



**Speech by Mary Hanafin, T.D.
Minister for Social and Family Affairs**
on
The Irish Social Welfare and Pension System
13th Raiffeisen Pension Symposium
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Dr. Sedlnitzky, thank you very much for inviting me to address your symposium today.

Ladies and gentlemen you are all very welcome to Dublin. I hope you enjoy your visit.

Your symposium here today is timely for a number of reasons. Not least of which is the fact that Government is currently developing a National Pensions Framework. In addition, we have recently introduced some significant changes to the pensions systems in Ireland in an effort to protect and support members of defined benefit, or DB schemes in particular.

Unfortunately, it is also a time when the economic and financial environment in which we find ourselves is



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challenging to an almost unprecedented extent. The world economy is grappling with the most severe and widespread slowdown experienced since the end of the Second World War stemming in large measure from the deterioration in global financial market conditions.

I understand that you are particularly interested in aspects of the social welfare or State pension and I will outline those details later. I would like to begin by outlining the structure of the Irish pension system and by explaining the context in which pension policy in Ireland has been developing in recent years.

Structure and Objective of the Irish Pension System

The pensions system in Ireland comprises two main elements. The first is the State run Social Welfare system and the second comprises voluntary supplementary pensions provided through a variety of arrangements and regulated by the State. These take the form of pensions sponsored by the employer which may be defined benefit or defined contribution schemes, and personal pensions such as Retirement Annuity Contracts and Personal Retirement Savings Accounts. With regard to this second pillar, contributions made by both employees and employers



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receive tax relief at the appropriate rate which is provided by the State through tax foregone.

The overall objective of our pensions system is to provide an adequate basic standard of living through direct state supports and to encourage people to make supplementary pension provision so that they may have an adequate income on retirement.

Green Paper

In October 2007 the Government published the Green Paper on Pensions. The Green Paper outlined the challenges facing the Irish pensions system in the years ahead, including the sustainability of the system over the longer term in light of demographic change and the adequacy of contribution levels and benefits. Specific issues in relation to State pensions were also set out, as well as considerations in relation to key aspects of the system including tax treatment, security of pension provision, the regulatory regime, public service pensions and work flexibility in retirement. It also set out key questions to be addressed in formulating the Government's response to these challenges.



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Publication of the Green Paper was followed by an extensive period of consultation. Written submissions were received from over 320 individuals and 62 organisations. Six regional seminars were held in early 2008 at which the 300 people who attended had an opportunity to discuss the issues involved and to make their views known. In May 2008, an international seminar was held in Dublin with speakers from the OECD, World Bank, United Kingdom, New Zealand, Australia and Ireland. This seminar was attended by 140 people from a wide range of organisations and interested parties.

The response to the consultation process reflected the wide range of views and interests held by individuals and organisations throughout the country. While there was no consensus on ways to respond to the challenges facing the pension system, it was clear that there were significant issues and problems that people wanted addressed.

National Pensions Framework

Following this consultation phase, the Government is currently developing a National Pensions Framework which I expect to publish shortly and which will shape the direction of pension policy in Ireland for years to come. The



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framework will address the many and varied issues that were raised in the Green Paper consultation process and that cut across all areas of our pension system – the social welfare pension, occupational and personal pensions, public sector pensions and retirement age.

While I am not yet in a position to announce what will be included in the Framework, I can confirm what I believe are the key issues that it should address. It worth stating now some of the many issues that face us in preparing a sustainable pensions policy:

- The population aged 65 and over will increase by 59% to 2021 and by a further 142% to 2061;
- There will be a relatively rapid and severe decline in the Pensioner Support Ratio – the ratio of the number of people of working age to the number of people over pension age – from about 6 to 1 at present to less than 2 to 1 in 2061;
- In the years ahead, the State faces an additional bill for pensions which amounts to some €8 billion in today's terms;



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- The pension coverage rate for people at work has been hovering between 50 and 55%, despite vastly improved awareness of pension issues and the need for people to provide for their retirement;
- Even where people are contributing to pension schemes, the adequacy of those contributions may not be enough to meet their expectations in retirement.

These figures are real and they allow us to see the scale of the challenge ahead. But they tell us little about the very real human impact of pension problems on the people of this country.

Recent Developments

The recent economic downturn has meant that the challenges facing pensions in Ireland have become more urgent. Employers and trustees are finding it increasingly difficult to manage defined benefit schemes, while members are concerned about their future benefits.

It is estimated that in excess of 90% of defined benefit schemes are currently in deficit with estimates suggesting a shortfall of up to €30 billion. The Government is very much



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aware of the threat that the current financial environment is presenting for some defined benefit schemes where the employer becomes insolvent leading to a wind-up of the pension scheme.

Members of defined contribution schemes have also seen the value of their funds eroded due to the sharp fall in equities. There are no easy answers to these problems but the Government been developing a package of measures to underpin pension provision in Ireland.

Our initiative started last December with the announcement of a number of short-term measures aimed at reducing the pressure on under-funded DB schemes by allowing greater flexibility and time to recover funding positions. These measures include:

- Granting additional time for the preparation of funding proposals aimed at restoring pension funds
- The Pensions Board dealing as flexibly as possible with applications for approval of funding plans;



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- The Pensions Board allowing longer periods for recovery plans in appropriate circumstances and that the term of a replacement recovery plan will be allowed to extend beyond the end date of the original plan; and
- Taking into account voluntary employer guarantees in approving recovery plans.

However, in order to ensure that these extensions are not seen as a weakening of supervision, the Pensions Board will reject recovery plans which fail to demonstrate an appropriate investment approach.

These measures have been broadly welcomed but we all recognise that these are only short-term solutions to ease the immediate and significant pressures currently facing defined benefit schemes and that more is needed to ensure the long term sustainability of pension provision in Ireland.

Very recently, in fact, just last week, I made a number of amendments to the Pensions Act in an effort to assist trustees of defined benefit schemes. Some of these changes include:



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(i) Change in the Priority Order on Wind-Up

In the event of such a defined benefit scheme winding-up, the Pensions Act stipulates the order in which the resources of the scheme must be disbursed. It gives priority to the liabilities accruing to pensioners before it distributes the remaining assets to those who are still in employment and those former employees who have not yet retired. The calculation of the liabilities includes provision for post retirement increases in the third of schemes that provide for such increases.

As I am sure you are aware, with increases in pension costs, the liability for post retirement increases can be substantial and, in a situation where a severely under-funded scheme is wound up, the allocation of assets for pensioners in payment can significantly reduce the assets available for other scheme members.

In this regard, and in order to achieve a greater equity in the distribution of scheme assets on wind-up of a scheme, I re-ordered the wind-up priorities by moving the provision for post retirement increase to a lower priority.



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This change will not impact on the current pension payment to pensioner but it will enhance the level of resources available to other scheme members.

Once the basic pension entitlements of all scheme members are covered, the distribution of scheme assets for post retirement increases will then be applied.

This is an important change in the priority order and will, without impacting on the pensions of those already retired, improve the situation of other scheme members.

(ii) Greater flexibility for schemes to restructure benefits in the event of under-funding

It is desirable to ensure that current pension legislation supports the viability of current pension schemes and that nothing in current legislation would be considered restrictive in the ongoing maintenance and sustainability of a pension scheme.

Legislation provided for the restructuring of a DB pension scheme but only to the extent that it affects the benefits of those currently employed by the employer sponsoring the scheme. This restructuring did not extend to the accrued



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benefits of scheme members who are no longer employed in the company or to post-retirement increases in benefits. This limitation in restructuring a scheme could give the trustee no option but to wind-up the scheme.

I have amended the Pensions Act to broaden the scope of a scheme restructuring to include those currently in employment, those who have ceased employment with the current employer, and the provision of post retirement increases for all scheme members including pensioners. It must be stressed that this change will not impact on the pension currently in payment to pensioners.

The purpose of this change is to help trustees secure the viability of the pension scheme by extending the elements of the scheme which may be considered in any restructuring of a scheme.

This will help the trustees to maintain the ongoing viability of the pension scheme and hopefully avoiding the scenario of a scheme wind-up.

It is important to point out that the measures I have outlined will retain the current priority given to pensions in



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payment which means that employees who have retired, and those who have reached normal retirement age, will not see any diminution of their entitlement to a pension.

I have also strengthened the role of the Pension Regulator to assist him in bringing successful prosecutions against employers who fail to remit employee contributions to the trustees of a pension scheme.

Pensions Insolvency Payments Scheme

The moment of insolvency provides a pension scheme with a situation which will invariably lead to a wind-up of the pension scheme. Where the sponsoring employer is also insolvent there is really no possibility of saving the scheme.

This may mean that some – and perhaps even many – pension scheme members who have yet to retire, will face a shortfall in their pension. This is of particular concern for those close to retirement who have few options in terms of making alternative provision for their future.

For this reason, the recently passed Social Welfare and Pensions Act 2009 included a power to enable the Minister



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for Finance to provide for a Pensions Insolvency Payment Scheme, or PIPS.

At the moment, if a defined benefit scheme is in deficit and the sponsoring employer becomes insolvent, the trustees must first provide pensions for the retired members of the scheme, usually by buying annuities. Whatever is left is apportioned among the active and deferred members of the scheme. The more expensive the annuities the less money is available for those yet to retire.

Annuities provided on the open market are priced to include certain costs such as commissions and expenses as well as a profit margin.

Crucially, annuity providers must hold reserves to back up their annuity commitments, a cost which can add significantly to the final annuity price.

The PIPS will provide an alternative for trustees of defined benefit schemes in deficit with an insolvent employer. In simple terms, trustees of participating schemes would pay to the Exchequer the amount necessary to cover the cost of providing pensions to its retired members. With commissions, expenses, and the cost of capital distilled from



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the equation, PIPS should be able to provide these payments at less expense to the trustees. This should then free up extra money to go towards the pensions of those yet to retire.

Let me be clear: PIPS has been carefully designed to ensure that it will be cost-neutral from an Exchequer point of view. We must be careful that our attempt to assist those in need is not misrepresented.

Of course, many people will want to know the bottom line on this and the amount of difference it will make to their pension. The simple answer is that it depends. Each scheme involved will have to be actuarially assessed and so the costs and savings will depend on the age profile of the scheme, the prevailing interest rate and other relevant factors. The intention is that this technical calculation will be carried out by the National Treasury Management Agency so as to make PIPS cost neutral to the Exchequer.

PIPS will operate on a pilot basis and will be reviewed within three years of its establishment.

Detailed arrangements will be out in regulations, which are currently being drafted by the Minister for Finance in



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consultation with me. The PIPS can commence once those regulations are in place.

People should be confident and secure about their retirement expectations. They should not arrive at pension age and find that their incomes are well below what has been promised to them. Our system must provide surety so that all of us can look forward to retirement, confident that our pensions are safe.

This should begin with the very basis of our system – the social welfare pension. It is the ground on which everything else lies and we will ensure that this remains the case in the future.

The Social Welfare Pension

I know you have a particular interest in the Social Welfare pensions and so I will talk about that in some detail now.

This Government has shown an unparalleled commitment to improving the State Pension and this has resulted in a very significant reduction in the level of poverty among our older people. Just 2% of our older people are now in consistent



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poverty, representing a halving of this rate in the last five years.

Social Welfare pensions are the very basis upon which the rest of our pension system rests. The pensions provided under the Social Welfare system are intended to provide an adequate basic standard of living. The State Pension (Contributory) is paid to those people aged 66 and over with the required level of social insurance contributions.

For those that do not qualify for a contributory pension, or only qualify for a reduced rate pension, they can apply for the State Pension (Non-Contributory) – a means-tested payment, also paid to people at 66 years of age. Both pensions are flat rate payments and are not related to previous income.

Just to add some detail for a moment, the contributory pension is funded through pay-related contributions made by employers, employees and the self-employed to the Social Insurance Fund. When the fund is in deficit, the Exchequer provides a subvention. To qualify for a contributory pension, a person must have made at least 260 paid contributions over his or her working life. In addition, a yearly average of at least 48 contributions is required to



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achieve a maximum pension, with an average of 10 required for a minimum pension, which is paid at half the rate of the full pension.

Where a person is unemployed or receiving other social welfare payments, a person can continue to keep up their social insurance record through signing for credited contributions. In addition, the homemakers scheme allows up to 20 years to be disregarded when we determine the average number of contributions for pension purposes. This makes it easier for people who have taken time out from the workforce to provide care for elderly people, people with disabilities or young children – to qualify for a higher rate of contributory state pension.

For the non-contributory pension, the level of pension is determined by a means test. While means testing remains an important part of the system, it is becoming less so. The social insurance system is now very comprehensive and the numbers relying on means-tested pensions has decreased significantly in recent years.

The contributory pension is paid to over a quarter of a million people while there are 100,000 people in receipt of the non-contributory pension. Expenditure on contributory



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and non-contributory state pensions in 2008 amounted to over €4 billion which represents some 25% of all social security expenditure. The vast majority of that expenditure was on the contributory state pension.

Ireland was fortunate over the last decade to be in a position to provide significant improvements to the level of social welfare pensions. The Government was determined to improve the position of our pensioners. In 2009, the maximum rate of contributory pension is €230.30 per week while the maximum non-contributory pension is €219 per week. Over the last 10 years, this represents increases of 104 per cent and 120 per cent respectively.

In addition to the payments, pensioners may also receive other benefits. The household benefits package, for example, which includes an electricity or gas allowance, telephone allowance and free television licence is generally available to people living in the State aged 66 years or over who are in receipt of a social welfare payment or satisfy a means test.

Issues related to social welfare pensions featured very strongly in the Green Paper consultation process. The average contributions test, determining eligibility for the



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contributory pension, has served us well but it raises certain anomalies. For example, a person with a higher total of contributions may end up with a lower pension than someone with fewer contributions, depending on the stage in life where they first started to contribute.

The Green Paper discussed options for reform, including the introduction of a universal pension for all or adopting a total contributions approach whereby people would qualify for a contributory pension on the basis of their total number of contributions rather than an average.

There were also issues relating to backdating the homemakers scheme beyond its operational date of 1994, converting the homemakers disregard to credits, indexation of state pension increases, providing for a higher pension for those that delay receiving it, and, of course, the issue of retirement or state pension age.

The Government is considering all of these issues and will make decisions in the context of the national pensions framework, which, as I outlined is currently being finalised.



Conclusion

To conclude, the changes to the pensions system which I have made recently are aimed at supporting workers in defined benefit schemes and assisting trustees in securing the future of pension schemes.

I am also aware that there are many other challenges facing pension policy and provision in Ireland. These include issues such as pensions coverage and the adequacy and sustainability of our pensions system generally, all of which were set out and discussed in the Green Paper on Pensions.

Pension reform is an extremely complex issue and the Government must ensure that it has considered all of the issues involved before making decisions which have such a strong impact on people's livelihoods.

A good, robust pensions system is costly no matter how it is organised. The challenge faced by Government is to strike the appropriate balance between those involved, including employers, people in employment and the State.

Our objective must be a pension system which will deliver an adequate retirement income for all which is, at the same



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time affordable and sustainable for the State, and those who sponsor and provide occupational pensions systems.

Discussions with my Government colleagues on the final framework are ongoing, and I expect that the framework will be published in the near future.

Thank you again for inviting me here to-day.

I hope you have a good conference.

ENDS