Submission on behalf of James R Kehoe, Consulting Actuary in response to the Green Paper

Dear Minister,

In July 2007 I prepared the enclosed Paper for an International Conference on Government Retail Debt hosted by the National Treasury Management Agency (NTMA). I would like you to consider this Paper as a submission in response to the Green Paper on Pensions which you published last Autumn as it sets out my vision of a practical and pragmatic strategy for change in response to a rapidly changing pensions environment.

I have been involved in the pensions business for the past forty years – being the Scheme Actuary to some of Ireland's largest Public and Private Sector Pension Funds. I am semi-retired at this stage but I retain my Scheme Actuary responsibilities for a number of large pension funds. I have served as a member of the Pensions Board for ten years from its inception in 2001 – representing the Society of Actuaries in Ireland.

In formulating my strategy for change I have been particularly conscious of the following:

- The inevitable and terminal decline of the Definer Benefit Pension Schemes in the Private Sector.
- The social inequity of shunting the next generation of private sector workers into a DIY pension regime (Defined Contribution Schemes) with no protection against the risks involved.
- The failure of PRSAs to make a serious contribution towards 2nd tier pension provision in terms of either workforce coverage or benefit adequacy.
- The social inequity of State subvention (in the form of tax relief) towards 2nd tier pension provision being so heavily weighted in favour of higher rate tax payers.
- The growing chasm between cosseted Public Sector pension provision and the pension plight of private sector employees and the self employed.
- The need for public pension policy to achieve equity between employed persons and the self employed.
- The potential to build on what is good about Ireland's present pension system – particularly the fact that our PRSI system ensures universal coverage for a basic level of benefit.
- The potential to involve the NTMA in managing investment risks to a level justifiable in the context of **Social Protection.**
- The potential to utilise the cost effective administration system of the Department of Social Protection in the provision of **Supplementary Social Welfare Pension.**
- The proven success of SSIAs as savings media for young people.
- The growth and progress of the National Pension Reserve Fund and the potential to expand the role of the NTMA in the long term savings market with particular reference to the provision of **Supplementary Social Welfare Pension.**

The Green Paper is long on detail but short on innovative thinking. Whilst it does consider some innovative ideas (e.g. my suggested 15 to 1 Plan) its bias is unreasonably negative and could be summarised as representing a conventional response to unconventional thinking. Some of the negative arguments put forward are quite erroneous and entirely without foundation. I would be happy to elaborate given the opportunity to do so.

The innovative ideas in the enclosed Paper are pragmatic and socially equitable with the potential to transform the attractiveness of Ireland's 2nd tier pension provision to the benefit of all employed and self-employed people.

With kind regards

Yours sincerely

James R Kehoe

SAVING FOR RETIREMENT CHALLENGES AND OPPORTUNITIES

Presented by James R Kehoe
June 7, 2007

IRISH GOVERNMENT RETAIL DEBT SOCIO – POLITICAL IMPACT

"Our retail debt activity is an arm of Government, and that impacts on the way we conduct business on a day to day basis and also on our planning for the future. Commercial focus, while necessary for efficiency and good customer service, has to be tempered by a sensitivity to the socio-political environment in which we operate."

Felix Larkin

International Retail Debt Management Conference
South Africa, 8 June 2006

I would like to begin my presentation with this quotation from a Paper given be Felix Larkin to the International Retail Debt Management Conference in South Africa this time last year – virtually to the day. Felix is the Head of Retail Debt at Ireland's National Treasury management Agency (NTMA) and it is as a consequence of his invitation that you are required to enjoy or endure my presence at your conference this morning.

In his 2006 Paper Felix identified that Government retail debt operations have certain features which are inherently non-commercial. Among those listed are the following which are particularly relevant to my Presentation:

- Political approval for rates of return and other terms and conditions of products

- Mandate to encourage thrift – a "moral" imperative as well as anti-inflation policy
- Government as banker of last resort for less sophisticated investors and the "unbanked"
- Public demand for special products which the private sector cannot or will not provide, e.g., inflation – proofed products and guaranteed pension facilities
- Link with distribution channel for Government social welfare and other benefits
- Accountability to parliament, not shareholders – tending to reinforce the importance of non – commercial factors

Within the context of opportunities for long term savings I would add:

- Government's responsibility for long term financial planning to meet the challenges of a changing demographic profile – an aging population in the developed world.
- Government's ability to spread financial risks across the broad spectrum of economic activity to the extent required by the principle of SOCIAL PROTECTION.

DEMOGRAPHIC CHANGE – AN INTERNATIONAL PERSPECTIVE

The challenges and opportunities posed by an aging population are truly International in nature. Despite the obvious uncertainties associated with very long term projections (expanding funnel of doubt et al), the following slides illustrate the general shape of things to come in terms of likely demographic profiles and expected changes to age dependency ratios over the next half century or thereabouts.

EU 27 Median Age of Population 2005 & 2050

Number of Persons aged 15 – 59 for Each Person aged 60+

The dynamics of demographic change make Ireland an interesting case study over the past decade or so. The vital statistics may be summarised as follows:

- **Population: 4.235 million – the highest since 1861**
- **Population growth 2002 – 2006:2.0% per annum**
- **Gross inward migration 2006: 86,900 per annum (net 69,900)**
- **Median age: 34 years (lowest in EU 27)**
- **Employment: 4.2% per annum growth 1997 – 2006**
- **Unemployment rate (2006 average): 4.4%**

Ireland's unprecedented rate of economic growth (averaging over 7% per annum for the past decade) and rapidly expanding demand for labour has meant that the historical trend of net emigration from Ireland reversed in the mid 1990s; and Ireland has experienced a net inflow of immigrants since then. Returning Irish Nationals accounted for just under a quarter of the 2006 gross immigration figure while 63% were nationals of other EU-25 countries. Nearly half (43%) of the immigrants were nationals of the states that joined the EU on 1 May 2004 – 26% from Poland and 7% from Lithuania.

In the light of these trends it is clear that the most uncertain aspect of long term population projections must be the long term effects of emigration (positive or negative). Will Ireland's Eastern European guests remain a permanent feature of our demographic profile? Will they become more Irish than the Irish themselves or will they feature as a transient part of the Irish labour force? How will the loss of such young talent impact on the economic and demographic profiles of their Home Countries?

These and similar questions lead to one imperative requirement, namely, the need for all EU states to make sensible and sustainable long term financial planning for an overall aging population so as to lessen the burden of age dependency on future generations.

I further contend that a Government sponsored long term savings plan which is attractive to the retail market, is simple, flexible and transferable across the EU 27 could and should be a central feature of such long term financial planning.

THE ECONOMIST

I do not think I would have been asked to speak to you today if there wasn't general agreement that developed and developing economies alike are facing the challenge of demographic change. The October 2003 "Economist" cover posed one particular tongue-in-cheek way of meeting this challenge. However, in the absence of a commitment to larger families and longer working lives we all really do need to explore practical and socially equitable ways of meeting the financial pressures which will result from rising age dependency ratios.

SOCIAL SECURITY PENSIONS – THE IRISH EXPERIENCE

In designing a Pan European long term savings product I would like to draw on lessons which can be learned from the Irish experience of recent years in relation to retirement provision and the savings market generally. If you will bear with me I think you will agree that there is indeed an International dimension to these lessons.

My thinking in this area has been stimulated by the following slide which I used in a Paper for the Society of Actuaries in Ireland about four years ago. Whilst it has not been updated, it is fairly timeless in that the general pattern will not have changed materially.

MANDATORY – V – VOLUNTARY PENSION PROVISION

Pension provision is all about maintaining living standards in retirement. What this slide indicates is that different European jurisdictions have addressed this challenge in very different ways. Most of the developed economies rely very heavily on high levels of Mandatory Social Security Pensions (relative to average earnings) financed on a Pay-As-You-Go basis. Such systems provide high levels of security for retiring workers but will need to contend with serious funding pressures as aging populations give rise to increasing age dependency ratios.

At the other end of the spectrum, Ireland shows up in lights as very heavily dependant on voluntary 2nd tier pension provision.

I strongly contend that over reliance on voluntary 2nd tier pension provision without State support in terms of monetary safeguards is not sustainable in any jurisdiction.

My view is reinforced by the reality that, increasingly, voluntary 2nd tier pension provision means shunting the next generation of workers into a **D**o-**I**t-**Y**ourself approach to pension provision in the form of **Defined Contribution Pension Plans** under which benefits depend solely on the accumulated value of contributions paid by or on behalf of individuals. This trend is very clear from my next slide relating to the Irish experience but the pattern is very much an International trend.

DRIFT TO DEFINED CONTRIBUTION PENSION PLANS

PENSIONS BOARD STATISTICS 1995 - 2005

Whilst still at the scene setting stage, we need to look at two particular initiatives taken by the Irish Government in recent years, namely;

1. **The establishment of a National Pensions Reserve Fund**
2. **The success of Special Savings Incentive Accounts**

The National Pensions Reserve Fund (NPRF) was established in April 2001 in order to part pre-fund the public pension system. Its objective is to meet as much as possible of the costs of social welfare and public service pensions from 2025 onwards when these costs are projected to increase significantly due to the aging of the population.

The Government is required to invest 1% of GNP in the NPRF annually. No money can be taken from the Fund before 2025. From then on draw-downs will be used to spread the Exchequer burden arising from Ireland’s additional social welfare and public service pension commitments over a lengthy period thereby achieving a degree of intergenerational equity as regards future costs.

The NPRF is controlled and managed by the National Pensions Reserve Commission. The Commission is required to operate the NPRF on a commercial basis so as to secure the best possible financial return subject to prudent risk management.

The National Treasury Management Agency (NTMA) acts as Manager of the NPRF and the Commission performs its functions through the NTMA.

The NPRF's value at end 2006 was some €18.8 billion, a sum equivalent to 12.6% of GNP.

The following slide depicts the asset distribution of the NPRF as at end 2006.

ASSET DISTRIBUTION OF NPRF

I am deliberately spending some time on the detail of the NPRF as I believe it is central to the way in which the State can play a crucial role in the long term retail savings market to the benefit of current and future generations of Irish workers. I also believe it is a model which could and should be replicated in other jurisdictions.

The most important feature of the investment strategy being followed by the NPRF is that over 80% of the Fund is invested in real as opposed to monetary assets i.e., equities as opposed to bonds. This is exactly the right type of investment strategy for a Fund of this nature which can take a long term perspective. To examine this a little further I will take you through a few slides on the general theme of long term investment returns.

TRIUMPH OF THE OPTIMISTS

Ever since its original publication in 2002, I have regarded "Triumph of the Optimists" by Elroy Dimson, Paul Marsh and Mike Staunton of the London Business School as the Bible/Koran of Long Term Investment Strategy. If you never read any other research book on investment strategy – read this one!

2007 YEARBOOK

Their annual Yearbook updates the numbers and I have selected a few slides from the recently published 2007 edition to illustrate my point regarding expected long term investment returns from a diversified equity based portfolio.

UK NOMINAL RETURNS 1900 – 2006

I do need to mention that this graph has a logarithmic scale; if it were linear the equity graph would probable ascend through the roof of this building! The significance of the equity return figure of 21,174 at end 2006 is that over the time period involved an equity holding would now be 80 times – not 80% more – but 80 times more valuable than a corresponding bond holding. If you want to deal in percentages, the actual uplift is about 8,000%!

UK REAL RETURNS 1900 – 2006

A more meaningful way of looking at the disparity between equity and bond returns is by reference to inflation adjusted values over time. This slide shows the cumulative value of a unit investment in real terms since 1900. The purchasing power figure of 324.5 from equities as compared to a corresponding figure of 4.1 for bonds means that you could just about buy a pint of Guinness from the proceeds of a £ invested in bonds in 1900 whereas your equity investment would probable stretch to 3 cases of half decent wine!

REAL RETURNS INTERNATIONALLY 1900 – 2006

Let us broaden our horizons a little and look at inflation adjusted returns from a cross section of International equity markets – as depicted in this slide.

These are annualised real returns and the clear message is that a long term real rate of return of 5% to 6% per annum is a very reasonable expectation from a diversified equity portfolio. This is a particularly important conclusion as will be seen later in my presentation.

SPECIAL SAVINGS INCENTIVE ACCOUNTS THE IRISH EXPERIENCE

About six years ago the then Minister for Finance introduced Special Savings Incentive Accounts with a 25% State subvention to encourage personal savings and curb inflation by temporarily removing money from the economy. Qualifying savings were limited to a maximum of IR£200 (€254) per month per participant.

SSIAs proved to be spectacularly popular for the following reasons:

- The 25% State subvention was direct and transparent
- The commitment term was short – 5 years
- The tax on maturity was a straightforward 23% of investment gains

In other words, they were delightfully simple to understand, all participants were treated equally irrespective of their personal tax status; non tax payers received exactly the same State subvention as top rate tax payers.

These characteristics, simplicity, equality, flexibility and a short time horizon proved extremely attractive to young people.

It is estimated that SSIA maturity values in the recent past amounted to about €7.5 billion and a significant proportion of participants have continued their regular savings.

The SSIA experience has important lessons for the design of Government sponsored long term savings products.

RETIREMENT SAVINGS PRODUCTS POTENTIAL FOR STATE INVOLVEMENT

The principles which I believe should govern the extent to which the State should play a role in the long term savings market are:

Social Protection: Objective should be to maintain living standards in retirement relative to Average Earnings

Equity: All participants should be treated equally regardless of personal tax status

Simplicity: Witness the success of SSIAs

Flexibility: Products must be attractive to young people and this will only happen if participants have flexibility to meet their changing financial needs.

My fundamental point is that within the context of Social Protection the State can offer guarantees and value to long term savers that cannot be matched by the private sector.

Let me illustrate my point by looking at the Annuity Market.

A member of a Defined Contribution Pension Plan who goes along to an Assurance Company to purchase an inflation proofed pension at age 65 (the State Pension Age for Social Welfare Pension) with a 50% contingent spouses pension will be charged an annuity factor of 25 to 1 (each €1.00 of annual pension will cost €25).

My view is that a corresponding pension could be provided by the State on the basis of a factor of 15 to 1 (each €1.00 of annual pension would be provided for €15)

The reason for this disparity is simply that within the context of Social Protection the State can take a long term investment perspective and, as I have shown earlier, can expect to earn a real rate of investment return on an equity based portfolio of at least 4 to 5% per annum.

A Life Assurance Company, on the other hand, must operate within constraints imposed by:

- The need to honour all its guarantees to all its policyholders by accumulating reserves and investing conservatively to match its liabilities – normally Government Stock to match annuity business
- The need to satisfy statutory solvency margins
- The need to reserve conservatively for longevity risk
- The need to make a reasonable return on capital.

My view is that the Annuity Market operates as efficiently and as effectively as could reasonably be expected given the constraints imposed by commercial and statutory

considerations. My contention, however, is that considerations of Social Protection would enable the State to play a role in 2nd tier pension provision within prescribed limits thereby reducing the reliance of long term savers on ultimate value offered by the commercial Annuity Market.

STATE SPONSORED RETIREMENT SAVINGS PRODUCTS – THE DETAIL

Drawing the threads of the above arguments together would suggest to me that there are three products which the Government could and should offer to the retail savings market.

1. **An Inflation Plus Savings Account - IPSA**
2. **An Inflation Plus Retirement Bond - IPRB**
3. **An Inflation Linked Retirement Option - ILRO**

As always, the devil is in the detail but I would envisage these products operating broadly as follows:

1. Inflation Plus Savings Accounts

These would operate in much the same way as SSIAs. Any member of the public (employed, self-employed, homemakers etc) could contract to save for a 5 year period regular amounts of up to 10% of the Average Industrial Wage. The savings limit would be adjusted annually. Currently the limit would be about €260 per month – which happens to be broadly equivalent to the SSIA limit.

There would be a direct Government subvention of 25% - exactly as applied to SSIAs

Each monthly payment (plus the 25% Government subvention) would be adjusted by reference to the subsequent rise in the Consumer Price Index. At the end of the 5 year period a 10% bonus would be applied to the inflation adjusted uplifted amount This would have the effect of guaranteeing the participant an investment return equal to price inflation plus approximately 2% per annum.

At the end of each 5 year period a participant could:

- Either withdraw the accumulated value subject to the inflation adjusted uplift (including the 10% bonus) being taxed at the rate of 20%, **or**
- Transfer the accumulated value with no tax deduction to an **Inflation Plus Retirement Bond**

Within an Inflation Plus Retirement Bond the accumulated value would continue to be adjusted by reference to inflation plus 2% per annum up State Pension Age (currently 65). At State Pension Age a participant could withdraw 25% of the ultimate cumulative value tax free and the balance would be converted to Supplementary Social Welfare Pension by reference to a 15 to 1 conversion factor (each €15 of accumulated value converts to €1 of inflation proofed annual pension).

This is the kind of flexibility which would be needed to attract young people, and especially migrant workers, into the savings net. They may not be interested in a long term savings commitment in their 20s or 30s but over time the penny would drop and the Inflation Plus Retirement Bond would win the day.

2. Inflation Plus Retirement Bond

This would very specifically be a long term retirement savings product – maturing only at State Pension Age or earlier death. Monies received would be uplifted by reference to price inflation plus 2% per annum up to maturity at State Pension Age.

As described above, transfers could be made from Inflation Plus Savings Accounts on a rolling 5 year basis.

In addition, I suggest that Employers (on behalf of employees) and the Self-Employed could regularly contribute up the prevailing limit applicable to IPSAs. These additional contributions would not qualify for any direct State subvention but would rank as a trading expense for tax purposes in the same way as any other form of approved retirement benefit contribution.

At retirement 25% of the Bond Value could be paid out tax free and the balance converted to inflation proofed Supplementary Social Welfare Pension on the 15 to 1 basis as described above.

3. Inflation Linked Retirement Option

The above concepts of Inflation Plus Savings Accounts and Inflation Plus Retirement Bonds represent a blueprint for the future.

But what about the present? What should be done for the generation of workers within existing DIY or Defined Contribution Pension Plans?

In my view Social Protection considerations provide a compelling reason to allow immediate transfers from any form of Defined Contribution Pension Plan (up to a prescribed limit) at State Pension Age to secure from the State inflation proofed Supplementary Social Welfare Pension on the 15 to 1 conversion basis which I have already described.

At €209 per week the current rate of Social Welfare pension in Ireland is about one third of the Average Industrial Wage. A facility to double this by purchasing Supplementary Social Welfare Pension would mean that retiring employees (and the self employed) would have a facility to receive an overall State pension of 2/3rds of the Average Industrial Wage through a maximum transfer payment of about €165,000.

IS THERE AN INTERNATIONAL DIMENSION?

The International Dimension is twofold:

- The principles and concepts I have articulated are equally applicable to any jurisdiction which provides modest levels of Social Security Pension relative to the prevailing Average Industrial Wage. In time they could become equally relevant to jurisdictions with high levels of Social Security pensions if such liabilities become financially unsustainable through rising age dependency ratios.
- Inflation Plus Savings Accounts could be particularly attractive to migrant workers who may have an uncertain time horizon in any jurisdiction. Their accumulated inflation adjusted savings could be left to maturity or, ideally, transferred to similar State Sponsored pension facilities within their home jurisdictions. Either way, their future dependency on unfunded State resources – either at home or abroad – would be reduced.

SO WHAT ABOUT THE COST?

The investment aspect of what I am suggesting is essentially cost neutral on the basis that an Agency such an NTMA can reasonably expect to generate a long term real rate of investment return consistent with the value offered to the participants. The required real rate of return is about 4.5% per annum to support the 15 to 1 pension exchange rate at State Pension Age. A modest 2% real return is needed to support the pre retirement Inflation Plus Savings Accounts.

The only real cost to the Exchequer would arise from the 25% State Subvention.

The 25% Subvention could be financed by reforming the tax relief system currently operating for Occupational Pension Schemes. It is estimated that existing personal tax relief on pension scheme contributions costs the Exchequer about €2 billion per annum. As tax relief is available at an individual's marginal tax rate (currently 41% in Ireland) this means an almost one for one State subvention for higher rate tax payers, a one for four subvention for standard rate tax payers and no State subvention at all for non tax payers.

This is socially inequitable. What possible incentive is there for non tax payers to commit to long term savings under this structure?

Reform could be achieved by, for example, providing standard rate tax relief on the first tier of pension contributions – up to 10% of Average Industrial Earnings – and marginal relief on the balance up to a prescribed upper limit. This would mean treating Occupational Pension Scheme members and Inflation Plus Savings Account participants equally as regards a State subvention.

I venture to suggest that most if not all of the €2 billion Exchequer subvention is enjoyed by higher rate tax payers so limiting a tranche of such pension contributions to relief at the standard tax rate has the potential to achieve significant Exchequer savings and thereby provide scope for a more socially equitable distribution of long term savings incentives.

I have been advocating State involvement in 2nd tier pension provision in Ireland for the past few years and the most trenchant opposition has consistently come from the Irish Department of Finance.

To put these objections in context let us look again at the plight of our Defined Contribution retiree seeking to protect his or her living standards in retirement in a way which matches the privileged position of retiring Public Servants.

Like Beauty, Value is in the eye of the beholder! Our retiring employee will be told by a Life Assurance Company that to purchase a pension at age 60 (the age at which most Civil Servants are entitled to retire) of half his salary indexed to price inflation he would need a fund of 15 times his retiring salary. But despite this high cost, this is very much below the quality of the retirement benefits enjoyed by our Public Servants in one particularly important respect. Irish Civil Servant pensions increase on a parity with pay basis and this is much more valuable and therefore more costly that a pension indexed to price inflation. It is in fact so valuable that money cannot buy it in the marketplace!

But if our retiring Defined Contribution member could actually buy such a privileged benefit how much is it likely to cost. Well if a half salary pension linked to price inflation costs 15 times salary I venture to suggest that if you could buy such a pension linked to pay rises and add in a gratuity of 1.5 times salary the overall value at age 60 would be about 25 times salary – a tidy sum indeed for our retiring Department of Finance Officials. This measure of value suggests that these pensions are equivalent in value to about 60% of salary per year of service.

Supposing a particularly brave Minister for finance were to recognise that the growing disparity between civil servant pensions and pensions available to the rest of Ireland's labour force was unsustainable and that, instead, all public servants would be transferred to a first class Defined Contribution Pension Plan into which 15% of salary would be paid and pensions would have to be bought in the market place at retirement. In those circumstances I wonder how quickly the objections to my 15 to 1 Plan would evaporate!

At the end of the day my message is simple.

Workers generally (including homemakers) deserve a modicum of the quality of retirement benefits available to public servants at a fair price. I have shown how this can be achieved within the context of Social Protection by spreading the risks associated with funding for retirement benefits across the broad spectrum of society on a fair and equitable basis.

Saving for Retirement – Challenges & Opportunities Presented by James R. Kehoe

7th June 2007

Irish Government Retail Debt – Socio – Political Impact

"Our retail debt activity is an arm of Government, and that impacts on the way we conduct business on a day to day basis and also on our planning for the future. Commercial focus, while necessary for efficiency and good customer service, has to be tempered by a sensitivity to the socio-political environment in which we operate."

Felix Larkin
International Retail Debt Management Conference
South Africa, 8 June 2006

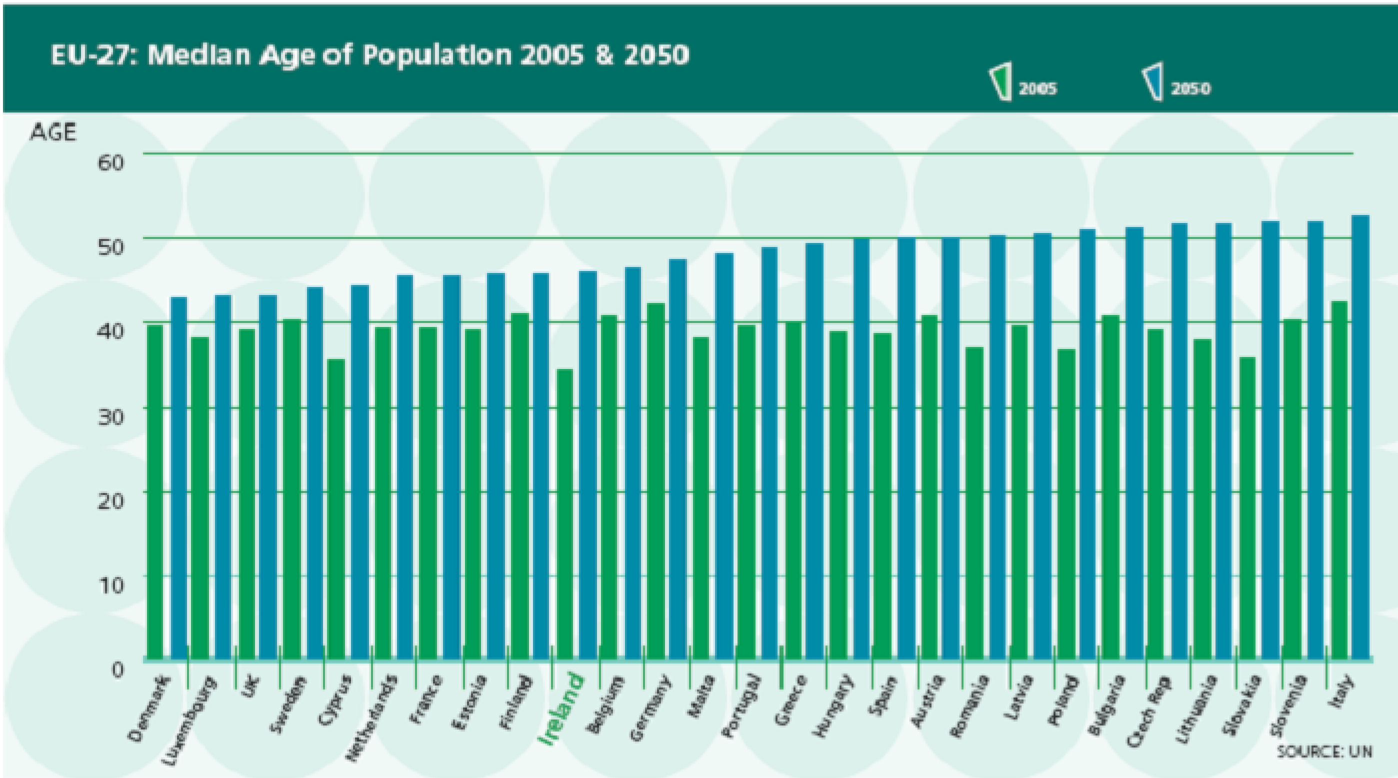
Non Commercial Features of Government Retail Debt

- Political approval for rates of return and other terms and conditions of products
- Mandate to encourage thrift – a "moral" imperative as well as anti-inflation policy
- Government as banker of last resort for less sophisticated investors and the "unbanked"
- Public demand for special products which the private sector cannot or will not provide, e.g., inflation – proofed products and guaranteed pension facilities
- Link with distribution channel for Government social welfare and other benefits
- Accountability to parliament, not shareholders – tending to reinforce the importance of non – commercial factors

Additional Features pertaining to long term savings

- Government's responsibility for long term financial planning to meet the challenges of a changing demographic profile – an aging population in the developed world.
- Government's ability to spread financial risks across the broad spectrum of economic activity to the extent required by the principle of SOCIAL PROTECTION.

Demographic Change – An International Perspective



Ireland – Dynamics of Demographic Change

Population: 4.235 million – the highest since 1861
Population growth 2002 – 2006: 2.0% per annum
Gross inward migration 2006: 86,900 per annum (net 69,900)
Median age: 34 years (lowest in EU 27)

Employment: 4.2% per annum growth 1997 – 2006
Unemployment rate (2006 average): 4.4%

The Challenges of Modern Migration

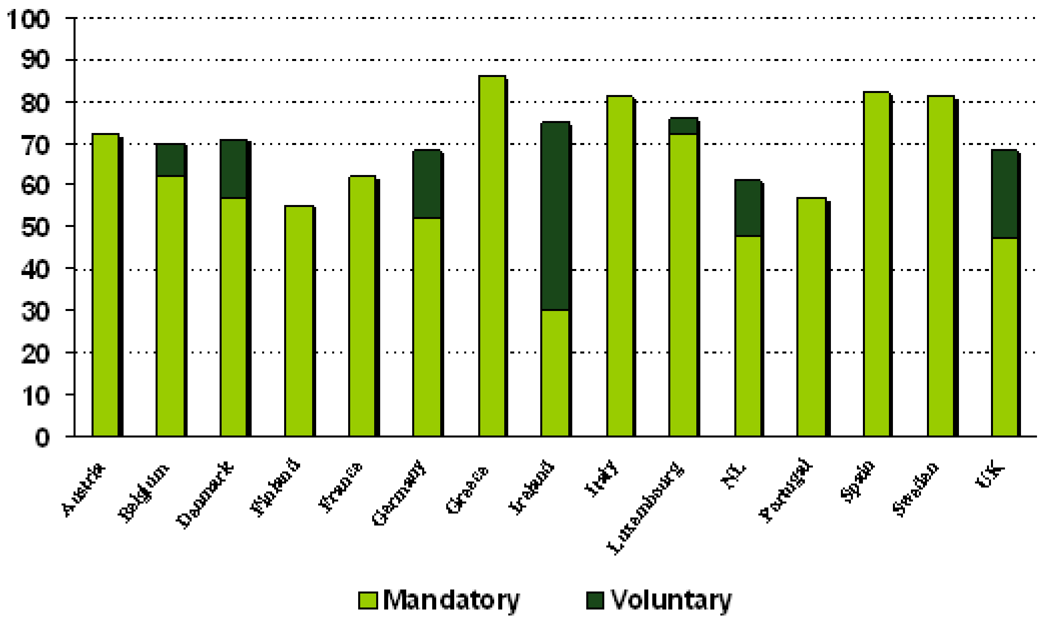
- Will Ireland's Eastern European Guests remain a permanent feature of our demographic profile?
- Will they become more Irish than the Irish themselves?
- Will they be a transient part of the Irish Labour force?
- How will this impact on the economic and demographic profiles of their Home Countries?

The Need for Sustainable Long Term Planning

- These and similar questions lead to one imperative requirement, namely, the need for all EU states to make sensible and sustainable long term financial planning for an overall aging population so as to lessen the burden of age dependency on future generations.
- A Government sponsored long term savings plan which is attractive to the retail market, is simple, flexible and transferable across the EU 27 could and should be a central feature of such long term financial planning.

Mandatory –v- Voluntary Pension Provision

Pension expressed as a % of National Average Earnings



- Ireland over reliant on 2nd tier pension provision
- Over reliance on 2nd tier pension provision without State support in terms of monetary safeguards is not sustainable in any jurisdiction
- Next generation consigned to Do – It - Yourself (Defined Contribution) Pension Plans.

Drift to Defined Contribution Schemes

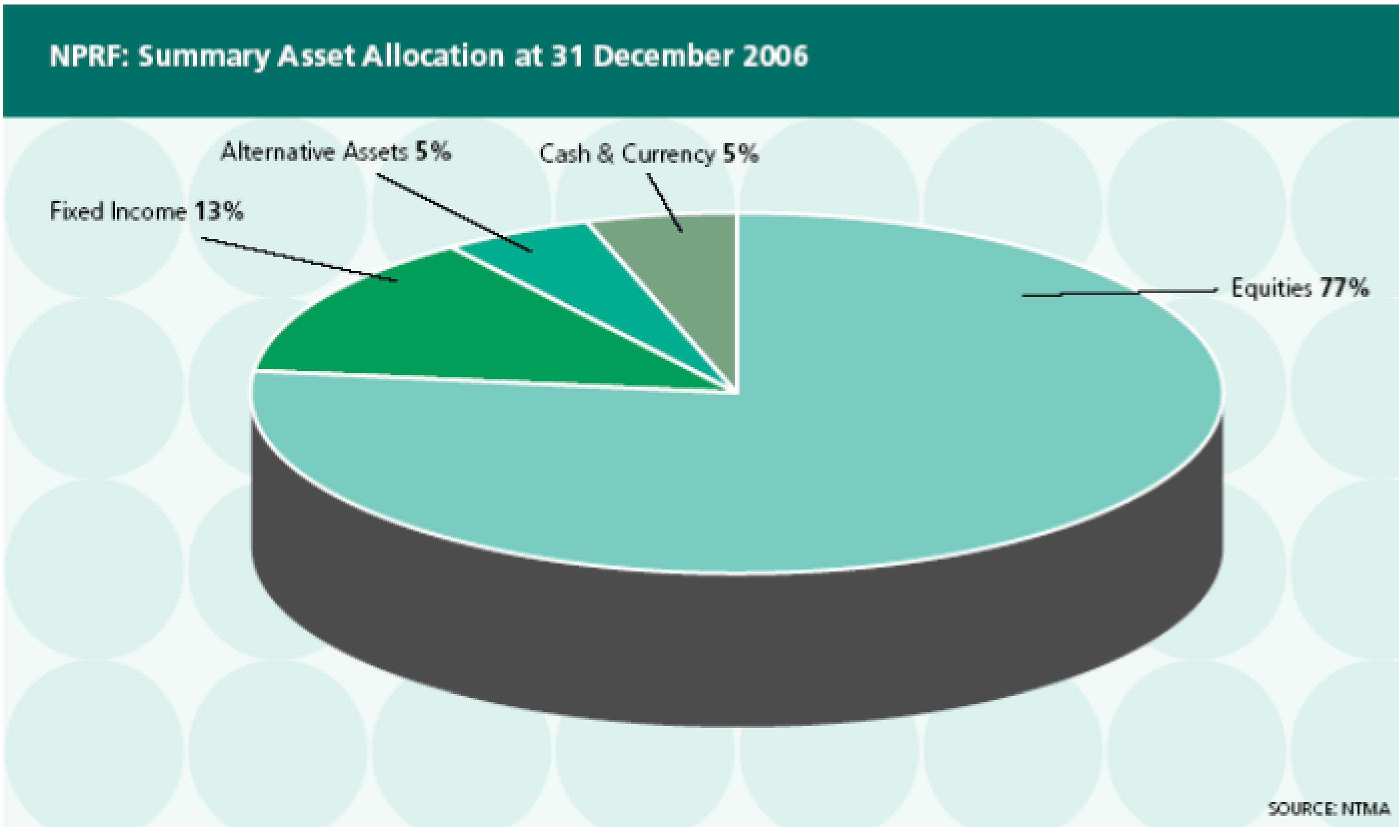
No. Of	Defined Benefit Schemes*	Defined Benefit Scheme members*	Defined Contribution Schemes	Defined Contribution Schemes Members
1995	2,067	203,146	42,565	78,974
2005	1,305	239,127	82,841	234,814
% change	- 37%	+18%	+95%	+197%

***Subject to the funding standard**
Available from Pensions Board Annual Reports

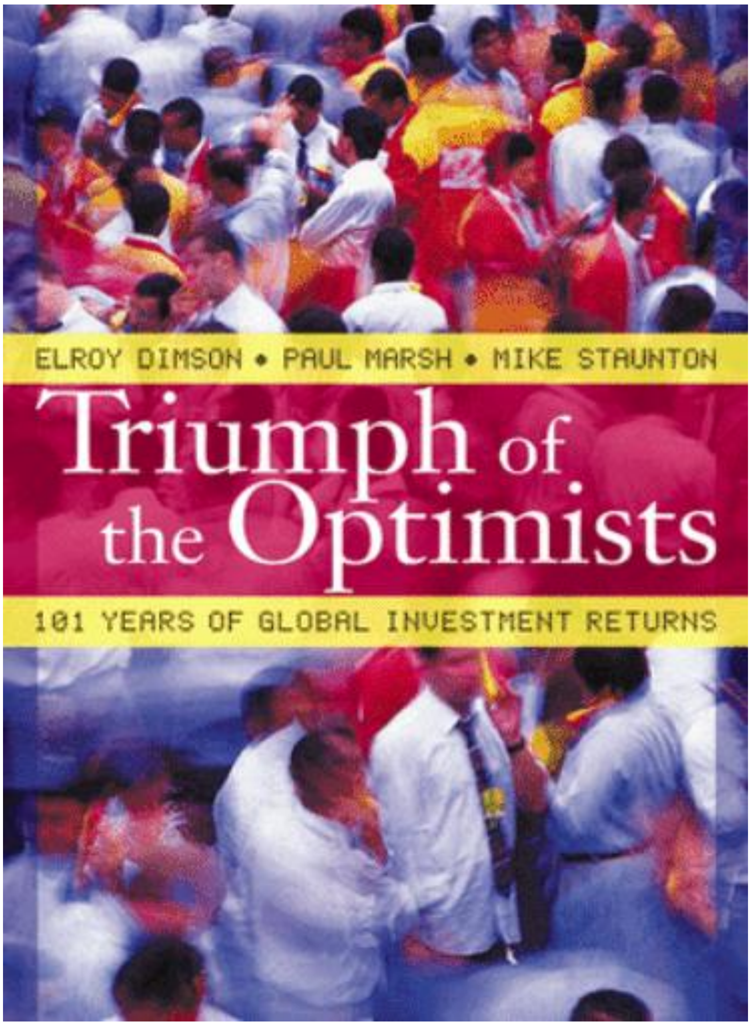
Recent Government Initiatives

- The establishment of a National Pensions Reserve Fund
- The success of Special Savings Incentive Accounts (SSIAs)

National Pensions Reserve Fund – Asset Distribution



Triumph of the Optimists



2007 Yearbook

Produced by: ABN AMRO Bank NV

ABN·AMRO

Global Strategy

February 2007

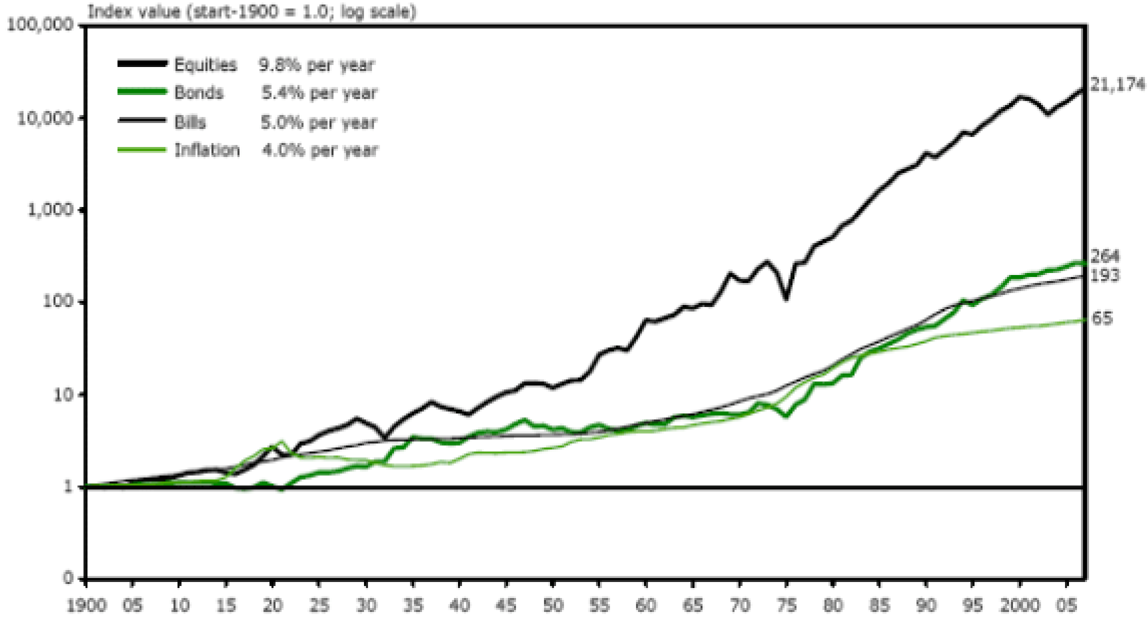
Global Investment Returns Yearbook 2007

Elroy Dimson, Paul Marsh and Mike Staunton
London Business School

Rolf Elgeti
ABN AMRO

UK Nominal Returns

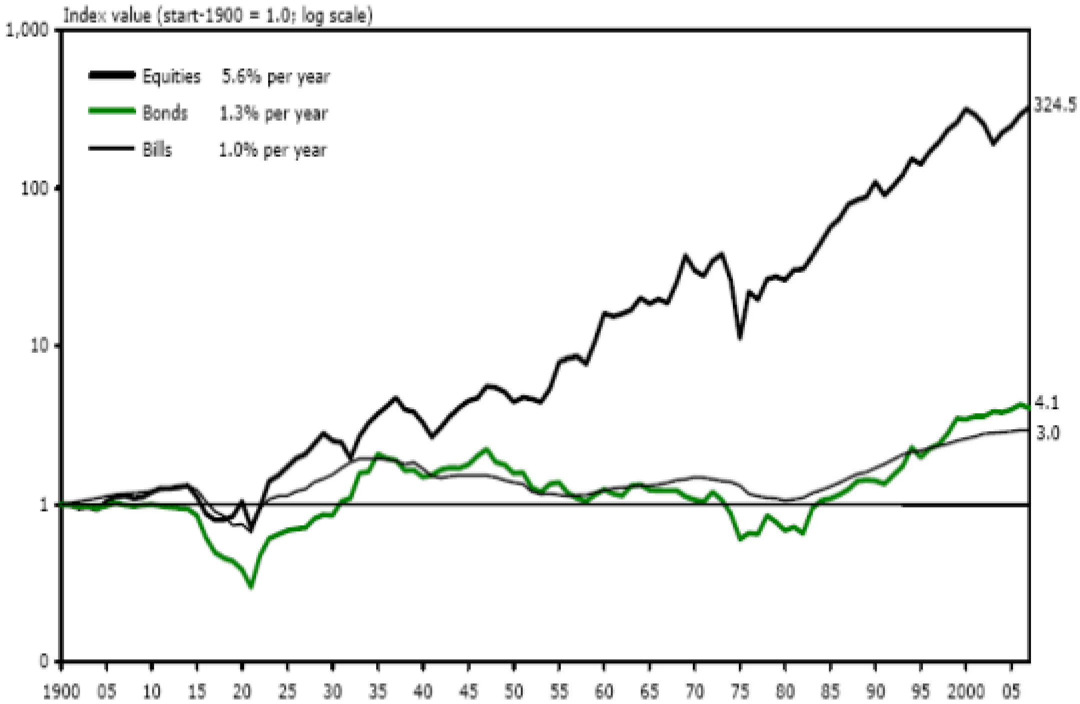
Figure 4: Cumulative returns on UK asset classes in nominal terms, 1900–2006



Source: *ABN AMRO/LBS Global Investment Returns Yearbook 2007, chart 12*

UK Real Returns

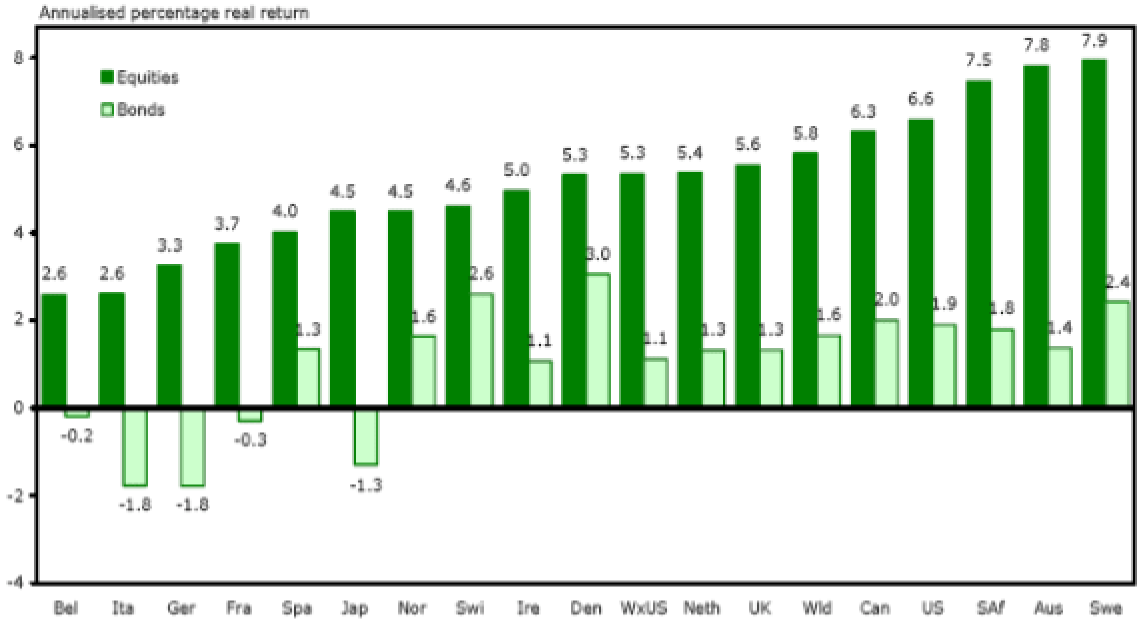
Figure 11: Cumulative returns on UK asset classes in real terms, 1900–2006



Source: *ABN AMRO/LBS Global Investment Returns Yearbook 2005, chart 13*

Real Returns Internationally

Figure 5: Real returns on equities and bonds internationally, 1900-2006



Source: ABN AMRO/LBS Global Investment Returns Yearbook 2007, chart 14

Special Savings Incentive Accounts - The Irish Experience

SSIAs proved to be spectacularly popular for the following reasons:

- The 25% State subvention was direct and transparent
- The commitment term was short – 5 years
- The tax on maturity was a straightforward 23% of investment gains

They satisfied the KISS Principle!

Retirement Savings Products - Potential for State Involvement

The Principles

Social Protection: Objective should be to maintain living standards in retirement relative to Average Earnings
Equity: All participants should be treated equally regardless of personal tax status
Simplicity: Witness the success of SSIAs
Flexibility: Products must be attractive to young people and this will only happen if participants have flexibility to meet their changing financial needs.

Within the context of Social Protection the State can offer guarantees and value to long term savers that cannot be matched by the private sector.

The Annuity Market –v- State Pension

Annuity cost at 65: 25:1 for Index Linked Pension

State as Pension Provider: 15:1 for Index Linked Pension

Annuity Market Constraints

- Conservative Investment to match guarantees
- Statutory Solvency Margins
- The Longevity Risks
- Return on Capital

Within the context of Social Protection, State can take a long term investment perspective. Witness the N.P.R.F.

Annuity Market –v- State Pension Provider

- Annuity Market operates as efficiently and as effectively as could reasonably be expected given the constraints imposed by commercial and statutory considerations
- Social Protection would enable the State to play a role in 2nd tier pension provision within prescribed limits thereby reducing the reliance of long term savers on ultimate value offered by the commercial annuity market

State Sponsored Savings Products

- Inflation Plus Savings Account – IPSA
- Inflation Plus Retirement Bond – IPRB
- Inflation Linked Retirement Option - ILRO

Inflation Plus Savings Accounts

- Same structure as SSIAs
- One for Four (25%) State Subvention (in lieu of tax relief)
- Savings limit of 10% of Average Industrial Wage (currently €260 per month)
- Savings term of 5 years
- Monthly payment indexed to Consumer Price Inflation
- 10% of inflation uplift as Terminal Bonus

Options at Maturity

- Cash withdrawal with 20% tax on gain
- Tax free transfer to Inflation Plus Retirement Bond

Inflation Plus Retirement Bond

- Long term Savings Instruments
- Maturing at State Pension Age
- To accept transfers from Inflation Plus Savings Accounts
- To accept regular contributions up to IPSA limit from Employers (for Employees) and Self Employed
- Payments indexed to Consumer Price Inflation plus 2% per annum
- 25% of Maturity Value paid tax free
- 75% of Maturity Value buys State Pension on 15:1 basis

Inflation Linked Retirement Option

- To offer Social Protection to Defined Contribution Plan members
- To accept transfers from DC Plans to secure Supplementary State Pension
- Conversion Basis of 15:1
- Transfers subject to prescribed limit
- Limit set at cost of doubling Social Welfare Pension
- Social Welfare Pension plus maximum Supplementary Pension = 2/3 Average Industrial Wage

Is there an International Dimension?

Principles equally applicable to any jurisdiction providing modest Social Security Pensions relative to average earnings

- Further potential as funding instruments for jurisdictions with high Social Security Pensions as liabilities become excessively onerous
- IPSAs especially attractive to migrant workers
  - Inflation adjusted savings left to maturity
  - Transferred to similar State Sponsored pension facility within Home Jurisdiction

Reduces future dependency of migrant workers on unfunded state resources at home or abroad

So what about the cost?

- Investment Aspect is self financing
- Target real rate of investment return:
  - 4% for 15:1 Option at State Pension Age
  - 2% for pre retirement accumulation

- 25% State Subvention – Funded by reform of Occupational Pension Schemes tax relief

Reform of Occupational Pension Scheme Tax Relief

- Tax Relief currently costs €2 billion per annum
- Tax Relief Equals
    - 1 for 1 State Subvention for Higher Rate Tax Payers
    - 1 for 4 State Subvention for Standard Rate Tax Payers
    - Zero State Subvention for non tax payers
- **Reform**
    - Apply Standard Rate relief up to €260 per month
    - Everyone then has equality of savings opportunities regardless of tax status up to a prescribed limit.

Department of Finance Objections – are they pulling up the ladder?

- Compare Defined Contribution Member with retiring Public Servant
- At age 60 annuity cost of ½ Salary pension is 15 TIMES SALARY if linked to PRICE INFLATION
- Corresponding benefit if linked to PAY INCREASES cannot be bought but would probably cost 25 TIMES SALARY when retirement gratuity is added
- By this measure the real value of Public Servant Pension is about 60% of Salary per year of service!

What if

- Public Servants transferred to Defined Contribution Scheme with 15% of Salary as pension contribution and open market purchase of pension at retirement?
- How quickly would objections to 15:1 Plan evaporate?

Final Message

Workers generally (including homemakers) deserve a modicum of the quality of retirement benefits available to public servants at a fair price. I have shown how this can be achieved within the context of Social Protection by spreading the risks associated with funding for retirement benefits across the broad spectrum of society on a fair and equitable basis.