GREEN PAPER ON PENSIONS – IIF RESPONSE

Chapter 6 - The Social Welfare Pension: Reform Options

- IIF members support the State pension as the best way of providing an income in retirement for those on low incomes. Our members are also of the view that a universal State pension (with a residency requirement) is the best way forward and would refer you to the work carried out by Life Strategies on our behalf in relation to this. (A copy of the Life Strategies research is attached at Annex 1.)

- IIF would also support Government having an explicit target in relation to the State pension which is agreed by all parties.

- IIF would however add the following caution. At current levels (i.e. the State pension tracking at approximately 34% of Average Industrial Wages (AIW)) the cost of the State pension alone will increase from 3% currently to10% of GNP by 2056. If, as has been suggested in the Green Paper, the State Pension should immediately increase to approximately 40-50% of AIW, the current cost of the State pension would increase to 3.5% (at 40% of AIW) or 4.4% (at 50% of AIW). Over the long-term the following costs to the State can be expected:

  40% = 3.5 –11.8% of GNP by 2056
  50% = 4.4-14.8% of GNP by 2056

  Source: Life Strategies

- A key issue is, as far as possible, to avoid means testing of the State pension. In the UK the discussion about supplementary pensions has been hampered by the fact that for many borderline low income individuals, any additional supplementary savings that they make could result in them losing out on State means-tested benefits. This makes it difficult for low income individuals to plan for their retirement and also makes the provision of advice to such individuals problematic.

- Given that people are living longer it would appear that there is little option but to raise the retirement age for State benefits for all workers, including public servants. We would refer you to the work carried out by Life Strategies which shows the cost savings in GNP terms of increasing the State pension age by one year each decade starting in 2015 (see Annex 1).

Chapter 7 – Supplementary Pensions – Incentives for Retirement Saving

- Tax reliefs are an important component of the current pensions system. They play a key role in influencing individuals to contribute to pensions arrangements and should be maintained. The current Irish system is broadly consistent with that applicable in most other EU countries. We do not consider that all the possibilities of tax incentives to encourage private pension provision have yet been realised. We would caution that any significant change to existing reliefs and incentives risks endangering the entire system.

- Changes to the current reliefs for higher rate tax payers may discourage them from making retirement provision whilst not necessarily having the effect of incentivising the less well-off. In our experience the tax incentives for middle and higher earners are an important reason why such individuals make supplementary pension provision.

- Those who have entered into pension arrangements (both individuals and employers) have generally done so on the basis of regular and ongoing contributions. A key element in setting the level of these contributions has been the tax treatment and the assumption that it will continue. We believe that it would be a very dangerous decision to prejudice in any way the sustainability of existing defined benefit or defined contribution private and public sector schemes.

- It is also important to remember that pensions represent *deferred* taxation. Although much emphasis is often placed on what are perceived as generous tax reliefs up front, the income arising from such investments is fully taxed under PAYE. Therefore tax reliefs and incentives at the contribution and investment stages are necessary to offset this.

- Emphasis is often placed on the position of high earners and the use they make of pension tax reliefs. However our members would suggest that in their experience most customers come from the middle earning group and benefit significantly from these reliefs.

- Tax incentives on their own may not be sufficient to persuade those who are not currently doing so to make provision for retirement. Tax incentives should be part of a range of measures which might include financial education and automatic enrolment.

- It would be difficult to develop tax incentives aimed specifically at individuals who are not currently making provision for retirement which can comfortably interact with the current arrangements (and we give at Appendix 1 an example of how tax changes can have unintended consequences). However we would suggest that initiatives such as SSIAs, run in parallel with the existing system of tax reliefs for pension products, can help increase awareness of the importance of savings generally.

- IIF would support the extension of the availability of approved retirement funds to all individuals reaching retirement although we note that this may present some practical difficulties for the public sector and defined benefit schemes in general. (We would also agree with the replacement of the current Approved Minimum Retirement Fund (AMRF) requirement with a requirement for a minimum level of *income*.) Whilst there may be some concerns about the possibility of funds being exhausted before an individual has died there will also be clear cases, e.g., persons in ill health, when approved retirement funds are definitely the better advice. It would also be helpful to explore the possibility of applying a fixed commutation factor so that individuals could choose to surrender part of their annuity for an approved retirement fund.

Chapter 8 – Possible Approaches to Pensions Development

- IIF supports a retirement philosophy based on a combination of State pension (with an agreed target level) and supplementary pension provision.

- We do not support the idea of mandatory pensions. The introduction of fully mandatory pensions would create more problems than it would solve. There would be a high degree of complexity involved and it would be very difficult if not impossible to design a regime which would be appropriate for all participants. In our opinion the better option is a reasonable basic State pension and voluntary provision on top of this.

- Why not mandatory? Because:

  - Enhancing the "Pillar 1" State pension, as recommended, would go a long way towards providing an adequate retirement income for low- to middle-income earners; this in turn reinforces the idea that any additional pension provision – while it should be promoted and incentivised by the State – should remain voluntary;
  - It represents an abdication of personal responsibility and it weakens the link between effort and reward;
  - It removes personal choice;
  - It enshrines the principle that citizens must be taken care of by the State from 'Cradle to Grave' and increases 'Big Government';
  - It creates a dilemma regarding who should manage funds and may result in a lack of individual savers' control over the management of their retirement funds.

- In a mandatory pension regime it would be necessary to give investment guarantees to participants which would prove very expensive to provide. In a voluntary system providers can make a range of investment options available with varying degrees of risk and individual investors can opt for a lower risk or guaranteed investment if that is what they want.

- If additional measures need to be considered then we would support the idea of auto enrolment as an effective way of encouraging individuals to participate in supplementary pensions. (The term "soft mandatory" is not helpful. We would suggest that the preferable term would be "auto enrolment" as it describes the scenario where individuals have a right to opt out and does not have the negative connotations of "mandatory".) In our experience inertia marketing can be very effective.

- An auto enrolment scheme should provide for a default level of employer and employee contributions to be effective. The actual level of employer contributions would be a matter for agreement at Partnership negotiations.

- Auto enrolment:

  - Recognises the culture of partnership that has given us industrial stability and develops it;
  - Preserves the value and importance of personal responsibility;
  - Provides additional options to the individual;
  - Uses the existing infrastructure and skills within the pensions industry and spares the State the substantial extra administration it would have to take on to implement and run a mandatory system;
  - Harnesses 'natural' inertia;
  - Delivers on NPR coverage and adequacy targets;
  - Provides a way forward that does not impose undue costs on the State;
  - Encourages financial literacy;
  - Incentivises personal pension provision within a coherent overall framework;
  - Could encourage collusion between our target market of employees and employers to opt out. However, appropriate safeguards can be put in place to prevent this and evidence from the US suggests the % taking the 'opt out' option is small.

- We would refer you to the Life Strategies report. In this we describe how an auto enrolment system might operate. It is important to note that individuals earning below a certain level are better off relying on a State pension.

- We also attach information on our "Pensions for Children" proposal (see Annex 3) which could be developed in conjunction with an auto enrolment regime.

Chapter 9 – Issues Regarding Defined Benefit and Defined Contribution Pension Schemes

- Information about risk and reward could be provided to members on joining a scheme. It would also be helpful to look at ways of improving awareness of these issues in the population as a whole. The financial literacy of our population and financial education in our primary and secondary schools is a topic that is exercising minds at a European level. The Financial Regulator aims to pursue a general policy of increasing the level of financial literacy/competency among the population. The members of the IIF firmly hold the view that the objective of a financially literate population making informed individual choices will benefit our society and all players in financial services markets. We support the roll-out of "Project Maths" in secondary schools in September of this year.

- When looking at the security of pensions it is important to remember that the pensions business of insurance companies is subject to the same requirements as all life assurance business. Life assurers are regulated by the Financial Regulator and must meet significant prudential requirements.

- The perception may be that defined benefit schemes are guaranteed and this is of course currently not the case. If the security of pension scheme benefits were to be increased, it would not be unreasonable to expect pension schemes to be subject to a similar prudential regime as applies to life assurance companies when they offer guarantees. However, improving the security of defined benefit schemes could have a wider significance. On the one hand the increasing burden of regulation on defined benefit schemes is already having a negative effect. On the other, the failure of a defined benefit scheme could shake confidence in the entire pensions regime and in pension providers in general.

- The current system whereby pensioners rank before anyone else would appear to be inequitable to current and deferred members and we would suggest that this should be reviewed. Other options to improve security might include increasing the funding standard, the introduction of a pension protection fund or having a Government guaranteed annuity rate.

Chapter 10 – The Funding Standard

See comments at Chapter 9 above. Any changes to the funding standard itself or to the underlying benefit entitlements should be phased in slowly to avoid undue market/systemic shocks.

Chapter 11 – Annuities and Related Issues

- We would suggest that annuities do offer value for money. The recent Indecon/Life Strategies report found that " the market is not as malfunctioning as suggested in some quarters and most of the recent price trends can be explained."

- As previously stated, IIF members would support the extension of the availability of approved retirement funds to all persons reaching retirement.

- Insurers would have no issues with other annuity providers e.g. the State, entering the market as long as proper reserving requirements apply.

- We would refer to the comments which we made in our submission on the annuity market e.g. the Revenue rules for annuities are too restrictive and insurers would support a wider choice of matching assets. (A copy of this submission is attached at Annex 2.)

- In relation to providing information about annuities it would be helpful if the Financial Regulator (which has involved itself in a number of cost surveys) would carry out a similar exercise for annuities and put information on its website for consumers.

Chapter 12 – The Role of Regulation

- Much pensions regulation is very effective. However some issues have arisen in relation to the sale of PRSAs. These were originally intended to be a simple and regulated product. The regime introduced by the Pensions Board was extremely comprehensive. However the Financial Regulator then imposed an additional layer of regulation in relation to the sales process. In general it would be our view that it is not helpful to have two regulators involved in the same area. This leads to over-regulation and increased costs for consumers. Regulation should be as streamlined as possible.

- It also makes sense to have a regulatory regime where the requirements are broadly consistent across the full range of defined contribution pensions (i.e. PRSA, RAC and Group DC).

- IIF members are of the view that the issue of charges is best addressed by ensuring their full and proper disclosure so that consumers can make informed choices.

- IIF would support the extension of disclosure requirements to group pensions on a consistent basis across all providers (with an adequate lead-in time for appropriate changes to literature and systems). This regime should take into account the fact that non-insurer providers are a feature of this market and that comparisons should reflect the fact that the cost of some services are often directly billed to the employer.

- Any changes in the regulatory burden should take into account the fact that much of the competition that pensions providers face comes from unregulated investment sectors such as overseas property. Looking at pensions provision only through highly-regulated pensions products does not accurately reflect the range of options open to individuals when it comes to retirement planning.

Chapter 13 – Public Service Pensions

- It is vitally important, in the interests of equity, that the broad regimes applicable to public and private sector arrangements be consistent.

- We would refer you to the Life Strategies research which we commissioned in relation to the cost of public service pensions. (See Annex 1.)

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

- IIF would support flexibility in relation to retirement with a proviso that the State retirement age should be increased as previously stated. Some provision might need to be made for manual workers who may be physically incapable of retiring at a later age.

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JH\LD

APPENDIX 1

Appendix

It has been suggested that one way to increase take up of pensions amongst those on lower to middle incomes would be to increase the level of tax relief and that this could in part of all be funded by reducing the level of relief given to top rate tax payers. While on initial consideration this suggestion might appeal on closer analysis it would prove to be unworkable for a number of reasons.

Firstly take the example of an occupational defined contribution scheme where the employer and employee are both paying 7.5% of salary. Employer contributions are not taxable in the hands of the employee which is equivalent to granting tax relief at the marginal rate. If the tax relief on the employee contributions was restricted for top rate tax payers then they would request their employer to change the scheme so that the employer contribution rate was 15% employer and 0% employee and would accept a salary cut of 7.5% in exchange thus preserving their marginal rate tax relief. Lower rate tax payers would conversely switch to 15% employee contribution plus a 7.5% salary increase to take advantage of tax relief at the new higher rate. While this might increase pension take up for those on lower incomes it would be far from cost neutral as the anticipate tax savings from higher rate tax payers would fail to materialise. The same logic would apply to a contributory defined benefit arrangement.

For PRSA’s and Retirement Annuity Contracts employer contributions are subject to benefits in kind but relief can be claimed up to a maximum of 15% - 40% of income depending on age. Within this regime it would be harder for the top rate tax payers to maintain their relief at marginal rate. However, the simple step of replacing the PRSA or Retirement Annuity Contract with an occupational defined contribution arrangement would allow them to do so.

In order for this regime to have the desired effect it would be necessary to introduce benefit in kind taxation on employer contributions to all pension schemes. This would be extremely difficult and deeply unpopular for many reasons. For defined benefit schemes the actual cost attributable to any given members is extremely difficult to calculate as it is a function of future salary progression, marital status, number of children, gender etc. In addition equity would require public service pensions to be included within the regime. The cost of the public service pension scheme when applied as a benefit in kind would lead to very significant tax bills for those who were just in the top rate tax band.

ANNEX 1

c_IIF - Pensions research report - FINAL.pdf

ANNEX 2

Irish Insurance Federation

Mr. Robert Watt,
Indecon (Ireland),
Indecon House,
4, Fitzwilliam Place,
Dublin 2.

9th February 2007

Dear Mr. Watt,

Thank you for your letter of 19th January to Michael Kemp. Our comments on the Irish annuity market are given below and we would be happy to meet with you to discuss them in more detail.

The Irish Insurance Federation is not aware of significant problems in relation to the annuity market. The introduction of the Euro and the arrival of reinsurers have recently increased the investment and longevity insurance options available to life offices helping increase capacity and supply in the market. The market would appear to us to be effective in meeting customer demands aside perhaps from inflation-linked annuities which life offices are not in a position to supply because of the lack of matching assets.

It is important to note that the market need for annuities arises from pension regulations which set out the retirement options available to pension scheme members and individual pension policyholders. The introduction of ARFs for the self-employed and director market shows that the demand for annuities reduces when the forced purchase of annuities is removed. The Irish Insurance Federation has for many years supported the extension of ARFs as a retirement option to members of Defined Contribution schemes.

It also appears to us that a large part of the debate about annuities stems from the fact that the cost has a knock-on effect on the funding standard for defined benefit schemes. We have included some comments below on the funding standard and on comparisons that have been made between annuity prices and the pension costs typically assumed by defined benefit pension schemes.

How annuity prices are set and the factors determining annuity prices

Please note that the Irish Insurance Federation, as a trade body, must not get involved in competitive issues including the pricing of products. We have made general comments below on the factors that impact on annuity prices and, where possible, given comments on the sensitivity of annuity prices to these factors.

Annuity prices are calculated using the following inputs.

a) Investment Yield

Life offices will use the investment yield from a portfolio of risk-free bonds that matches the income stream of the annuity. Constructing a portfolio of matching bonds is not a trivial exercise because of the very long duration of annuities and the fact that the income stream from an annuity is very different to the income stream from government or corporate bonds. However the introduction of the Euro and the rapid growth of the corporate bond market in recent years have helped in this regard.

It can be argued that by investing in corporate bonds there is potential of benefiting from the higher yields on these bonds. In taking additional credit risk the shareholder will want to be paid for carrying that risk and therefore it is arguable how much, if any, the shareholder would be willing to pass on to the annuity pricing.

One of the features of the bond market over the last 10 years, in addition to the reduction in overall yields, has been the tightening of the spreads available on corporate bonds. The spread for AAA corporates is approximately 20 basis points above sovereigns. Most of this spread can be attributed to the default and the downgrade risk. The downgrade risk is the most significant for life offices as the probability of downgrade of even a highly rated corporate over the lifetime of an annuity is not insignificant. The amount of the spread that can be attributed to liquidity has greatly reduced as the scale and liquidity of the corporate bond market has increased.

The impact on price from investing in corporate bonds is often overstated. Passing on 10 basis points, which is half of the spread for AAA corporates above, would be to reduce prices by approximately 1%. Any meaningful impact on price would require significant investment in much lower rated corporate bonds resulting in real additional default and downgrade risks.

It is perhaps worth mentioning that if an insurer takes investment risks on its annuity liabilities and things go badly, it cannot go back to the purchasing scheme / employer for more money, as it is providing an unconditional guarantee. In contrast, a defined benefit scheme which mismatches its pensioner liabilities may be able to obtain increased contributions from the employer to make up a deficit.

b) Baseline mortality assumptions

In addition to information on their own mortality experience life offices have a lot of data available to set their baseline mortality assumptions. The Society of Actuaries in the past have provided information on both Irish life office mortality experience and the experience of pension schemes in Ireland that self-insure the longevity risk. The Continuous Mortality Investigation Bureau in the UK publishes regular updates on UK annuitant mortality experience. Life offices also now have access to reinsurers who have data on current annuitant mortality experience.

One point to note is the evidence of selection against life offices. Trustees of DB pension schemes have the option to self-insure. Directors and self-employed policyholders have the option of selecting an ARF. Given these options one would expect a divergence in self-insured pension experience and life office experience and indeed this difference in experience can be seen in the mortality experience published through the Society of Actuaries. The impact on price of the difference in experience could be in the region of 5%.

c) <u>Mortality Improvement Assumptions</u>

Future mortality assumptions are the most difficult input into annuity pricing and are a significant factor in determining price. There has been much comment and analysis on the increasing longevity of annuitants and pensioners. Life offices in Ireland and the UK have incurred significant losses in underestimating the extent of these improvements.

The accepted methodology in Ireland and the UK for analysing and allowing for future mortality improvements is the cohort methodology. This methodology tracks the mortality experience to date of people currently retiring and compares this to the experience of previous cohorts of pensioners. The analysis helps you predict to what extent these differentials in mortality experience will continue to exist into the future.

Information from the Society of Actuaries shows that allowing for future improvements in mortality rates of 2.5% per annum adds approximately 10% to the cost of a flat annuity and 15% to the cost of an annuity with 3% escalation.

It is already known that pensioners retiring today have significantly lower mortality rates than previous pensioners. Cohort analysis suggests that this differential will continue to exist as they grow older but it is difficult to predict the actual future outcome. The cohort analysis would suggest future improvements in mortality rates somewhere between 2% per annum and 4% per annum. Clearly this is a very significant risk for life offices given the very tight margins available in the annuity market.

It is important to note that these improvement assumptions are only to allow for the differential that already exists between current and previous pensioners continuing into the future. Any significant medical breakthrough like better treatment for cancer would result in even greater improvements in mortality rates.

d) <u>Initial expenses</u>

Initial expenses will be largely the broker commission as life office expenses in setting up new annuity cases are low. Typically brokers will take up to 2% commission on annuities which is lower than commission typically taken on other single premium products and lower than typical commission on ARFs.

The Irish Insurance Federation believes that brokers play an important role in creating a competitive and efficient market. The majority of annuity business is placed with life offices through intermediaries who will shop around on behalf of their clients for the best price. The amount of business a life office writes is very sensitive to its competitive position in the market.

e) *Renewal Expenses*

Figures below on the size of the market show that average single premium for new annuity cases is in excess of €70,000 which is a significant amount. The fixed renewal expenses of life offices should not be a significant factor in determining price.

f) *Cost of capital*

Life offices are required to set aside significant capital to secure their continued solvency and to make sure that they can honour the benefit promises to policyholders. Under EU and Irish regulations life companies are required to calculate reserves to meet their liabilities on prudent investment and mortality assumptions. In addition the Financial Regulator expects life companies to hold 150% of the solvency margin, which for annuities is 4% of the reserves. Shareholders will obviously look for return in providing this capital and these requirements have a significant impact on the prices charged by life offices.

Size, scope and working of the annuity market in Ireland

The following figures have been collected by the IIF.

New Annuity Business 2001 to 2005 – In €000's

	No. Policies	Premium
2001	2,417	166,605
2002	3,079	215,020
2003	2,703	243,276
2004	3,047	219,187
2005	3,105	238,603

Interim figures for 2006 indicate that annuity sales in 2006 are substantially up on 2005. However the growth in the annuity market has been low compared to the growth in other life products and this can be attributed the introduction of ARFs for the director and self-employed market.

The IIF figures indicate that there are up to five active providers in the market.

The vast majority of annuity sales are made through insurance intermediaries. When intermediaries look to purchase an annuity on behalf of a client the major issue for the client is the amount of pension that can be provided for the purchase money. Companies that have the best annuity rates will attract the greater portion of those funds purchasing annuities in the open market.

Since the introduction of ARFs as a retirement option the majority of annuity sales are to trustees of defined benefit schemes purchasing annuities for members of the DB schemes. Schemes have the option to self-insure longevity risk and many schemes select this option. Members of defined contribution schemes purchase annuities with the balance of employer and employee contributions that have not been taken as a tax free lump sum. The numbers retiring out of defined contribution schemes is low relative to the numbers retiring out of defined benefit schemes.

Life offices supply products, aside from inflation-linked annuities, that meet the market demand. The demand from DB trustees is for products that match the promise made to the scheme members which is typically a flat pension or fixed escalation pension. Schemes may also promise minimum guaranteed payment periods or attaching spouses' and children's pensions. These are also supplied by life offices. Typically DC members will look to maximise income and mostly select flat pensions.

The scope for innovation in the market is low. There are many revenue restrictions which restrict the pension options available at retirement and the existing market has largely arisen to meet the needs that are allowed. For example one criticism often made against annuities is that the customer loses all the money if he/she dies. An annuity with death benefit of original premium less payments made could be provided by life companies but is not allowed by Revenue, neither are annuities with guarantee periods for longer than 10 years.

The introduction of ARFs has taken away the potential demand for unit-linked or with profit annuities.

Sometimes concerns are raised about capacity constraints in the market. However while the business volumes above are significant, they are small compared to the Euro sovereign and corporate bond market. Reinsurers are also willing to supply life offices and this has increased longevity risk capacity.

There are no barriers to entry by firms from within or outside Ireland. EU legislation facilitates the selling into Ireland of life assurance products by an insurer situated in another EU member State. Reinsurers are the most recent new entrants into the market and can easily access volume through the life office infrastructure.

Inflation-Linked Annuities

Life offices could more easily offer inflation-linked annuities if matching assets were issued by the Irish government. IIF would support the introduction of a wider choice of matching assets e.g. the issue by the Government of index linked gilts.

The Government could also reduce the uncertainty that providers face by issuing debt where interest payments matched annuity payments. At one level this would be in the form of long term fixed interest and inflation linked bonds. At a more sophisticated level bond payments could allow for the longevity of the general population as it emerges. In essence the government would provide a global reinsurance facility. The taxpayer would be taking a risk for the sake of a proportion of the population and questions of equity would present.

Another option is for advisors, trustees and employers of defined benefit schemes to look to change inflation-linked promises they have made to members of their schemes. Clearly it is neither sensible nor prudent to offer promises that cannot be matched or secured in the market place. Possible options include converting to fixed escalation promises or at least switching from an Irish inflation promise to euro-zone inflation promises where more matching assets are available.

Funding Standard

The Irish Insurance Federation believes that the issues relating to the pricing and distribution of annuities are in essence the same as for any other product that life offices supply to the market. Most of the debate on annuities seems to stem from the fact the minimum funding standard for defined benefit schemes is on a wind-up basis and therefore uses annuity costs as an input.

We believe the current winding up rules give an inequitable degree of protection to current pensioners at the expense of those below retirement age. Addressing this point might reduce public dissatisfaction with pension schemes and should be considered from a public policy point of view.

The biggest advocate against the cost of annuities has been the IAPF who have claimed that annuity costs can exceed the long-term expected cost by 32%. It is interesting to look at their analysis in this regard. In the analysis 18% of the additional cost is due to the excess cost if investment is restricted to bonds. Achieving a saving of this magnitude requires investing in assets that have a spread above government bond yields of approximately 180 basis points. Clearly this type of pick-up is not available in the rated corporate bond market and instead requires investment in the unrated or junk bond market. As we have stated above the true cost of annuities must be calculated on the yield available on a matching portfolio of <u>risk-free</u> assets.

The remaining 14% of the additional cost as per the IAPF analysis is due to capital requirements of life offices, the selection impact experienced by life offices, commission payable to intermediaries and expense and profit loadings of life companies. All of these must be allowed for in life office pricing.

It is fair to say that the liabilities calculated by a pension scheme as a going concern will be lower than life office annuity costs because they do not need to allow for the mortality selection impact and they do not need to allow for the cost of capital. However when it comes to assessing these liabilities on a wind-up basis these additional factors must come into play for the annuity provider. If the funding standard is to be based on wind-up costs it is difficult to see how one can avoid using the annuity rates available in the marketplace.

Summary

Our concluding points are as follows.

- We believe that ARFs should be extended as a retirement option to defined contribution schemes.

- Life offices have no desire to be the corner stone of the defined benefit funding standard but it is difficult to see what alternative exists.

- Defined benefit schemes should be much more pro-active in reducing their exposure to Irish inflation-linked liabilities.

- IIF would support the introduction of a wider choice of matching assets e.g. index linked gilts.

Yours sincerely,

JENNIFER HOBAN
Life Assurance Manager

ANNEX 3

EXTRACT FROM PRE-BUDGET SUBMISSION TO BRIAN COWEN 2005/2006

The establishment of a personal pension for every child in the State

A persuasive case can be made for the establishment of a personal pension for every child (up to age 18) within the State, building on the successful State/citizen partnership SSIAs. All the evidence demonstrates that there is a serious crisis ahead in relation to pensions and that radical steps are now required without further delay. The total number of children who would immediately qualify under a scheme is approximately 1.1 million. The IIF considers that an approach on the following lines provides a blueprint for a practical and effective scheme that will yield very worthwhile long-term benefits:

- A personal pension account should be opened for every child in the country, all 1,076,040 of them, and the Government should deposit €10 a month into each child's account until he/she turns eighteen. (Cost: €130 million per annum).
- The annual cost might be funded through the assignment of approximately 10% of the annual allocation to the National Pension Reserve Fund ensuring a net neutral effect on the public finances at this stage of the proposal.[1]
- Sponsor(s) (normally a parent or guardian of the child) may make additional contributions from **NET** earnings to the child's account of between €5 - €50 per month over the same time period (i.e. until the child's eighteenth birthday).
- For every €5 contributed by sponsors the Government contributes an additional €1 (See table on following page for costs to the exchequer).
- Every child is taught about pensions in secondary school, including a recommended guide on contribution levels, (91% of people surveyed believe this is a good idea! 'Project Maths' pilot is commencing September 2008. The IIF support contextual maths as a crucial part of the future 2nd level curriculum)
- Responsibility/Control of the fund falls to the child at 18.
- On the account-holder's 25th birthday he/she may withdraw 25% of the current gross value of the fund tax-free **<u>if and only if she has been contributing at least 5% of earnings when working</u>**.
- On her 35th birthday she gets access to a further 20% of the current value of the fund tax-free **if and only if** she has been contributing at least 10% of earnings between the ages of 25 and 35.[2]
- Remainder cannot be accessed until retirement, unlike the child trust fund in the UK, which gives <u>all</u> the money back.

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[1] This pension funding is consistent with the recommendations of the National Pensions Policy Initiative that highlights the need for action in this area.

[2] If Government feels it needs compensation for this tax-free early access and/or there are concerns that this access will dilute final values then consider reducing or eliminating the tax-free lump sum an individual is entitled to on retirement. Remember … 'A bird in the hand…'

<u>Costs to Sponsors and the Exchequer</u>

	Total Number of Children	Monthly Contribution	Annual Contribution
Government Contribution	**1,076,040**	**€10**	**€130 million**
Cost to Sponsors*		**€5-50**	**€60-600**
Government Credit on Sponsor Contributions	**50% of children***	**€2.15 million**	**€26 million**
Government Credit on Sponsor Contributions	**100% of children***	**€4.3 million**	**€52 million**

* Assume children are sponsored for €20 per month

FUND VALUES

SCENARIO 1			
Basic plan with no contributions above Government €10pm up to age 18. Individual then contributes 5% of earnings from age 18, & 10% from age 25.	<u>Age 18</u> €3,467	<u>Age 25</u> €14,374	<u>Age 35</u> €60,001
SCENARIO 2			
Sponsor matches Government contribution of €10pm to age 18. Individual then contributes 5% of earnings from age 18, & 10% from age 25.	€7,627	€20,228	€67,152
SCENARIO 3			
Sponsor matches Government contribution of €10pm to age 18. Individual then contributes 5% of earnings from age 21, and 10% from age 25	€7,627	€16,119	€62,133
SCENARIO 4			
Sponsor doubles Government contribution of €10pm to age 18. Individual then contributes 5% of earnings from age 18, and 10% from age 25.	€11,787	€26,081	€74,303

Assumptions:
-6% growth less 1% charges
-Starting Salary = €20,000 or £13,666 Sterling
-Assume inflation, (wage and contribution) of 4.5%.
-Assume 25% of fund taken at age 25

FINAL FUND VALUES

Assume that 25% of the fund is taken at age 25, a further 20% of the fund is taken at age 35 and contributions are continued at 15% thereafter until retirement at 65, then even scenario 1 above provides over 22% of final salary income on retirement. Add that to one's guaranteed State Old Age Contributory Pension of 34% of the Average Industrial Wage and even those on lower incomes can expect a substantial improvement in their retirement living standards.

BENEFITS

- Every child in the country automatically has a growing private pension fund from birth, which he/she **can't** opt out of and about which he/she receives regular personalised benefit statements;
- At 18 the child may opt out but with schools, parents, Government and industry all promoting the funding of these products private pension provision will become the norm;
- Access to a portion of the fund at crucial times in the child's life cycle provides a significant incentive to contribute which helps foster a positive attitude to saving and a savings habit;
- Making the future secure for their children allows parents to spend more time **and resources** making the future more secure for themselves.
- The volume of accounts -100% of the population over time- and the simplicity of the product will generate increased competition in the industry which in turn will promote competitive charging and value-adding customer services;
- Children/Young adults will take more responsibility for their own financial futures;
- State expenditure reduces –over time- because well financed pensioners:
  - Pay tax;
  - Have private health insurance;
  - Spend money in the economy;
- This proposal reduces Irish society's dependency on the pay-as-you-go system thus de-politicising pension provision;
- It could pave the way for the incremental introduction of soft mandatory (opt out) pensions for this new work force, including all public servants.

- It is important to be clear about the point of this scheme - it is **not** initially about the size of the fund, or how these 'early' contributions increase the final fund value at retirement; it **is** about the development of a "Savings Habit" at an early age which if successful will produce an adequate retirement income.

The scheme outlined above requires elaboration as to its detail. Now is the time however to open a public debate on the subject. At a minimum the Government should explore the merits of this approach, with a view to developing a solution to the major difficulties ahead in relation to pensions.