IRISH SMALL AND MEDIUM ENTERPRISES ASSOCIATION LTD

The Pensions Green Paper – the Employer's Perspective

JARDINE LLOYD THOMPSON IRELAND Limited

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1. Introduction

The Green Paper on Pensions is the result of a commitment made under the social partnership agreement 'Towards 2016'. It was published in October 2007 and represents the big picture review of future pensions policy in Ireland. The Green Paper raises questions of how pension provision should be shared between the State, individuals and employers[1] and we are currently approaching the end of the consultation period, with the expectation that future pensions policy will be shaped by government over the next year. The Irish Small & Medium Enterprises Association - ISME - has worked with leading financial advisers Jardine Lloyd Thompson Ireland in preparing this response to the Green Paper, looking at the issues from the employer's point of view.

ISME, the ***Independent*** Business Organisation, is the only representative group in Ireland specifically representing the SME sector with a membership of over 5,000 member companies. Membership is comprised exclusively of entrepreneurs who own and manage competitive businesses, the true risk-takers in the economy

[1] Green Paper, 1.44

2. Executive Summary

The Green Paper's stated agenda is to build a sustainable pensions system for the future. This raises the potential financial impact of any changes both on business and Ireland's future economic performance. Options include raising taxes to pay for improved State benefits and forcing employers to contribute to employees' pensions. Sustainability is not only about future costs but also involves recognition of what has been achieved to date in developing both State and supplementary (i.e. private) pension provision.

Improving the productive capacity of the economy is vitally important if Ireland is to avoid the fiscal drain experienced in other countries, such as Italy where an overambitious State pension provision is crippling economic performance. Any radical changes arising from the Green Paper may lead to unintended consequences and one has only to look to the UK's experience in the past 20 years to see how a functioning pensions system can be undermined by well-intentioned initiatives. Radical changes to the current pensions system will only undermine what has been achieved to date.

Policymakers will need to accept the fact that Ireland has changed considerably since the last major pensions review, the National Pensions Policy Initiative ('NPPI') of 1998. Trends since that time include wider home ownership, net immigration (which has boosted the productive capacity of the economy), the creation of a more entrepreneurial culture and a general increase in wealth. Ireland was ranked second wealthiest nation in a 2006 survey of OECD countries[2]. This means that any discussion of how supplementary pensions coverage beyond Social Welfare provision[3] works also needs to take non-pension assets and other forms of saving into account. This view was put forward by ISME in 2005[4] and is as relevant today as it

[2] Bank of Ireland, Wealth of the Nation report, 2006

[3] Green Paper, 3.34

[4] ISME, Addressing the Pensions Timebomb, 2005

was in 2005 despite any current downturn. Realistically, any discussion of pensions policy must take account of wider actual and potential sources of retirement income.

The Green Paper puts forward five potential policy options for the future of pensions in Ireland. These involve maintaining the status quo, more State provision with higher taxes, mandatory private pensions along the lines of the different schemes introduced in Australia and New Zealand, or building on the existing voluntary system of private pensions. **ISME favours retaining the voluntary system as the most practical and sustainable approach for the future**. Mandatory employer pension contributions will only increase business costs and are a blunt instrument intended to fix a complex problem. Shifting the burden of costs and responsibility onto employers will cost jobs. There is little evidence that employees want mandatory pensions and the real issues are ones of education, to create an understanding of what is required for effective retirement planning.

Personal Retirement Savings Accounts ('PRSAs') were introduced on the back of NPPI as an attempt to fix the pensions problem. They were intended as low-cost, portable retirement savings vehicles, with a cap on charges. Designed as flexible pensions, PRSAs were intended to cope with diverse career patterns and a changing Irish workforce, covering employed, self-employed, homemakers and atypical workers. The experience with PRSAs to date has been mixed and is examined in more detail later in this report. PRSAs are likely to figure in some form in the post-Green Paper world, being a child of NPPI and one of the Pensions Board's pet projects.

Policymakers will need to understand that the employer's role in the current pensions regime is largely voluntary, a point often overlooked in the rush for quick solutions. This voluntary approach is supplemented by a legal responsibility in making a pension scheme available to its workers as, for minimum compliance, an employer must provide access to a PRSA. The Green Paper puts forward possible changes to the existing system, including mandatory pensions provision within the workplace. A move from voluntary to mandatory employer involvement in pensions will be strongly resisted by employers, due to costs, both in bottom line terms and the extra administration involved.

Mandatory pensions have been put in place in other countries, usually those with a less developed pensions framework, such as Australia where State provision was means tested and other retirement savings were minimal. In contrast, Irish employers and individuals are already paying into a mandatory State pension through the Pay Related Social Insurance ('PRSI') system. At 10.75%, PRSI already represents a significant payroll cost for employers. A move from a voluntary system to any form of mandatory employer pension contributions in Ireland would be counter-productive as it will increase costs, leading to employers cutting jobs to maintain the financial viability of their businesses.

An easier solution is to modernise the current supplementary pensions system. This should be updated to reflect the needs of Ireland today by removing out of date, petty restrictions on pensions and widening access to vehicles like Approved Retirement Funds ('ARFs'). Whilst government states that it wants to boost pensions saving, the ordinary consumer has to grapple with arcane rules dreamt up in the early 1970s, covering minutiae on maximum benefits, earnings definitions and so on. The current rules often confuse the experts so how is the ordinary person supposed to cope? The experience with Special Savings Investment Accounts ('SSIAs') shows what can be achieved with the creative use of incentives. **The challenge is to demystify pensions and engage individuals in taking ownership and planning for their retirement income.**

Pensions policy in Ireland since 1998 has been to increase private pensions coverage by setting coverage targets. Coverage is only part of the story and consumers need to be educated to take ownership of their planning for retirement as part of their overall savings and investments. There is a real danger that simply signing up individuals into pension schemes will lead to low contribution levels which will not translate into realistic saving for retirement. The experience with PRSAs to date shows that enrolment into pension schemes does not always translate into proper saving for retirement.

The existing private pensions system is unduly complicated with rules and regulations dating back nearly 40 years. Ireland is a different country today and individuals and businesses have different needs. Many of the current restrictions are pointless and act as a block on labour mobility and are a disincentive to saving. Regulators seem to be at cross-purposes at times, such as the need for a factfind for some PRSA enrolments. Some ‘joined up’ thinking and imagination could go a long way to solving current pensions problems.

Demographic trends mean that the current favourable worker to pensioner ratio will change in the future. Ireland is expected to move from the current position where there are 6 workers to each retired person to one where there are 2 workers to every retiree. This will impact on Social Welfare costs unless the productive capacity of the economy is maintained. More flexible approaches to retirement can help here as can greater encouragement of private provision.

Employer mandatory pension contributions are favoured by trade unions and other commentators. Apart from cost considerations, ISME sees this as being based on flawed logic. Such systems have been introduced in countries such as Australia with weak State pensions and little private saving, or as in the UK where continuous pension initiatives have wrecked a functioning private pensions system. Are workers willing to trade pay rises for pension contributions in the current economic environment, when individuals have short terms needs such as living costs and mortgages? Businesses will cut costs and jobs if forced into mandatory pensions.

If the Government is serious in its concern for the working citizen who will not save for retirement on their own initiative then, rather than placing the onus on employers, more pressure must be put on the working citizen themselves, as is the case in other areas deemed to be for the common good (for example, the smoking ban). Legislation to force retirement savings on the employee is the more equitable option. This scenario need not be as problematic as initially thought if the compulsion approach is tempered with visible, easily understood benefits such as were used to excellent effect with SSIAs.

In summary, ISME recommends that future pensions policy in Ireland should:

- **Educate consumers on the need to take personal responsibility for their retirement income. Increasing coverage is only part of the deal. Getting consumers to save more for retirement involves simplifying the current**

regime, putting pensions within the context of wider saving. Efforts should focus on explaining to consumers what is involved in creating the assets to fund a decent standard of living in retirement. This will help address the confusion and suspicion surrounding 'pensions'.

- **Build on the current voluntary supplementary pensions system. We already have mandatory PRSI contributions to the Social Welfare system to provide basic income in retirement.**

- **Make pensions easy to deal with for the ordinary consumer. Incentivise saving using the SSIA model of 'you pay €x and the government pays €y', funded by straightforward tax reliefs. Tax reliefs encourage saving and are deferred taxation and not government giveaways.**

- **Simplify the current tax relief regime by allowing higher rate tax relief for personal contributions to supplementary pension schemes, subject to limits.**

- **Simplifying the 'disclosure' rules on all types of pensions would also help in creating trust on the part of the consumer. Putting pensions into plain language still presents a major challenge.**

- **Simplify the existing tax and regulatory regimes for private pensions. Many of the benefit limits rules date back nearly 40 years and are irrelevant today and a disincentive to save.**

- **Offer a range of State Retirement Ages – a 'retirement window' – with different outputs depending on when an individual chooses to draw the State pension.**

- **Consider some form of early access to funds during the saver's pre-retirement phase, e.g. a once-off withdrawal in connection with house purchase. This would engage the twenty somethings in the long-term savings process but also offer them flexibility on their savings during their working lifetime.**

- **Introduce some flexibility on the drawdown of funds at retirement as the current system has different treatment for different classes of savers. Extending the ARF facility to all defined contribution schemes would go a long way to encouraging saving for retirement and would deal with the current 'annuity trap' which is a major obstacle to consumers in retirement saving.**

3. Current system and future challenges

The Green Paper describes[5] the current pensions system in Ireland as being a tripartite arrangement between the State, employers and individuals. It recognises that each of these stakeholders has a different perspective on 'pensions'. This is an understatement, as the real challenge facing policymakers is how to engage individuals in the need to take ownership of and plan for their retirement. The Green Paper outlines the two pillars of the existing Irish pensions system as:

- **Social Welfare** – run by the State and financed through social security taxation (Pay Related Social Insurance -'PRSI') of employers and individuals plus supplements from the Exchequer. The stated objective is to provide adequate income in retirement and the State Retirement Pension has increased steadily in recent years, now comprising over 35% of average industrial earnings for those with a full PRSI contribution record.

- **Voluntary saving** – this is through private pension plans, regulated by the State. Broadly, these range between employer-sponsored company pension schemes of various types, the newer Personal Retirement Savings Accounts ('PRSAs') and on to individual Personal Pensions (or Retirement Annuity Contracts). The range and complexity of options is a recipe for confusion for the ordinary individual, let alone the experts. There is no obligation on an employer to contribute to an employee's pension scheme at present so that employers' pension provision is voluntary, depending on the needs of the marketplace and the specific employment deal on offer. The tax system offers incentives to pensions saving and tax relief system on pension contributions has been liberalised in recent years. Tax relief is available at an individual's highest rate on pension contributions of between 15%-40% of earnings, with some restrictions for very high earners to prevent abuse of the system.

The Green Paper identifies a number of issues facing Ireland on pensions policy:

[5] Green Paper, Executive Summary

- **Adequacy of retirement saving** – creating and maintaining a level of retirement income which is reasonably comparable with pre-retirement income. The Green Paper states that Social Welfare payments are the main source of income for Irish pensioners[6]. It expects this situation to continue as, although 50% of workers are members of supplementary pension schemes, retirement income from this source may not be adequate in view of current levels of contributions. Surprisingly, the Green Paper sees other savings and investments as important but unlikely to make a difference as the main income source in retirement.

- **Sustainability and demographics** – Ireland has enjoyed favourable demographics with a relatively young population compared with other developed countries. This has been supported by net immigration as migrant workers brought much needed skills and additional labour resources. Future projections see this as set to change, with a knock-on impact on the costs of pensions as the ratio of workers to retirees becomes less favourable. The Pensioner Support Ratio – the ratio of workers to retirees – is set to change from 5.6 in 2006 to 1.8 in 2061[7]. In broad terms this means moving from a position where there are 6 workers to each retired person to 2 workers to every retiree. This raises questions on the future affordability of State pensions relative to the productive capacity of Ireland's economy. People are living longer thanks to general prosperity and advances in health. Fertility rates are set to fall, contributing to an ageing population. This exacerbates the problem of providing for retirement income for longer than would currently be expected, on both a State and supplementary pensions level. An increase in fertility rates or continuing immigration will slow down population ageing. The debate on sustainability centres on the balance between State and private provision, with a consequent impact on taxation and private savings. Saving for an ageing population will spread the ageing costs over a longer time period[8].

[6] Green Paper, Executive Summary

[7] Green Paper, Executive Summary

[8] Society of Actuaries in Ireland, Population Ageing in Ireland and its Impact on Pension and Healthcare costs, 2003

- **Modernisation** – ideally the pension system should reflect changes in the labour market and society in general. Pensions are a long-term project so rapid change is difficult to accomplish. However, many aspects of the present system such as Revenue pension rules are firmly stuck in the early 1970s. We now have a very different labour market from 40 years ago – women have jobs and careers outside the home, where broken service for pensions savings due to childrearing still creates problems. The 'job for life' has largely disappeared, in the private sector at least, so the old pension model of 'two-thirds of salary after 40 years' service' is largely irrelevant to most private sector workers. Also, the current system cannot cope with migrant workers, who have played an important part in the recent Irish economy. Migrant workers find themselves locked into an Irish pension after 2 years' scheme membership even though they may well return home long before retirement date. Trying to transfer these pension assets back home is often a non-starter, even though relatively small amounts of money are involved. This illustrates the difficulty of trying to engage individuals in the retirement savings process when they see such petty restrictions at almost every turn, such as pension transfer rules which cannot cope with the globalisation of labour markets and maximum benefit rules which catch out job changers and late starters in retirement savings.

PRSAs – a good idea that hasn't quite worked yet?

The experience with PRSAs shows how earlier attempts to modernise the Irish pensions system were stymied by regulatory overkill. Introduced from 2002 on the back of NPPI, PRSAs were intended to be low-cost, portable retirement savings vehicles, with a cap on charges for the Standard PRSA product. Designed as flexible pensions, PRSAs were intended to cope with diverse career patterns and a changing Irish workforce, covering employed, self-employed, homemakers and atypical workers. Charges for a Standard PRSA product were fixed at a maximum of 5% on each contribution and an annual charge of 1% of the savings fund. The cap on charges meant that pension providers had to improve their operations management and run these new savings vehicles in a lean and cost-effective manner.

This welcome move towards transparency and flexibility in pensions was countered by the regulatory rules on the set-up or sales phase, creating a sense that the pensions and financial services regulators were at cross-purposes. The Pensions Board designed the PRSA product as a no-nonsense savings account but then the Financial Regulator loaded up the sales process with the need for an adviser to conduct a financial factfind for each potential PRSA saver. How can PRSA salespeople engage consumers when PRSAs are stuck with much higher point-of-sale processes than potentially more complicated mainstream pension products? This layer of regulation ran counter to the objective of trying to create a simpler, easily understandable retirement savings platform that ordinary people could relate to. Some 'joined up' thinking is required if the government seriously expects to extend pensions coverage when policymakers and regulators are working at cross purposes.

The real dilemma - pensions coverage versus individual responsibility

The overall aim of policymakers has been to increase supplementary pensions coverage, with NPPI targeting 70% of workers in the 30-65 age ranges by 2013[9]. The difficulty here is that 'pensions' has become too narrowly drawn in the policymakers' mindset, whilst the wider concept of 'retirement income' is more appropriate.

One concern with the language used in the Green Paper is that it appears to be stuck in a different pensions landscape, with a narrower, statist approach to retirement saving. The reality is that policymakers need to persuade consumers to save money in a spending culture[10]. Younger consumers will point to the fact that they have other financial priorities - getting on the housing ladder, paying the mortgage, raising their children and so on. Also there is a general lack of confidence when it comes to making personal finance decisions despite improvements in consumer protection. So the challenge is that of engaging people in the retirement savings process.

[9] Green Paper, para 8.44

[10] Malkani, G., 'Inspire the young to finance a grand old age', Financial Times, 17 October 2005

The mantra of increasing coverage smacks of coercion and also fails to address the issue of savings adequacy. Data shows that pensions coverage has increased post-NPPI so this indicates that we are moving in the right direction within the current voluntary framework. Signing people up for a pension does not mean that the problem is fixed, as there is plenty of evidence which shows that even when people are enrolled in a pension scheme, they are not saving enough to provide for a comfortable retirement – this is referred to as 'adequacy' in policymaker-speak.

The experience of Special Savings Incentive Accounts ('SSIAs') offers a road-tested example of how to promote a savings culture. SSIAs gave conventional savings a makeover, capturing the public's imagination with the simple incentive that for every €4 saved the government contributed €1 extra, for a maximum period of 5 years (based on 60 monthly contributions). SSIAs worked because they were easy to understand. The current challenge is how to change boring old pensions into something more relevant and appealing to the average person. Tax relief on contributions is important but it would be far easier to offer 'you pay €x and the government will pay €y' as a way of incentivising pensions saving. Also, educating consumers on the need to consider the creation of retirement income as opposed to just pension saving offers the possibility to create a wider saving and wealth focus, taking account of the other potential sources of retirement income in modern Ireland.

4. The Green Paper's future policy options

The Green Paper addresses five policy options:

1. **Doing nothing – maintain the current system**
2. **More State provision - enhancing Social Welfare**
3. **Introducing 'soft-mandatory' private pensions**
4. **Introducing mandatory private pensions**
5. **Enhancing the current voluntary provision**

These options are considered in more detail below.

Option #1 - Do nothing – maintain the current system

The current Social Welfare structure offers relatively low contributions and low benefits, covering the First Pillar of retirement income. Ireland has so far avoided the pitfalls of expensive State schemes which some European countries are now having to reform.

Recent government policy has been to enhance the Social Welfare retirement pension (which now stands at €11,611pa) and this provides a basic level of support for lower earners whilst offering less for those higher up the earnings scale. Historic gaps in Social Welfare provision, such as coverage for homemakers, have been addressed.

As has been seen from future population projections, there are demographic and economic issues for Social Welfare provision which need to be addressed in the future. The main concern here is to avoid policies which would straitjacket future policy options. The Green Paper estimates that plugging the funding gap through higher taxation would lead to fall in output and employment of up to 6%[11] with a knock-on impact on competitiveness. Recent experience has shown that unexpected developments can have a positive impact, such as the inflow of migrant workers who provided a boost to the labour force and helped propel parts of the Irish economy in

[11] Green Paper, p121

recent years. This shows that help can come from unexpected sources, provided overall competitiveness can be maintained.

The challenge for supplementary pension provision has been that, although private pension coverage has risen, gaps remain in certain sections of the labour force (such as women, hospitality workers and part-timers). The Pensions Board is already taking the initiative with its publicity campaigns to encourage saving for retirement. The real challenge is to take this concept further and educate people into owning their retirement planning and encouraging them to save more to provide realistic benefits.

The problem of achieving a decent pensions result – 'adequacy' in policymakers' jargon – was illustrated by recent research. The initial work in this area by one of the largest pensions providers, Irish Life, looked at the current level of saving through defined contribution pension schemes. This was subsequently developed by the Society of Actuaries in Ireland[12] with the aim of identifying the funding gap between what people expect and what they currently save for retirement. For this research, the actuaries used a target retirement income of 67% projected final earnings, including the State Retirement Pension, as a possible income target. The research showed that, whilst current levels of funding proved adequate at lower earnings levels (where both private saving and Social Welfare produced the target result), there was a significant shortfall for higher earners, even allowing for contributions at greater levels than other groups.

Salary	**What's needed**	**Actually paid**	**Difference**
€15,000	5%	9%	(4%)
€25,000	13%	10%	3%
€40,000	18%	11%	7%
€62,500	21%	13%	8%
€87,500	22%	15%	7%
€125,000	23%	16%	7%

[Source: Irish Life, as quoted in Society of Actuaries in Ireland, DC paper, 2005]

[12] Society of Actuaries in Ireland, Defined Contribution funding review, 2005

In looking at the current system, Ireland can take some credit for providing a basic Social Welfare pension which works. Population trends mean that this his will need to adapt for the future. The real issue is how to encourage supplementary saving through consumer education and awareness of retirement planning.

Option #2 - More State provision - enhancing Social Welfare

This option uses the State as the prime mover in providing higher retirement income and pensions coverage. Its advocates will point to the near-universality of the Social Welfare system, which through the PRSI mechanism is able to capture those groups who traditionally lose out in the current private pensions system, e.g. low earners, atypical workers and women. The Social Welfare route also supports labour mobility as everyone is insurable under the PRSI system.

The Green Paper outlines a scenario where improved Social Welfare pensions will be paid for by an increase in State retirement age, on a phased basis up to age 70, as a trade off for higher benefits. Higher State benefits are intended to deal with the adequacy issue highlighted in the previous section, where people are not saving enough to secure realistic incomes in retirement. Research carried out for the Green Paper reveals the following:

- Based on current benefit and contribution levels, the deficit in the State's Social Insurance Fund is projected at 6.4% of GNP by 2061.
- This projected deficit will drop to 5.3% GNP if State retirement age is increased.
- If the State pension is increased to 50% average earnings, the projected deficit increases to 10.0% (or 8.3% if retirement age is raised)[13].

Higher State benefits will extend the scope for delivering a higher retirement income further up the scale, to middle-income groups rather than just the lower paid, tackling he adequacy issue. An increased State retirement age fits in with the fact that people are living longer and are more likely to be able to contribute to the workforce, particularly now that the skills and attitudes of older workers are valued by

[13] Green Paper, 8.15-8.23

employers. The downside is that an extension of State retirement age will mean other State benefits, such as unemployment and disability, being paid for longer. Will taxpayers, both employers and individuals be willing to pay for higher Social Welfare benefits? A fixed retirement age makes little sense in a world where individuals have a range of skills to deploy in different situations. Changing State Retirement Age upwards depending on an individual's date of birth only compounds the existing problem. What is needed is more flexibility, not less. **We would recommend offering a range of State Retirement Ages – a 'retirement window' – with different outputs depending on when an individual chooses to draw the State pension?**

Option #3 - Introducing 'soft mandatory' private pensions

The 'soft mandatory' approach to supplementary pensions involves mandatory access to a pension scheme, but with an individual opt-out facility after a set period of time, hence the 'soft' aspect.

New Zealand has gone down the soft mandatory route, with the KiwiSaver scheme launched in 2007. New employees aged 18-65 are automatically enrolled at the point they start a new job, but are able to opt out of the scheme within 6 weeks[14]. Existing workers can opt in, as can the self-employed and those not currently working. Funds are not tied up until retirement as members of KiwiSaver can access these at one point in their working lives to assist in the purchase of a first home. KiwiSaver uses investment-based personal retirement accounts on a defined contribution basis, using the tax system to collect contributions and pass them on to pension providers[15].

One concern of consumers is that saving for retirement through traditional pension structures involves their money being 'locked away' for years ahead. KiwiSaver addresses this by allowing a one-time capital withdrawal and providing financial advantages for first-time home buyers. Some critics see this pro-housing element in KiwiSaver as promoting housing investment at the expense of retirement saving. There have also been some calls for KiwiSaver to be made compulsory, dropping the

[14] National Pensions Review, Appendix C, 2006

[15] OECD Economic survey of New Zealand, 2007

soft mandatory approach altogether. The main advantage of compulsion is seen as forcing a larger increase in private saving. Critics of compulsion see this as having a negative impact on low-income households, restricting consumption during their working lives regardless of personal circumstances just to provide a higher income in retirement[16].

The Green Paper sets out a possible soft mandatory model for Ireland, covering new hires who cannot join an employer's pension scheme, plus those already in employment and the self-employed, if they so wished. There would be a compulsory employer contribution of 2% of earnings, plus 5% from the employee and 2% from the Exchequer (capped at €750 maximum each year). Employees would be able to opt-out of the scheme after 3 months (and also rejoin at a later date). Contributors would be able to access 25% of their funds at retirement or at one point during their working lives.

This soft mandatory type of scheme deals with employee inertia on pensions as it sweeps them up into a savings scheme (and inertia might stop them opting out at a later date). The danger is that any mandatory system, soft or otherwise, will undermine existing pensions provision. Faced with compulsory access and contributions, employers may decide to close existing pension schemes, leading to a 'dumbing down' of workplace pensions. Employers will also resist what is, in effect, another payroll tax with compulsory contributions on top of their existing PRSI bill. The measures could be self-defeating as employers seek to trim costs and maintain competitiveness with job cuts. Any form of compulsion on employers is a blunt instrument to solve a complex issue. The dangers of 'dumbing down' existing provision will not help with adequacy as the real issue is encouraging greater saving.

Option #4 - Introducing mandatory private pensions

This policy option is the big one - mandatory pension access and contributions. Advocates point out the apparent success of this model in Australia and its imminent introduction in the UK.

[16] OECD

With the coverage agenda, NPPI had targeted 70% pensions coverage amongst workers in the 30-65 age ranges. The Green Paper puts forward the view that only a compulsory savings scheme can reach this sort of target for coverage and adequacy[17]. The Green Paper's mandatory model covers both employed and self employed people, covering earnings between 125%-500% of the level of State pension or earnings between €15,000 - €60,000 (at 2006 levels). Contributions would be set at 15% of earnings in the income bands, to include a 5% Exchequer contribution. The proposed mandatory model would target both the employed and self-employed. Savers would not be able to access their funds before retirement date. This represents a radical rethink and is very different to the current system.

Australia embraced mandatory pensions (or 'superannuation') in 1983 and has been seen as a leading exponent of this approach to pensions coverage. The scheme was originally introduced as part of a national pay agreement between employers and unions, before the system became universal in 1992. Originally set at 3% of pay above a certain threshold, contributions have now increased to 9%. On the face of it, the coverage agenda has been achieved, increasing to over 90% of the target population. Superannuation assets under management now exceed Australia's GDP, making it the fourth largest managed funds industry in the world[18] The retirement savings landscape has changed radically with only 300 superannuation funds remaining as the industry has consolidated, with a change in the manner in which providers and advisers operate. The traditional link between employment and superannuation has been broken so that anyone under age 65 can pay into a superannuation fund[19]

Whilst Australian policymakers appear to have addressed the issue of coverage, they still face the challenge of adequacy of retirement savings and customer engagement in the savings process, the same issues identified by the actuaries in Ireland. Although the Australian government mandated the scheme, it provided little incentive for individuals to make their own contributions on top of those made by their employer.

[17] Green Paper, 8.44

[18] Alembakis, R., 'Superannuation industry poised to exploit new legislation', Global Pensions, December 2007

[19] Jones, R., 'Developments in the reform of the Australian pensions system', 2005

The Simpler Super rules introduced in 2007 now allow savers to leave their funds invested after retirement, drawing down income as necessary. Income from these super funds is tax-free for people aged over 60, so long as a minimum amount of money is drawn down each year. These changes are designed to act as an incentive for savers to increase contributions during their working lives, to continue to leave funds invested post-retirement with some income on these funds being tax-free, along with the ability to tailor their retirement plans to their own circumstances by continuing working if they wish to do so[20].

So would compulsion work in Ireland? Both Australia and the UK have approached compulsion from different directions. It was originally introduced in Australia during a period of high inflation through an accord between government, employers and trade unions[21] . These economic and political factors were unique to Australia at the time and the cost of compulsory employer retirement contributions was partly met through reduced pay rises for workers. The UK, like Ireland, had a well-developed supplementary pensions sector, but the wheels have fallen off the UK pensions wagon which is now suffering from initiative fatigue as successive UK governments brought in new waves of pensions regulation. The UK is looking to introduce compulsory accounts from 2012 and many see this move as leading to a levelling down of existing pension provision, with monies being 'recycled' from existing pension schemes rather than extending retirement saving[22].

Mandatory saving for retirement can create a false sense of security, lulling people into believing that their retirement will be comfortable and stop them from making additional savings[23]. In fact, the new Labor government in Australia has accepted that the 9% minimum contribution needs to be added to by increased individual contributions if a target 15% contribution level is to be achieved[24]. If this is the end

[20] Alembakis, 2007

[21] Jones, 2005

[22] Williams, H., 'So what happens after 2012?', Financial Times, 10 August 2007

[23] Cumbo, J., 'Debate looks at the ins and outs of the model from Down Under', Financial Times, 14 May 2005

[24] Holland, K., 'Australian Labor Party to hold steady course', Global Pensions, December 2007

result of compulsion then it would be a non-runner in Ireland with the urgent need to regain international competitiveness.

Compulsory saving for retirement will also make current pension problems worse for the non-national migrant workers who have played a significant role in the Irish economy in recent years. Globalisation in business has not yet lead to globalisation in retirement assets. The Pensions Ombudsman[25] has pointed out that the current pensions system is not well adapted to those who come to work in Ireland for a temporary period. As things stand at present, they can acquire pension rights which are locked away in Ireland as they cannot be readily transferred to other pension systems. Mandatory pensions would only make the existing problem worse and potentially act as a disincentive to the inward movement of skills and labour to Ireland as a mandatory pension would end up as a frozen, non-benefit to these potential migrant workers.

Mandatory pensions deal with the coverage objective from the NPPI era, with an expected 80% of the workforce being included in the scheme. The mandatory model misses out on target groups in current pension strategy because of income thresholds, as the 20% ineligible workers will include part-timers and some women workers. Again, the obsession with achieving NPPI targets obscures hard facts on employer costs and competitiveness. Employers will resist a further payroll tax and where will extra Exchequer monies come from to fund mandatory contributions? Employees already have to contribute to PRSI, which is a mandatory pension. Forcing workers to contribute to another mandatory pension will be seen as yet another government stealth tax so is likely to be counter productive.

Option #5 - Enhancing the current voluntary system

In 2006 the National Pensions Review report by the Pensions Board stated that almost twice as many people have supplementary pension provision as compared to the position in 1995[26]. The rapid expansion of Ireland's workforce was greater than anticipated at the time of the NPPI report in the 1990s. So whilst the National

[25] Annual Report 2006, Pensions Ombudsman

[26] National Pensions Review, para 1.12, 2006

Pensions Review points out that supplementary coverage is still not enough, it accepts that coverage levels are sensitive to changes in the composition of the workforce and NPPI targets for supplementary pensions for 2008 had already been achieved by 2002[27]. This is a clear illustration of how social policy goals can be achieved by sound economic management rather than diktat.

To build on this progress, the National Pensions Review provided some interesting ideas to enhance the current supplementary pension system:

- Borrow the SSIA matching principle with a State incentive for Personal Retirement Savings Account ('PRSA') personal contributions. Although tax relief on pension contributions is a valuable benefit, not everyone grasps the concept so a matching '€1 for €1' matching for each €1 invested in a PRSA (subject to an overall maximum) is likely to have a greater impact. The success of SSIAs is the proof that this approach works – so it is worth trying with pensions.

- PRSA contributors would be allowed limited access to their funds before age 45. This is similar to options in the USA and more recently New Zealand's KiwiSaver. Again, this is likely to prove an attractive incentive towards long term saving but without the negative factor of money being locked way until age 65.

- Simplify the current tax relief regime by allowing higher rate tax relief for personal contributions to supplementary pension schemes, subject to limits.

- The current PRSA point of sale rules make setting up a simple product far more complex than it needs to be and is self-defeating. The current need for a factfind questionnaire would be dropped.

- Simplify existing tax and regulatory structures by making the system relevant to real people and real life. There has been a marked shift to defined contribution ('DC') pensions since 1990 but we now have a two-tier system in how people can take their benefits at retirement. One group, the owner-

[27] National Pensions Review, para 4.10, 2006

managers of businesses and Additional Voluntary Contribution ('AVC') payers, can draw an income whilst continuing to invest their pension fund through Approved Retirement Funds ('ARFs'), subject to certain rules. However, the majority of those in DC schemes are forced to buy annuities at the point of retirement. Whilst they might offer certainty of income, annuities offer poor value to consumers in the current low interest rate environment. The annuity market has shrunk so is arguably more of a cartel than a market today. Research conducted on behalf of the Green Paper shows that the only people who buy annuities are those who are forced to do so.

The type of proposals as outlined in Option 5 and also put forward by the National Pension Review are practical and likely to work, once more pointing to the role for a voluntary approach to addressing the coverage and adequacy problems rather than State prescription. The PRSA vehicle is there already, being a child of NPPI. The Pensions Board has a much tighter monitoring regime of PRSAs compared with other pension products, so progress can be easily measured. National competitiveness will not be impacted and individuals would have greater involvement if the pension system was flexible and more relevant to their own needs.

5. Turning workers into savers

The issue facing future pensions policy in Ireland is how to encourage people to start saving for retirement and educate those who are pension savers to make sure they are saving enough. Increasing pensions coverage alone along the lines of the NPPI objectives is only part of the story. PRSAs were intended to achieve this but the large number of 'empty boxes' in the PRSA data shows that this has not worked so far, so the issue of adequacy in retirement saving is also important.

Consumer education on retirement planning

Studies by the actuarial profession[28] have highlighted the gap in retirement provision, with consumers failing to appreciate the long-term nature of the project to create an adequate retirement income. The actuaries came up with a benchmark of a fund of 10 times salary being required to resource an income of 50% pre-retirement earnings, including the State pension. Where individuals were saving for retirement, through an employer-sponsored scheme or on their own, there were large gaps in the amounts required to deliver adequate income in retirement. This reinforces the view that the real issues are consumer education and awareness of the need to take responsibility for their own retirement planning. Experience in Australia points to the significance of consumer education and communication. The Australian government spent the equivalent of €6.8M in this area during the eighteen months when complusion was introduced in the mid-1990s[29] so even mandatory systems have had to address the education issue.

The Green Paper debate centres on the level to which individuals should be compelled to contribute to saving for retirement, and also the extent to which employers should be involved. Although policymakers are attempting to extend pensions coverage and face up to the need for adequate saving, the real challenge is how to make 'pensions' relevant to ordinary people. Given the fact that employees are not currently connecting with PRSAs in the manner envisaged by NPPI, the Green Paper states that

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[28] Society of Actuaries in Ireland, 'Funding Targets and Contribution Rates in Defined Contribution and Individual Pension Plans', 2005

[29] Williams, 2007

the success of a purely voluntary system in increasing pensions saving depends on savings incentives[30].

This brings us back to the success of the SSIA model, which incentivised and popularised savings and investment to a wider public in Ireland. The National Pensions Review[31] proposed replacing the traditional tax reliefs on pensions saving by a State incentive and this is worth exploring as being a more practical solution rather than looking to other countries for the answer. Rather than ditch the current system for a radical mandatory model, matching retirement saving contributions on a €1 for €1 basis is simple to understand and is likely to start engaging people in the retirement planning process. This is the best means of increasing coverage at lower- and middle-income levels. SSIAs showed that incentives can work and are more likely to catch the public imagination than conventional tax reliefs or compulsory contributions.

Research in the UK explored attitudes to compulsory saving for retirement[32]. Some 70% of people favoured compulsory saving, although this tended to comprise those who were already saving for retirement, with most opposition to compulsion arising from the lowest and highest income groups. In the Australian model, the cost of compulsory employer retirement contributions was partly met through reduced pay rises for workers. Once this factor was explained to respondents in the UK survey, the knowledge that employer pension contributions might not be a 'free lunch' increased the proportion of respondents favouring no compulsion on employers. The study concluded that support for compulsion was heavily qualified in the context of any trade-off with wages and also on its impact on individuals' current approach to retirement savings. Current pay and competitiveness pressures mean that complusion along Australian lines will not work in Ireland.

Financial literacy and education are seen as major hurdles in engaging people in the pension planning process. PRSAs were supposed to simplify pensions but the regulators threw a well-intentioned spanner in the works. The Australian system

[30] Green Paper, 8.26

[31] Green Paper, 8.24

[32] Association of British Insurers, 'Compulsory pensions – an analysis of public attitudes', August 2004

allows individuals freedom to switch between different providers and this has meant that providers' attitudes to their customers have had to change. The traditional employer-worker link on pensions has been replaced by a provider-saver relationship, increasingly built on education, branding and marketing. We are only part way there with PRSAs in Ireland whilst in contrast, providers in Australia have been forced to focus on educating members and potential members on what superannuation means over their lifetime, as individuals are now expected to take responsibility for their retirement income. The challenge is for the pensions industry to become more 'user-friendly' and deal with public suspicion of providers head-on as part of a wider consumer education initiative on saving for retirement. One positive result from the Australian experience has been that boring terms like 'superannuation' were transformed into the short and snappy 'super'. A first challenge for the Irish pensions industry and regulators should be to replace the negative connotations of 'pension' with the idea of 'retirement income'. The next challenge is to try and promote pension products in a straightforward, easily understood way. Lack of transparency creates lack of trust on the consumer's part.

The way forward

In addressing the issues raised in the Green Paper on Pensions, policymakers should seek to create a culture of personal responsibility for retirement planning, supported by incentives from the State. The Australian model of compulsory provision relates to a different context, where State provision was weak (being means-tested) and compulsory saving was funded in part by wage restraint. These factors would not work in Ireland where State pensions financed by the Exchequer and PRSI are more generous and widely available.

The SSIA experience has shown how attitudes can be changed with fiscal innovation. Rather than adopting the blunt instrument of compulsion, Ireland should promote a savings culture to create adequate retirement income. Low-cost savings vehicles such as PRSAs can be readily adapted to take '1 for 1' contributions or similar incentives in tandem with existing tax reliefs. Providers will need to rise to the challenge of educating consumers and promoting long-term savings, but they already have the marketing resources and the SSIA track record to support this.

A review of the current regulatory rulebooks and petty restrictions is also urgently needed, stripping out restrictions dreamed up in the 1970s which just add to the cost and potential confusion for consumers. The objective should be to encourage personal responsibility for retirement planning and this means building on what we have already rather than a radical move to mandatory pensions.

In summary, ISME recommends that future pensions policy in Ireland should:

- Educate consumers on the need to take personal responsibility for their retirement income. Increasing coverage is only part of the deal. Getting consumers to save more for retirement involves simplifying the current regime, putting pensions within the context of wider saving. Efforts should focus on explaining to consumers what is involved in creating the assets to fund a decent standard of living in retirement. This will help address the confusion and suspicion surrounding 'pensions'.

- Build on the current voluntary supplementary pensions system. We already have mandatory PRSI contributions to the Social Welfare system to provide basic income in retirement.

- Make pensions easy to deal with for the ordinary consumer. Incentivise saving using the SSIA model of 'you pay €x and the government pays €y', funded by straightforward tax reliefs. Tax reliefs encourage saving and are deferred taxation and not government giveaways.

- Simplify the current tax relief regime by allowing higher rate tax relief for personal contributions to supplementary pension schemes, subject to limits.

- Simplifying the 'disclosure' rules on all types of pensions would also help in creating trust on the part of the consumer. Putting pensions into plain language still presents a major challenge.

- Simplify the existing tax and regulatory regimes for private pensions. Many of the benefit limits rules date back nearly 40 years and are irrelevant today and a disincentive to save.

- Offer a range of State Retirement Ages – a ‘retirement window’ – with different outputs depending on when an individual chooses to draw the State pension.

- Consider some form of early access to funds during the saver’s pre-retirement phase, e.g. a once-off withdrawal in connection with house purchase. This would engage the twenty somethings in the long-term savings process but also offer them flexibility on their savings during their working lifetime.

- Introduce some flexibility on the drawdown of funds at retirement as the current system has different treatment for different classes of savers. Extending the ARF facility to all defined contribution schemes would go a long way to encouraging saving for retirement and would deal with the current ‘annuity trap’ which is a major obstacle to consumers in retirement saving.