – has the lowest replacement rate at average earnings… The lowest pension wealth for someone on average earnings is found in Ireland, Mexico, and New Zealand, the UK and the US, where it is less than six times average earnings".

State pension provision is aimed at ensuring pensioners have adequate income in retirement and guaranteeing a basic living standard for pensioners as a protection against destitution and old age. In order to meet this objective, the NPPI (National Pensions Policy Initiative) recommended that the State should aim to provide 50% of average industrial earnings as retirement benefit. As an interim target, the report recommended that 34% should be achievable within a 5-10 year period. So far, almost 32% has been achieved. However with rising income disparity between those still in the workforce, the 34% earnings objective may not be good enough. IBEC believes it is not enough for the State to simply fund on the basis of guarding against poverty. A more robust system of State pension is necessary.

The State has traditionally relied heavily on occupational pension provision to paper the cracks in its basic provision. This has led to the private sector in particular carrying a disproportionate burden. It has to provide pensions for workers, fund pensions for State employees and also fund social welfare pensions. An ESRI report of 1996 showed that public sector workers recorded the highest coverage rates at 83% of final salary compared with 38% in the private sector. These figures have remained relatively constant and serve to illustrate the inequity in a system in which the public sector turns to the private sector to fund pensions for its employees, while the private sector is struggling to provide for its own.

COST OF OCCUPATIONAL PENSION PROVISION

The cost of pension provision is increasing for employers, particularly those offering a defined benefit pension. The average cost of providing a benefit of two thirds of salary has risen steeply in recent years as schemes grapple with increasing regulatory demands against a background of poor market returns and low interest rates.

We estimate that for many employers, the current average cost of funding a defined benefit scheme is between 20-30% of salary, most of which is borne by the employer. We believe that about 75% of employees contribute 5% or less to defined benefit schemes and that typically employers normally fund the remainder.

Employer contributions have increased significantly in recent years. While some have also increased employee contributions, the burden for meeting the funding shortfall has fallen largely on employers. This represents a large addition to labour costs which have already risen significantly. This will inevitably affect the ability of those employers to increase wages over the next several years. It also has implications for national wage negotiations and the ability of employers to fund wage increases for employees with defined benefit pensions in particular. This inevitably makes pensions funding a competitiveness issue for many Irish companies. It also exacerbates the cost gap between companies that have defined benefit schemes and those with defined contribution schemes, making the latter increasingly more attractive.

This cost of pension provision is significantly changing the options for employers. In particular it is causing many to close their defined benefit schemes to new entrants. IBEC’s 2003 Pay and Conditions of Employment survey indicated that 43% of respondents had defined benefit schemes. In a similar survey carried out in 2004 only 37.5% had defined benefit schemes. Companies having defined contribution schemes increased from 45% in 2003 to 52% in 2004. This change is due to the increased costs of funding defined benefit schemes, and the trend is likely to continue given the on going funding difficulties.

DB FUNDING STANDARD PROBLEMS

The biggest problem with defined benefit schemes at present is meeting the actuarial funding certification requirements of the Pension Board. The funding standard is on a discontinuance basis. Therefore the pension scheme must fund to a standard which enables it to meet all its liabilities if it were to wind up. This means assessing the value of the scheme on the basis that its liabilities are bought out by annuity purchase. Annuity costs have risen about 40% in the last 5 years. This effectively means that schemes are funded to a requirement which is higher than their needs on an ongoing basis. This, happening at a time when pension costs are already seriously inflated, means the current funding standard is seen as both artificial and impractical by the majority of employer sponsors.

According to a recent Mercer survey, 46% of DB schemes are failing the funding standard at present. Given that only about one third of schemes are required to produce an Actuarial Funding Certificate each year, that figure is likely to increase as certification comes up for renewal. For those schemes unable to meet the funding standard, a funding proposal to correct the situation is required by the Pensions Board. While 39% of the respondents to the Mercer survey stated that they were committed to keeping the defined benefit schemes, nevertheless the remaining 61% were either reviewing or intending to review or had made changes to their schemes. Of those that had made changes in the last three years, 59% of them had closed the schemes to new members, opting instead for DC provision for new hires. This invariably shows a trend away from defined benefit schemes.

While market difficulties and increased liabilities have been partly to blame for this, we believe the stimulus for either closing schemes or reviewing the DB provision has been the difficulty meeting the funding standard requirement. We also believe there is little likelihood of employers re-opening defined benefit schemes for new employees in the future and that gradually over time we will see fewer and fewer defined benefit schemes available.

In order to prevent further slippage we believe the funding standard now needs immediate and radical overhaul. The situation has worsened since the Pensions Board conducted its review last year and we now believe that unless the standard is reduced further, or indeed abandoned in favour of a lesser requirement, then there will be further contraction of defined benefit schemes.

We suggest:

(a) revisiting the priority order

(b) replacing the current discontinuance standard with the on going funding requirement as certified by the scheme actuary, or

(c) taking account of any guarantees or promises which an employer is willing to make in respect of future financing of indexed increases in the pensions. We would propose that this would form part of the funding standard and that therefore if a company has a strong asset base and is prepared to accept a debt on that for indexed increases, then their funding standard requirement should not include indexation. This would have the effect of diluting the funding standard for companies while protecting the value of any increases promised in pensions.

(d) reducing the extent to which the funding standard needs to be complied with from the current 100% to 80/90%

(e) creation of a State backed annuity fund for schemes that are forced into insolvency

Sample Cases to Examine Funding Issues

	Average Scheme	Mature Scheme
Ongoing Basis		
1. Funding level		
Assets	€ 99.0 m	€ 199.0 m
Accrued liabilities:		
Pensioners	€ 34.8 m	€ 139.4 m
Active members	€ 69.6 m	€ 69.6 m
Total	€ 104.4 m	€ 209.0 m
Surplus/(deficit)	-€ 5.4 m	-€ 10.0 m
Funding level	95%	95%
2. Recommended contribution rates		
Normal rate	17.2%	17.2%
Adjustment to fund deficiency	1.3%	2.5%
Total	18.5%	19.7%
Less members' rate	-5.0%	-5.0%
Balance of cost for employer	13.5%	14.7%

Key Assumptions	
Investment return	6.50%
Salary growth	4.50%
Pension cost	Long-term cost of paying pension from fund, assuming yield of 5.5%, pension increases of 2.5% and current mortality (lighter for future retirees)

	Average Scheme	Mature Scheme
Discontinuance Basis		
1. Funding level		
Assets	€ 99.0 m	€ 199.0 m
Accrued liabilities:		
Pensioners	€ 49.3 m	€ 197.3 m
Active members	€ 56.0 m	€ 56.0 m
Wind-up expenses	€ 2.1 m	€ 5.1 m
Total	€ 107.4 m	€ 258.4 m

			Key Assumptions
Surplus/(deficit)	-€ 8.4 m	-€ 59.4 m	1. During period of funding proposal
			Investment return 6.50%
Funding level	92%	77%	Salary growth 4.50%
			Pension increases 2.50%
			2. Benefits after 10 years:
2. Recommended contribution rates			- Annuities for pensioners
To restore solvency over 10 years	21.2%	29.4%	- Transfer values for others
Less members' rate	-5.0%	-5.0%	
Balance of cost for employer	16.2%	24.4%	

Notes

Average scheme has liability ratio of pensioners to active members of 2:1 (ongoing basis)

Mature scheme has liability ratio of pensioners to active members of 1:2 (ongoing basis)

Funding level for both schemes taken as 95% (ongoing basis)

Typical benefit structure used: n/60ths of final pensionable salary (integrated), a surviving spouse's pension of 50% and indexation

Death benefits and scheme operational expenses have been ignored

Scheme scale is based on 1000 active members. Similar results would emerge from smaller schemes with similar profiles.

Option 1: Discontinuance Basis - not required to guarantee pension increases on wind-up

1. Funding level			
Assets	€ 99.0 m	€ 199.0 m	
Accrued liabilities:			
Pensioners	€ 36.6 m	€ 146.5 m	
Active members	€ 44.2 m	€ 44.2 m	
Wind-up expenses	€ 1.6 m	€ 3.8 m	
Total	€ 82.4 m	€ 194.5 m	
			Key Assumptions
Surplus/(deficit)	€ 16.6 m	€ 4.5 m	1. During period of funding proposal

			Investment return 6.50%
Funding level	120%	102%	Salary growth 4.50%
			Pension increases 2.50%
			2. Benefits after 10 years:
2. Recommended contribution rates			- Annuities for pensioners (no pen incrs)
To restore solvency over 10 years	8.4%	10.7%	- Transfer values for others (no pen incrs)
Less members' rate	-5.0%	-5.0%	
Balance of cost for employer	3.4%	5.7%	

Notes

Relaxation of solvency test does not help schemes that provide nil pension increases

Option 2: Discontinuance Basis - guarantee of 90% of pension up to €50,000 p.a. on wind-up

1. Funding level			
Assets	€ 99.0 m	€ 199.0 m	
Accrued liabilities:			
Pensioners	€ 44.4 m	€ 177.6 m	
Active members	€ 50.4 m	€ 50.4 m	
Wind-up expenses	€ 1.9 m	€ 4.5 m	
Total	€ 96.7 m	€ 232.5 m	
			Key Assumptions
Surplus/(deficit)	€ 2.3 m	-€ 33.5 m	1. During period of funding proposal
			Investment return 6.50%
Funding level	102%	86%	Salary growth 4.50%
			Pension increases 2.50%
			2. Benefits after 10 or 3 years:
2. Recommended contribution rates			- Annuities for pensioners (90% of benefit)
To restore solvency over 10 years	15.3%	20.6%	- Transfer values for others (90% of benefit)
Less members' rate	-5.0%	-5.0%	

Balance of cost for employer	10.3%	15.6%
To restore solvency over 3 years	9.2%	48.7%
Less members' rate	-5.0%	-5.0%
Balance of cost for employer	4.2%	43.7%

COST OF PUBLIC SERVICE PENSIONS

Approximately half of all pensions are provided to civil servants and virtually all civil servants are in an occupational pension scheme. Most of these are defined benefit schemes. In the private sector, approximately half of the occupational schemes are defined benefit schemes. Also, in the public service pension there is the guarantee of indexation. This is only available in about a third of private sector defined benefit schemes. Allied to that, the disparity between pensions in the public and private sectors is exacerbated by the fact that public sector pensioners enjoy indexation increases linked to existing salaries rather than CPI, as is the norm in the private sector. This means that the value and cost of the public sector pension is increasing at a time when private sector employers have to cut back on their pension promises.

The Commission on Public Service Pensions reported in 1997. The pension cost for the then approximately 218,000 public servants was £608m. This broke down into pensions in payment of just under £500m and lump sums of £109m. Contributions to the scheme were estimated at £178m in 1996 leaving a net cost to the State of £430m.

Around this time we understand that public service pension entitlements were valued at approximately 35% of salary for each employee. The Commission had an actuarial review carried out on the cost of the scheme which reckoned that expenditure would increase to £1.4b per annum in 2025. It should be remembered that this actuarial valuation was done prior to benchmarking and was based on pay increases arising from increments, promotions and allowances based on normal career progression.

An assumption was made at that time that public service pay increased at the rate of 1.5% per annum above the rate of inflation. Also assumed was that public service numbers would remain constant. Neither of these assumptions nor other assumptions proved correct and were lower than subsequent reality.

The assumptions made then were:

a) Public service pay would rise by an average of 1.5% above inflation
b) Public service employment numbers would remain constant
c) Inflation would be an average of 2.7% per annum

In fact:

a) The public service pay bill rose by an average of 11.58% pa between 2000-2005 – Even allowing for increased employment, the increase is still well ahead of predictions
b) Public service employment numbers rose by 22% over that period
c) Inflation was an average of 4% per year

The Commission did say, “the size of the pension bill in the year 2025 will, of course, depend on the rate of pay increase between now and then. Given the length of the period involved, the terminal figure is highly sensitive to the assumed rate of increase in general pay levels. If, as approximates to the case between 1987 and 1995, average pay levels would rise by 5.2% annually and prices by 2.7% annually, the pensions bill in 2025 would rise to £2.9b in constant prices. This is an increase of almost one-third on the estimate of £2.2b based on the assumption of a more normal growth in public service pay of 1.5% per annum in excess of the rate of inflation.”

It is now clear that our public service pension bill is running well in excess of forecast. It remains largely a pay as you go system and as such pre-funding requirements are not in place that would clearly indicate the provision cost to the State. IBEC believes it is imperative that such costings are done annually by each government department and agency. Furthermore we believe that separate departmental and composite annual funding costs should be published. The State should publish its full projected pension provision cost and should evaluate how to reduce it. Given that this cost is passed to the private sector, any assessment of what the private sector should be asked to provide must take account of the public service and social welfare pension bill – as it is currently funded through taxes.

IBEC proposes that the State establish a Public Service Pensions Taskforce to examine the continued sustainability of those costs, and to recommend appropriate cost reduction mechanisms. This review should form part of an overall assessment of the role and financial commitment of the State in pension provision. It is vital that any review of occupation pension provision be set against this background rather than as is currently structured, i.e. without any examination of it. We fail to see how the current review of supplementary pensions can credibly recommend any action without also having looked at public service pension costs in particular.

In 2000 the cost to the State of its pay and pension bill was 9.8% of GNP – of which public service pensions accounted for 8.7%. By 2005 the cost to the Exchequer of its pay and pension bill was 11.3% of GDP, of which public service pensions accounted for 9.1%. The bill is rising and now needs a thorough review against future demands. Those demands arise particularly for better social welfare provision and enhanced incentivisation for better individual pension savings for those currently outside the occupational pensions net.

MANDATORY PROVISION – EXPERIENCE ELSEWHERE

IBEC is opposed to mandatory pension provision by employers and/or employees. At a time when employees have other expenditure priorities including high mortgages and childcare costs, forcing mandatory pension savings would be inappropriate. Pensions are a labour cost for employers and as such will inevitably be factored into wage negotiations regardless of how they are paid for. We also believe there is a credibility issue for private pension savings unless there is some form of State guarantee such as a State Pension Protection Fund, which we would not advocate, largely for cost reasons.

Occupational pension schemes in most countries are voluntary. There are mandatory pension systems in a number of countries, including Australia, Hong Kong and to some extent the Netherlands and Switzerland. Australia's mandatory Private Pensions System began in 1986 as a result of particular demographic problems which the country was then facing. By 2002 most employers were required to contribute 9% of employee income to a mandatory pension fund. Grafted on to this system were tax incentives for further voluntary contributions.

The mandatory pension arrangement was introduced by the Australians through a highly centralised system of wage bargaining known as the Award System, which included employers, unions and government. By that time Australians were heavily dependent on the state for a pension and the state was finding it increasingly difficult to provide benefit payments to its increasingly large ageing population. From 1994 – 2051 the number of Australians who are over 65 will climb from 12% to 23% of the total population.

We do not believe the Australian system to be a good example for Ireland to follow for a number of reasons:

1. Australians had a particular and problematic demographic problem which we do not have

2. Australian employers invariably pulled back on the provision of ‘better’ schemes and pitched their pension provision to the basic mandatory requirements, thus losing the more generous employer sponsored schemes
3. The system had an immediate and decided dampening impact on Australian savings – this would not be helpful here
4. This happened nearly twenty years ago to an economy better and more independently able to sustain itself than ours

TAX INCENTIVISING PENSIONS

> “Examination of membership of private pension schemes shows that tax incentives for pension saving result in high coverage rates for middle and high income taxpayers but poor coverage rates for low income taxpayers in both Ireland and the U.K. Evidence relating to the distribution of pension tax expenditure shows that the present tax treatment of private pensions is inequitable as about two-thirds of the benefits accrue to the top two income deciles in both countries and 3 per cent or less to the bottom two deciles”
>
> “There are two main reasons for the regressivity of tax expenditure on private Pensions… The first is that membership of occupational pension schemes increases strongly with income, …. The second is that the tax relief is given at the marginal rate of tax. Hence, the value of the tax relief as a percentage of income rises as income rises. The interaction of these two factors results in a steady increase in the absolute value of the tax relief on occupational pension contributions as the absolute value of income rises”.
>
> ***PRIVATE PENSIONS AND EQUITY IN IRELAND AND THE U.K.***
> ***Gerard Hughes, Economic and Social Research Institute 2002***

IBEC believes that tax incentivising pensions has been a major stimulus to supplementary pension take up here, as indeed has been the case in most OECD countries. Without it, neither employers, employees nor others with personal pension arrangements are likely to have made voluntary private pension provision for their retirement. They would otherwise have relied on the State for pension payments in retirement. As stated earlier we are a country that relies disproportionately heavily on occupational and personal pension provision for post retirement income and the State receives valuable tax revenues from such pensions, thus recouping some of its original tax relief expenditure. However, we do recognise disparities in the tax system which favour the better off and which need to be reviewed.

IBEC favours raising tax reliefs to the higher rate of tax. We propose that the Government should contribute €1 for every €5 saved to pensions by an individual employee paying tax at 20% marginal rate. For employees who are outside the tax net we propose that Government should sponsor their pension savings to the amount of €2 per €5 saved. These subventions should be subject to a limit of €500 per annum and subject to the claimant being over 30.

IBEC PROPOSALS

Specifically our proposals are:

- For the top rate taxpayers, tax relief at 42% would continue to be available on pension contributions

- For those in employment taxed at the standard rate, the government would contribute €1 for every €5 invested in a private pension plan or PRSA for a specific ten year period. The government subvention would be limited to €500 annually, allowing maximum supported pension investments of €3000 per annum

- For those in employment who are exempt from income tax (35% of all income earners) the government would contribute €2 for every €5 invested in a private pension scheme or PRSA. Again, the government subvention would be limited to €500 per employed person per year, supporting maximum pension investments of €1,750 annually

- The scheme would be restricted to those in employment, ages 30 and over

- Government subventions to qualifying pension investors would be guaranteed for ten years

- Qualifying pension contributions could be invested in existing pension products, PRSAs or other long-term savings instruments

- The proposed starting date for the scheme would be June 2007. It would thus be structured to foster the continuance of the regular savings habit pioneered so successfully by the SSIA initiative. A key characteristic of SSIA investors was their relatively low incomes, with 45% of investors earning less than €20,000 in 1999/2000 and a further 42% earning incomes of between €20,000 and €50,000 in 1999/2000.

Providing pension subsidies of €500 for one million workers in 2006 would cost an estimated €500 million. This proposal is focused on incentivising the lower paid to save for additional personal pensions. As such it is a targeted approach and will benefit only those who do not already have personal pensions. We believe an analysis of the cost benefit of the proposal will strongly support its implementation as a follow on to the SSIA savings model. The cost to the State of providing SSIAs was, according to Department of Finance figures as follows:

Tax Credits

The total tax credit payments made from commencement in June 2001 to 30 April 2005 on subscriptions to SSIAs are as shown in the table below. Also included are figures for the tax withheld in arriving at these payments in respect of amounts withdrawn or accounts closed:

Period	Tax Credit Payments made in period	Tax withheld in arriving at payments made
June – Dec 2001	€71m	€0.4m
Jan - Dec 2002	€433m	€4.6m
Jan - Dec 2003	€532m	€14.2m
Jan – Dec 2004	€548m	€16.1m
Jan – Apr 2005	€192m	€4.3m

It should be noted that the tax credit figures given above reflect the payments made from the Exchequer and are on a month-behind basis.

We believe this would act as a further attractive incentive to PRSA takeup as well as providing a more equitable pensions tax relief system.

PRSA's

We believe PRSAs are a good product and have the potential to significantly extend both pension choice and coverage. However there are problems with the extent to which they are regulated. We believe that if these issues were addressed together with the tax proposals we make in this submission, then there would be significantly improved potential for greater take up.

CONCLUSION

IBEC proposes that:

1. There is a need to tax incentivise those currently outside the occupational pensions net to establish their own personal pensions savings. This can be done either through conventional personal pensions or through PRSAs which the employer must make available.

2. We support the provision of tax credits for the lower paid at the higher rate of tax at 42%.

3. Revision of the actuarial funding standard to
   - i. Replace it by an ongoing standard with disclosure of the funding level in the event of wind-up but without the requirement to fund to that discontinuance standard, or
   - ii. Remove indexation funding as part of the funding standard and taking into account employer commitments instead
   - ii. Review priority benefits in the event of a wind-up with a view to giving the entitlements of active members priority over the indexed guarantees of pensioners in payment
   - iii. Reduce the funding standard to a percentage of the current full standard – we propose 80% as an appropriate standard which would be reviewed regularly.