THE LIFE & PENSIONS INDUSTRY RESPONSE TO THE NATIONAL PENSIONS FRAMEWORK

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EXECUTIVE SUMMARY

Pension tax relief

We propose the retention of tax relief at the marginal income tax rate on personal contributions to pension arrangements as the National Pensions Framework proposed fixed 33% relief is likely to:

- discourage middle income earners from making further supplementary pension provision., but
- have no appreciable effect on increasing supplementary pension coverage among lower income earners.

There has already been significant restrictions in the level of tax relief allowed on personal pension contributions such as the reduction of annual earnings cap for pension contributions to €150,000 from €275,239 in 2008 and the non indexation of the limit since then, as well as the disallowance of pension contributions for the income levy.

The proposal to change tax relief to a fixed 33% rate is inequitable as it will have a disproportionate negative effect on those in the private sector such as the unincorporated self employed and employee members of DC schemes, who fund from personal income most or all of the cost of their private pension provision, while having little or no impact on employees in defined benefit occupational pension schemes, both public and private sector, whose employer carries most if not all of the cost of their private pension provision.

The proposal also risks significantly damaging employment in the domestic life assurance industry with potential negative knock on effects on the cross border insurance industry based in the State.

Retirement benefit options

We suggest that the Approved Retirement Fund (ARF) option outlined in the National Pensions Framework document be amended to the following ARF option:

- The current AMRF alternative to annuity purchase be retained, but at a higher level of 10 x maximum personal rate of State Pension[1] i.e. €120,000 in today's terms AND
- Where a retiree meets in full the specified income test at any time before age 75 any funds then held by the retiree in the AMRF can be transferred to an ARF AND
- The specified income test be set at 100% of the State Pension and not 150%, as suggested by the National Pensions Framework.

[1] *currently €12,000 pa*

EXECUTIVE SUMMARY

Taxation of retirement lump sums

We suggest in relation to the National Pensions Framework proposal to tax retirement lump sums in excess of €200,000 that:

- the change be phased in over a period of time from an initial lump sum limit of, say, €500,000 down to the proposed €200,000 level AND
- The €200,000 level should be indexed linked AND
- The rate of tax to be applied to the excess over the relevant lump sum limit should not exceed the standard rate of income tax as suggested by the Commission on Taxation.

State Pension changes

Receiving the State Pension at 68 instead of 65, as outlined in the National Pensions Framework and stiffer requirements to qualify for it will reduce the entitlement of many to the State Pension in the future. This will make it even more important to encourage supplementary pension provision. However, other proposals in the National Pensions Framework such as reducing tax relief on pension contributions for higher rate taxpayers will disincentivise supplementary pension provision.

Auto enrolment scheme

We welcome the proposal in the National Pensions Framework that individuals in the proposed auto enrolment scheme will be provided with a range of investment funds to be managed by the private sector. However, we query whether:

- the default fund option should always be low risk.
- no investment advice will be needed by contributors to the scheme, as stated in the National Pensions Framework, given that retirement savings will be the second largest financial asset for many individuals after the family home.

There is a significant risk that the Auto scheme benchmark contribution rate of 8% on a band of earnings, will drive down contribution rates in DC occupational pension schemes, particularly in the current straightened economic conditions. It is also likely to provide inadequate retirement benefits for most contributors.

We feel that the existing employer designated PRSA scheme infrastructure offers a faster, cheaper and better route to implement the auto enrolment scheme, rather than the State building such a scheme.

EXECUTIVE SUMMARY

Simplification

We feel a simpler and more effective approach to pensions simplification as suggested in the National Pensions Framework would be to:

- maintain Buy Out Bonds and Retirement Annuities as product choices
- offer the same ARF option to all members of DC arrangements, including BOBs, and
- allow full mobility and eliminate technical anomalies between PRSAs, RACs and BOBs, to remove any benefit or regulatory arbitrage potential

Any proposal to increase the transparency of pension charges must be applied uniformly across all pension arrangements and not just to insured products.

INCOME TAX RELIEF

The NPF announced:

Tax relief for contributions to existing occupational and personal pension arrangements currently based on a contributor's marginal rate of tax will be replaced with a State contribution equal to 33% tax relief. This will promote simplicity and equity and ensure that similar options are available to all groups of employees.

Response

- There has already been significant restrictions in the level of tax relief allowed on personal pension contributions, including more recently the disallowance of pension contributions for the purposes of the income levy.
- We propose the retention of tax relief at marginal rate income tax on personal contributions to pension arrangement as the proposed fixed 33% relief is likely to:
    - discourage middle income earners from making further supplementary pension provision as they may only get tax relief on future contributions at a rate of 33% but face paying tax on taxable retirement benefits at a higher rate of (top rate income tax (currently 41% + the income levy).
    - Have no appreciable effect on increasing supplementary pension coverage among lower income earners due to the high income replacement coverage already provided by the State Pension for the lower paid.

  The net effect is likely to be a *reduction* in supplementary pension coverage and its quality at a time when State Pension entitlements are being scaled back.

  The proposal, therefore, runs counter to one of the seven Government stated principles of the stated (in the NPF) Government seven principles of pension reform : '*Supplementary pension coverage must be increased to improve adequacy of incomes in retirement*[2]'.

- The proposal is inequitable as it will have a disproportionate negative effect on those in the private sector i.e. the unincorporated self employed and employee members of DC schemes[3] who fund from personal income most or all of the cost of their private pension provision, while having little or no impact on employees in defined benefit occupational pension

[2] *NPF, page 15*

[3] *Employee members of DC scheme typically contribute about 50% of the total retirement contribution, i.e. the employer tends to match the employee contribution level.*

schemes, both public and private sector, whose employer carries most if not all[4] of the cost of their private pension provision.

The proposal therefore runs counter to one of the seven stated (in the NPF) Government principles of pension reform : '*The system of tax incentives offered by the State should be equitable'*[5]'.

- The proposal also risks significantly damaging employment in the domestic life assurance industry, through a significant decrease in future pension contribution inflows. In turn this may have a negative knock on effects on the cross border insurance industry based in the State.

  The cross border life assurance industry depends for its continued success on a readily available supply of highly qualified technical personnel. The domestic life assurance industry recruits, trains and develop such personnel, which are then drawn on by the cross border industry as a qualified experienced workforce. The interruption of this expertise supply chain to the cross border life assurance industry could undermine future development of this industry.

- If the proposed tax credit system is to apply equitably to all then the current marginal rate tax relief afforded to public servants in respect of their superannuation and public service pension levy contributions will also have to change to an equivalent net contribution rate i.e. the current gross contribution rate would have to be reduced by the 33% tax credit rate to 66% of its previous level and then taken from net income.

  For higher rate public servants, this will drive *up* the net cost of their superannuation and pension related levy contributions.

Restrictions in pension tax reliefs.

Tax relief on personal contributions to pension arrangements has already been significantly restricted in recent years in a number of different ways:

- The capping of annual earnings which qualify for pension tax relief at €150,000 in 2009. (The previous limit in 2008 was €275,239)
- The non indexation since 2009 of this €150,000 earnings limit.

[4] *E.g. civil servants recruited before 6th April 1995 make no explicit contribution to the cost of their Superannuation benefits.*

[5] *NPF, page 15*

- Revenue clarification issued in September 2009[6] on the claiming of pension tax relief where the individual has two sources of income. The clarification reduced the level of pension tax relief which such taxpayers could claim, as compared with previous practice.
- The disallowance of pension contributions for the purposes of the income levy, which has increased the net cost of making a personal pension contribution. E.g. Before the levy the net cost[7] to a higher rate taxpayer of making a €1,000 pension contribution was [€1,000 - €410 (tax relief)] = €590. After the introduction of the levy the net cost is at least [€1,000 - €410 (tax relief) + €20 (income levy @ 2%] = €610.

Unbalancing the EET system

The proposal to change the effective rate of relief on personal contributions to pension arrangements from marginal rate relief to a fixed 33% will change the EET system to:

***E*xempt contributions i.e. effective rate of tax relief afforded on contribution**	***E*xempt investment return**	***T*ax on taxable retirement benefits**
[33% - income levy[8]]	As before, i.e. tax free	[marginal rate income tax+ income levy[9]]

For middle income taxpayers[10], therefore, personal contributions in such a system carry a potential tax loss, whereby effective relief is obtained at 33% (maximum) but taxable retirement benefits could be taxed at a higher rate of (top rate income tax+ income levy rate) e.g. currently at (41% + income levy rate).

When combined with the proposal to tax retirement lump sums in excess of €200k and the proposed compulsory annuity purchase for funds of up to €500k (circa), the revised EET system outlined above would actively discourage middle income earners from making further supplementary pension provision beyond a level perceived by them to be fiscally beneficial.

[6] *Revenue Tax Briefing 74, September 2009*
[7] *Ignoring potential PRSI and Health Levy relief.*
[8] *The contribution has to be paid from income that has already been subject to the income levy.*
[9] *Pension payments and ARF withdrawals are subject to the income levy.*
[10] *Currently a single person can pay higher rate income tax with a gross income of circa €36,000 or €45,000 for a married couple (one income). The proposal therefore substantially affects middle income earners.*

INCOME TAX RELIEF

Encouraging lower paid to make pension contributions

One argument put forward for providing a fixed tax credit rather than marginal rate income tax relief on pension contributions is that it will encourage non standard and standard rate taxpayers to make pension contributions or to make higher contributions than they already do.

However, the maximum rate of State Pension currently replaces 50% of income in retirement for:

- Up to €24,000 income, for single persons, and
- Up to €45,000 income, for a married couple (one income).

Therefore is it difficult to see how a tax credit incentive would encourage the lower paid to make pension contributions, given the coverage already provided by the State Pension and the deferred nature of the tax credit incentive.

In this regard, it is instructive to note the poor take up by lower paid employees of their right to contribute to PRSAs. Out of 90,000 employer designated PRSA schemes, only 17% have contributors.

Therefore, the proposed revised tax credit system for personal contributions to pension arrangements is likely to:

- discourage those who are already making such contributions from making further contributions or increasing their contributions, while
- having no appreciable effect on increasing private pension coverage among the lower paid.

Public service pension and pension levy contributions

If the proposed tax credit system is to apply equitably and uniformly across all employees and the self employed, then the current marginal rate tax relief afforded to public servants in respect of their superannuation and public service pension levy contributions will have to change to a net contribution rate, i.e. the current gross contribution rate would have to be reduced by the 33% tax credit rate to 66% of its previous level and then taken from net income.

Inequity between employer funded and personally funded arrangements

The NPF proposes no change in the current system of exempting employer contributions to occupational pension schemes from a Benefit in Kind (BIK) charge for the employees involved.

In the case of members of unfunded public service pension schemes, there is an implied or implicit employer accrual cost of providing retirement benefits. The McCarthy Report estimated the accruing unfunded public sector pension cost at 30% pa of salary roll[11]. Employee members of funded defined benefit occupational pension schemes also benefit from a significant global contribution made by their employer to the scheme, without suffering a BIK on such benefit.

The proposed reduction, for marginal rate taxpayers, of tax relief from marginal rate to an effective rate of 33% will apply *only* to *personal* contributions to pension arrangements. It will not impact on explicit or implicit employer pension contributions to occupational pension schemes, as such contributions are exempt from a BIK charge in the hands of the relevant employees.

This creates an inequity in terms of the impact of such a measure as between:

- those in the private sector i.e. the unincorporated self employed, AVCs and employee contributions to DC arrangements, who fund from personal income most or all of the cost of their private pension provision, and
- those whose employer funds or pays most if not all of the cost of their private pension provision e.g. members of funded and unfunded defined benefit occupational pension schemes.

[11] *"The real annual cost of providing public service pensions is some €7.7bn each year, made up of an annual accrual cost of €5.4bn each year over and above the €2.3bn cash cost of existing pensions in 2009 (on the assumption of an accruing pension cost of, on average, 30% of nominal salary." Page 7, Report of the Special Group on Public Service Numbers and Expenditure Programmes, Volume 1.*

RETIREMENT BENEFIT OPTIONS

The NPF (Chapter 5.3.2) proposes:

- *All DC arrangements, from 2011, to have similar retirement benefit options for new retirees.*
- *An increase in the specified income test (to qualify for the ARF option) to 150% of State Pension, i.e., to €18,000 pa currently, will be 'examined'.*
- *the AMRF option would no longer apply, i.e. to qualify for the ARF option a retiree will have to meet the €18,000 pa specified income test.*
- *Existing retirees with funds in an AMRF who subsequently meet the specified income test (but didn't at the time of retirement) to be allowed to move their AMRF funds to an ARF.*

Response

- We welcome the principle of providing the same retirement benefit options to *all* members of DC retirement arrangements. This makes sense. In particular, we welcome the proposal to extend the ARF option to all employee members of DC occupational pension schemes.
- We also welcome the proposal to allow existing retirees with funds in an AMRF to move such funds to an ARF if and when they meet the specified income test.
- However, if the ARF option is not to be denied to those who already have it and to those to whom it is proposed to extend it, we propose the following revised ARF option:
  - The current AMRF alternative to annuity purchase be retained, but at a higher level of 10 x maximum personal rate of State Pension or €120,000 in today's terms AND
  - Where any retiree meets in full the specified income test at any time before age 75, any funds then held in the AMRF can be transferred to an ARF AND
  - The specified income test be set at 100% of the State Pension and not 150%, as suggested by the NPF.

The annuity purchase deferral option

Requiring retirees from DC arrangements to use their retirement fund to buy an annuity at one point in time involves a lottery in terms of the resulting income secured due to the interaction of two fluctuating factors:

- The value of their DC fund on that day, and
- The open market annuity rate ruling on that day.

In volatile financial markets, as have existed over the last 3 years or so, the income which can be secured by a retiree from a DC arrangement can vary significantly over a relatively short period of time, depending on *when* the annuity is purchased. And once it is purchased, there is no going back. It cannot be unravelled. It is a once in a lifetime purchase decision.

In this context, therefore, the annuity purchase deferral option introduced by the Minster for Finance on the 4th December 2008 for members of DC occupational pension schemes was very welcome as it removed the compulsion (at least until 31st December 2010) to purchase an annuity at a time of low fund values.

The benefit to the retiree of removing the compulsion to purchase an annuity on a particular day can be gauged from an example of an employee member of a DC scheme who we will assume retired at age 65 on the 5th December 2008 with a residual DC fund of €100,000 (after taking a tax free lump sum) which he/she opted to leave in a typical Consensus Managed Fund.

Assuming the balance in the DC fund was maintained in the same Consensus Managed fund throughout, the pension which could have been purchased at different times during the deferral period was as follows:

	5th Dec 2008	1st Jan 2009	1st April 2009	1st July 2009	1st Oct 2009	1st Jan 2010	1st April 2010
Fund value[12]	€100,000	€99,714	€96,000	€105,257	€115,828	€121,600	€129,200
Annuity rate[13]	6.363%	6.496%	6.45%	6.724%	6.696%	6.597%	6.536%
Annual Pension	€6,363	€6,477	€6,192	€7,077	€7,756	€8,022	€8,445

[12] *assuming the DC member was invested in a typical Consensus Managed unit fund at retirement @ 5th December 2008 and remained in that fund during the period since then.*
[13] *based on a leading Life office open market annuity rates at the relevant dates for a single life level pension, guaranteed 5 years, for a male with date of birth 5th December 1943.*

So over a period of about 18 months of annuity purchase deferral, the pension that could be secured by the fund varied from a low of €6,192 pa (on the 1st April 2009) to a high of €8,445 pa (on 1st April 2010), a difference in retirement income of some €2,253 pa.

This example (based on *real* fund values and annuity rates over the period) illustrates the benefit of not being compulsorily required to purchase an annuity on one particular day.

The benefit of annuity purchase deferral is also provided by the ARF option, as funds transferred to an ARF can subsequently be used to buy an annuity at any time. In effect, the ARF option offers an open ended annuity purchase deferral option.

The ARF specified income test

- We support the principle of a secure income test in order to qualify for the ARF option.
- However, the suggested level of 150% x State Pension would *currently* require the following *minimum* level of retirement fund to be committed to annuity purchase to secure €18,000 pa income at the point of retirement, *before* entitlement to the ARF option would apply:

	Retirement Fund required to meet the €18,000 specified income test at age				
	50	**55**	**60**	**65**[14]	**70**[15]
Male	€437,280	€395,300	€348,690	€298,640	€82,700
Female	€459,200	€424,200	€385,180	€342,470	€99,300
	Source : A leading life office annuity quote: 5th June 2010				
Current alternative AMRF requirement	€63,500	€63,500	€63,500	€63,500	€63,500

In effect the imposition of a €18,000 pa specified income test at the point of retirement to qualify for the ARF option, *with no AMRF alternative*, would :

- *Change the rules by removing the ARF option from the vast majority of current RAC & PRSA holders and proprietary directors, currently entitled to it, and replace it with compulsory annuity purchase at the point of retirement*.

[14] *Assuming retiree not in receipt of State Pension at 65. Class S contributors do not qualify for the State Pension until age 66, while the State Transition Pension (payable from 65) is being abolished in 2014. The State Pension age is now 67 for those born between 1955-60, and 68 for those born in 1961 or later.*
[15] *Assuming retiree is in receipt of full rate of State Pension.*

Current RAC & PRSA holders and proprietary directors have a legitimate expectation, based on current legislation, that at retirement they will not be required to use any part of their retirement fund to purchase an annuity. Contributions have been made since 1999 on this legitimate benefit expectation.

However the majority of individuals with funds at retirement less than €500,000 will be denied the ARF option under the proposed new 150% x State Pension specified income test with no AMRF alternative and will have to use 75% of their fund at retirement to purchase an annuity on that day. This amounts to rolling back the ARF option introduced in 1999 and amounts to retrospectively changing the rules of the game.

- *Act as a disincentive to making further contributions to RACs, PRSA and AVCs.*

  If the ARF option is, in effect, removed from those currently entitled to it, it is highly likely to act as a brake on further contributions to such arrangements, particularly in the period close to retirement.

  Such a move is, therefore, likely to lead to significantly reduced future contribution levels to PRSAs, RACs and AVCs, thereby reducing the level and quality of supplementary pension provision.

- *Force some retiring members of DC arrangements to buy annuities, which may not be in their own, or that of their dependants, best interests*.

  For example, take an individual who is taking ill health early retirement (before the State Pension age). Forcing such an individual to use 75% of their retirement fund to purchase an annuity risks the loss, through early death, to that individual's family and dependants of a considerable proportion of their retirement fund.

- *Deny the ARF option at retirement to virtually all employee members of DC occupational pension schemes*, so that in reality they would not be entitled to any new retirement benefit option, as suggested by the NPF.

- *Act as a significant disincentive to all members of DC arrangements taking retirement benefits before their relevant State pension age*.

  By waiting until State Pension age when entitlement to the State Pension kicks in an individual will be required to use less of their retirement fund to purchase an annuity. The NPF proposal of an increased specified income test with no AMRF alternative would therefore introduce inflexibility and disincentives into the retirement system. This would be a step backwards.

RETIREMENT BENEFIT OPTIONS

We therefore recommend the following revised ARF option to that proposed in the NPF document :

- *Retain the current AMRF alternative to annuity purchase* but at a higher level of 10 x maximum personal rate of State Pension i.e. circa €120,000 in current terms, which is virtually double the current €63,500 AMRF requirement AND
- *Allow all retirees with funds in an AMRF to transfer those funds to an ARF if and when they meet the specified income test in full*, rather than having to wait until age 75 as presently applies AND
- *Set the specified income test at 100% of the State Pension instead of 150% i.e. at approx €12,000 pa instead of €18,000 pa.*

  The State Pension level is the Government's benchmark minimum income standard in retirement. We see no rationale for forcing members of private pension arrangements to achieve a higher minimum income standard than the State generally accepts as the minimum acceptable income in retirement.

TAXATION OF RETIREMENT LUMP SUMS

The NPF (Chapter 5.3.3) stated:

The Commission on Taxation recommended that pension lump sums of less than €200,000 should not be taxed. The Government has accepted this recommendation and decided that arrangements for the tax treatment of lump sums greater than €200,000 would be considered and developed during the implementation of this framework.

Response

Any proposal to impose a tax on retirement lump sums in excess of €200,000 would have a significant impact on those affected who are near retirement and/or who have entered into pension mortgage[16] arrangements.

We suggest in relation to the proposal to tax retirement lump sums in excess of €200,000 that:

- the change be phased in over a period of time from an initial lump sum limit of, say, €500,000 down to the proposed €200,000 level AND
- The €200,000 level should be indexed linked AND
- The rate of tax to be applied to the excess over the relevant lump sum limit should not exceed the standard rate of income tax, as suggested by the Commission on Taxation.

[16] *Where the individual involved has entered into an interest only mortgage in anticipation of being able to repay the mortgage in full at retirement from their retirement lump sum entitlement.*

STATE PENSION CHANGES

The NPF confirmed:

- *From April 2012, minimum number of contributions to qualify for the State Pension increasing from 260 to 520, i.e. from 5 years to 10 years.*
- *From 2014, removal of State Transition pension and hence option for Class A contributors to qualify for State Pension at age 65.*
- *State Pension age is being increased to 66 in 2014, 67 in 2021 and 68 in 2028.*
- *From 2020, entitlement to State Pension age changing to an N/30ths basis, so that at least 30 complete years PRSI contributions will be required to qualify for the maximum State Pension.*

Response

The provisions in the National Pensions Framework in relation to State Pensions will:

- Reduce the entitlement of many future retirees to the State Pension, and hence make it even more important to encourage supplementary pension provision. However, other proposals in the NPF such as reduced pension tax relief and compulsory annuity purchase will disincentivise supplementary pension provision.
- Have a negative impact on integrated funded defined benefit schemes, as they will come under pressure to provide additional 'transition' or 'bridging' pensions to members from NRA to the new later State Pension age i.e. increase such scheme's liabilities.
- Not impact on public service employees, as :
    - Pre 6th April 1995 public service employees do not generally have their retirement benefits integrated with Social Welfare. They can take their full public service pension at any time between 60 and 65. The increase in the State Pension age has no impact on such employees
    - many public service schemes have a practice of providing '*supplementary*' or top up pension to retiring integrated employees not entitled ('*through no fault of their own*[17]') to the State Pension when they retire.

    Therefore the proposal introduces further inequities between funded private sector and unfunded public sector pension provision.

[17] See FAQ on www.cspensions.gov.ie for civil servants recruited after 6th April 1995 re pension entitlement at retirement : '***What happens (at retirement) if I do not qualify for State Pension or any other Social Welfare benefit?** If, through no fault of your own, you do not qualify for State Pension or any other Social Welfare benefit or qualify for only a partial entitlement then you may be entitled to receive a supplementary pension.*'

STATE PENSION CHANGES

Reducing State Pension entitlement

Many private sector employees and the self employed either explicitly (e.g. through integrated occupational pension scheme contribution rates or benefits) or implicitly (through setting the level of private pension contribution) allow for full entitlement to the State Pension from 65 (66 for the self employed).

However, the measures now announced in the NPF reduce the level of State Pension which many will be entitled to when they retire, and most will have to wait longer to get the pension. While we understand and accept the rationale for such changes in terms of an ageing population and the rapidly increasing burden of State and public service pensions, the result will be a *reduction* in the State Pension component of future retirement provision for many, with a consequent need to plug this hole through increased supplementary pension provision.

However, other proposals in the NPF such as the proposal to change tax relief on personal contributions to pension arrangements from marginal rate to a fixed 33% will disincentivise future supplementary pension provision.

Therefore, the proposal to change tax relief on personal contributions to private pension arrangements to a fixed 33% will expose the self employed and employee members of DC arrangements in the private sector to a double whammy of:

- reduced State Pension entitlement along with
- reduced incentives for supplementary pension provision.

AUTO ENROLMENT SCHEME

The NPF proposes the introduction, not before 2014, of an auto enrolment scheme, the details of which are set out in Chapter 4 of the NPR.

The stated objective of the scheme is to:

‘*increase occupational pension coverage for people who do not currently avail of such an arrangement rather than to replace current provision*’.

The NPF also states that the ‘*scheme targets lower and middle income earners*’.

Response

- We welcome any initiative which will increase supplementary pension coverage.
- We welcome the proposal that individuals in the auto enrolment scheme will be provided with a range of investment funds to be managed by the private sector.

  However, we query whether:
  - The default fund option should always be *low risk.*
  - no investment advice will be needed by contributors to the scheme, as stated in the NPF document.
- There is a significant risk that the scheme benchmark contribution rate of 8% on a band of earnings, will drive down contribution rates in DC occupational pension schemes, particularly in the current difficult economic conditions.
- We feel that the existing employer designated PRSA scheme infrastructure offers a faster, cheaper and better route to implementing the auto enrolment scheme, rather than building a State run scheme.
- Providing the amended AMRF/ARF retirement benefit option as suggested earlier to all contributors to the auto enrolment scheme will act as an incentive to:
  - remain in the scheme, and
  - increase contributions.

Investment fund options

We welcome the proposal that contributors to the auto enrolment scheme will be provided with a range[18] of investment funds, managed by the private sector.

However, we would query:

[18] *later qualified in Chapter 4.2.3 of the NPF as ‘limited number and types of funds’*

- *whether the default option or options should always be 'low risk', particularly for younger contributors.*

  Over the long term low risk implies low investment returns. Such a low risk default option, which is likely to apply to a considerable number of contributors to the scheme, is not consistent with the assumed 2% pa real investment return[19] underlying the projections in Table 4.1 of the NPF document. It is also not in the contributor's best long term interests.

  Therefore there is a basic inconsistency in the NPF document in relation to the type of default fund option proposed and the suggested adequacy of the scheme benefits.

- *The implication that no investment advice will be required by contributors to the scheme.*

  For many contributors, their retirement savings will be their second largest financial asset after the family home.

  Contributors will have different circumstances, different attitudes to investment risk and different retirement needs e.g. when they want to retire. It is suggested in the NPF that there will be a '*range*' of funds. Investment advice will therefore be required to better match contributors to funds, rather than adapting a one size fit all approach.

  Under employer designated PRSA schemes, investment advice is available from the PRSA provider and/or intermediary involved.

Does the scheme need to be State run?

Establishing a State run auto enrolment scheme has many potential risks and disadvantages:

- There will be a significant development cost to the taxpayer in designing the systems etc, to run a scheme involving the collection of employee and employer contributions through the PRSI system for onward transmission to the relevant private fund manager.

- There will be a significant cost to the taxpayer in maintaining the scheme.

  Experience of other similar schemes overseas suggests that the design of the scheme will change over time, as pressure mounts to add or delete certain features. Therefore, there is likely to be constant development expenditure in addition to normal maintenance expenditure.

- There is likely to be significant time delay in designing and implementing a State run scheme. It's not something the State has done before.

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[19] *7% pa investment return and 5% pa earnings growth.*

- A new system runs the risks of initial teething problems which could damage the auto scheme brand and negatively impact on contributor persistency.
- If the scheme is State designed and run, the scheme is likely to only offer very conservative investment strategies given the potential political fallout of short term volatile investment returns.

Using the existing employer designated PRSA scheme infrastructure

Life company PRSA providers have invested significant sums to develop the current employer designated PRSA scheme structure which includes:

- over 90,000 signed up employer schemes. This covers virtually all employers who do not currently operate occupational pension schemes.
- A facility for the deduction and remittance of employee contributions by employers to the PRSA provider.
- Statutory restrictions on the type of funds which can be offered under the scheme i.e. 'pooled funds' with no cash charges.
- Capped charges i.e. max 5% contribution charge and 1% pa fund charge[20].
- Statutory disclosure of information at the point of sale and half yearly throughout the term of the PRSA.
- A facility for the payment and collection of employer contributions, in addition to the deduction of employee contributions.
- The availability of pension and investment advice for contributors from the PRSA provider and/or intermediary involved in the scheme.
- A facility for contributors to stop, start or vary their contributions without charge.
- No initial charge on any transfer values paid into an employee's PRSA.
- A default investment fund option, combined with life styling.
- Flexibility to accept additional employee and/or employer voluntary contributions, over and above the defined Auto scheme contribution level[21]. Given the likely inadequacy of the planned total 8% Auto scheme contribution rate (on a band of earnings) for many, the PRSA structure offers the potential for contributors and employers to make *additional* contractual or occasional contributions over the minimum required level, thereby increasing the quality of coverage.

[20] *of which 0.05% pa is payable to the Pensions Board leaving an effective fund charge for the PRSA provider of 0.95% pa.*
[21] *4% employee + 2% employer on a band of earnings.*

> A State run Auto scheme with contributions collected through the PRSI system, is unlikely to be able to provide a similar facility for *additional* contractual or occasional contributions over the minimum required level.

In effect, the existing employer designated PRSA scheme infrastructure already fulfils *all* of the stated auto enrolment scheme design requirements and more.

We therefore feel that a faster, cheaper (to the taxpayer) and quicker route to rolling out the proposed auto enrolment scheme is to use the existing tried and tested employer PRSA scheme infrastructure.

The contagion risk

If a headline total employer + employee contribution rate of 6%[22] on a limited range of income between about 50% to 150% of average weekly earnings is officially a deemed adequate supplementary provision for retirement under the auto enrolment scheme, there is a significant risk that this benchmark contribution rate will drive down contribution rates in DC occupational pension schemes, from the current average 11% on all income.

While the NPF is primarily targeted at low income earners, where the State pension will replace a significant proportion of income in retirement, there is the risk that existing DC schemes covering middle to higher income earners will drop their contribution rates to something closer to the auto enrolment scheme template.

The proposed auto enrolment scheme, therefore proposes a considerable contagion risk to DC schemes which currently provide a higher level of adequacy of income replacement.

Retirement benefit options

It is suggested in the NPF that *'in as far as possible, these arrangements (i.e. use of auto enrolment scheme funds at retirement) will mirror those which apply to access to PRSA funds at present.'*

Given that the NPF separately proposes to change these retirement benefits options to provide the ARF option to all, but only *after* securing specified income of at least €18,000 pa, the reality is that the proposed retirement benefit options for members of the auto enrolment scheme will be:

- 25% tax free,
- Balance must be used to purchase an annuity.

[22] *i.e. 4% employee + 2% employer. 2% State tax credit on top brings total contribution rate to 8%.*

AUTO ENROLMENT SCHEME

Given the low contribution levels to the scheme and opt out options etc. it is therefore likely that very small pensions will be provided to members of the scheme in retirement.

Example : *take an 8% contribution rate for a member on a salary of €40,000 pa. Contributions are assumed to apply to earnings of €33,400 i.e. the earnings above €127 pw.*

Assuming constant money values throughout, this table shows in current terms the possible benefits provided by the scheme at age 65 based on different assumed contribution terms:

Contribution term	Retirement Fund	Tax Free Lump Sum	Pension[23] (single life)	Pension[24] (with 50% reversion)
10	€26,720	€6,680	815	644
20	€53,440	€13,360	1,668	1,326
30	€80,160	€20,040	2,522	2,008
40	€106,880	€26,720	3,375	2,690

Because of the capping of contributions at an upper earnings level of circa €50,000 pa, and with the facility to opt out on numerous occasions, the resulting retirement pension at retirement for many auto enrolment scheme contributors is likely to be very modest.

This will act as a disincentive to remain in the scheme, as the likely pension in retirement is hardly likely to make much financial difference to many contributors e.g. an extra pension of less than €100 pm, in today's terms.

This reinforces our earlier suggestion to amend the retirement benefit options suggested in the NPF in order to prevent forced purchase of annuities at retirement and allow the retention of retirement funds in an ARF/AMRF in retirement.

Consider these two alternative benefit propositions:

Retirement benefits of:

- €13,360 tax free lump sum, and
- €40,170 retirement capital in an AMRF/ARF

or

Retirement benefits of:

- €13,360 tax free lump sum, and
- Pension for life of €139 pm

Therefore providing the amended ARF/AMRF option as suggested earlier to all contributors to the auto enrolment scheme will act as an incentive to:

[23] *For a male; pension assumed to increase @ 3% pa. Source : A major life office annuity quotation: 6th June 2010*

[24] *Dependant assumed to be female and 3 years younger'; pension assumed to increase @ 3% pa. Source : A major life office annuity quotation: 6th June 2010*

- remain in the scheme, and
- increase contributions, as there will be a direct link between increased contributions and increased retirement capital.

  With forced purchase of annuity, the link between increased contributions and increased retirement benefits is diluted significantly through showing only a marginal increase in pension in return for a significant increase in contribution level, to a contributor, such an increase in contribution would not seem like value for money.

RATIONALISING PENSION PRODUCTS

The NPF states:

- *given the complexity of current arrangements, the range of personal pension vehicles available will be reviewed with a view to rationalising provision in this area. This refers specifically to Buy Out Bonds (BOBs) and Retirement Annuities (RACs)*
- *the Government will introduce regulations to increase the transparency of pension charges.*

Response

- We do not feel there is any logic in removing at this stage BOBs and RACs as a product choice, some 7 years *after* the introduction of PRSAs. We feel a simpler and more effective approach to simplification would be to:
    - offer the same ARF option to all members of DC arrangements, including BOBs, and
    - allow full mobility and eliminate technical anomalies between PRSAs, RACs and BOBs, to remove any benefit or regulatory arbitrage potential[25].
- Any proposal to increase the transparency of pension charges must be applied uniformly across *all* pension arrangements and not just to insured products.

  There is already substantial and sufficient statutory disclosure of charges for PRSAs, RACs and BOBs through PRSA and life assurance disclosure obligations. Additional disclosure obligations are not required for these products.

[25] *E.g. remove the current 15 year service bar on transfers from occupational pension schemes to PRSAs, and allow transfers from occupational pension schemes to RACs as well as to PRSAs and BOBs.*