Retirement Plans for the Future

Road Map for Ireland

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Retirement Plan Design for the Future – context

- Mercer has done extensive analysis of the challenges facing retirement systems around the world, including work with:
  - World Economic Forum (WEF)
  - the Organisation for Economic Co-operation and Development (OECD)
  - the Melbourne Centre for Financial Studies
- Analysis shows retirement systems under significant stress
- Exercise for Mercer: a system meeting Adequacy, Sustainability and Integrity criteria (as we rate current systems in the *Melbourne Mercer Global Pension Index*)

Retirement Plan Design for the Future – a fresh perspective

Holistic	• A clear, principles-driven review of how retirement systems *as a whole* can best be structured
Clean sheet of paper	• Principles-driven and transparent, not taking "installed base" or transition into account
Agnostic to politics	• Aims for simplicity to promote discussion while recognising that some facets may be politically difficult
Global	• Global – but allows for the significant flexibility necessary to adapt it to widely varying social and economic systems
Risk focused	• Couched in DC-like terms, but "DC or DB" is the wrong question

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More information at www.mercer.com/freshthinking

Core principles of Mercer's Point of View

Adequacy

- Simple, transparent design and predictable costs
- Predictable outcomes through:
  - Default risk-managed investment option
  - Regulated system of distributions to provide income for life
- Mandatory contributions and minimal "leakage"

Sustainability

- Avoid intergenerational subsidies and financial risks associated with generational shifts
- Individuals should have to make only a few key decisions

Integrity

- Government-run social insurance limited to basic pension
- Operation should be at arms length from the government
- Administration should be cost-effective, with some degree of competition

Basic provisions of Mercer's Point of View

Accumulation Phase

- Mandatory participation with 10% - 15% tax-favoured contributions
- Target retirement age 15 years below life expectancy
- Targeted benefit at 50% of projected covered income at target retirement age
- Mandated initial default fund, with discretion after 1-5 years

Payout Phase

- Savings divided into three accounts
  - Managed spend-down for 15 years set at 50% of median national wage at retirement age; limited indexation
  - Mandatory set-aside amount to mitigate longevity risk after 15 years; no indexation
  - Discretionary account provided by incremental pre-retirement savings
  - Use "near guarantees"

Basic provisions of Mercer's Point of View

Administration and Governance

- Centralised responsibilities for record-keeping, administration, participant education and investment management
- Multiple organisations in larger countries, providing competition for price efficiency and innovation

Ireland pension issues through the lens of the Mercer Point of View

- Social insurance system reasonably well positioned
  - Modest benefit levels
  - Retirement age being raised

- Benefits coverage beyond social insurance
  - Overall occupational coverage about 55%, with variance by employment sectors and income levels
  - To the extent additional benefits are needed, will auto-enrolment be sufficient?
  - Need to avoid fragmentation of vehicles for voluntary savings
  - Current and proposed vehicles have minimum “leakage”

Through the lens of the Mercer Point of View – retirement age

- Age for State pension rising to 68 in 2028
- Movement in the employer sector: technical and substantive issues?
- How much is enough?

	1972	2010	2028 State pen	2028 1972 ratio
Hire age	18	22	22	22
Retirement age	65	65	68	73
Life expectancy	79	86	89	89
Retirement/work ratio	30%	49%	46%	31%

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Through the lens of the Mercer Point of View – retirement age

- Changes to retirement age will provoke deep social adjustments whose consequences are not yet well understood

- At a minimum, we are going to have to develop a more realistic and positive approach to later retirement ages, such that individuals and employers embrace working longer

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Through the lens of the Mercer Point of View – spend-down

- Currently two options at the ends of the spectrum: ARF (essentially an unstructured lump sum) and a life annuity
- What's wrong with a pure lump sum?
  - Lack of knowledge leads to overspending – an inadvertent dependent, with more consumption in society but at least partially at society's expense
  - Uncertainty leads to under-spending – an inadvertent bequestor, with less consumption in society
- What's wrong with annuities?
  - Most are immediate, while it is most cost-effective to defer to late life
  - Cost/benefit of a "complete" guarantee rather than a "near" guarantee
  - There is no such thing as an absolute guarantee

Through the lens of the Mercer Point of View – spend-down

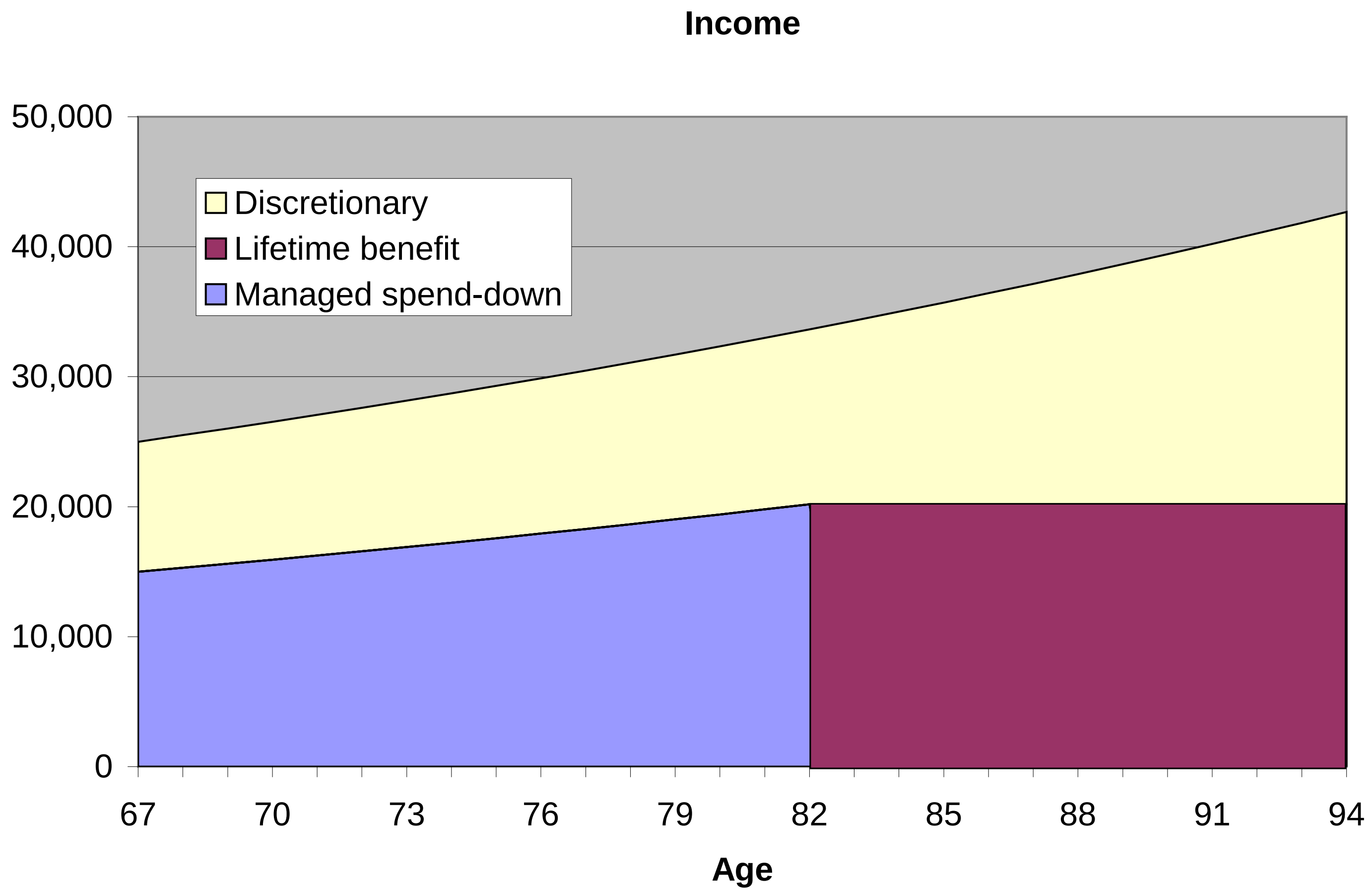
- Need a more flexible yet structured and easily accessible approach
  - Define basic components with more or less risk, and then mix and match –perhaps with some constraints
  - Do this within a single plan / administrative structure
  - Will force consistent pricing and tax treatment (unless society elects to promote a specific payment pattern)

Through the lens of the Mercer Point of View – spend-down

Retires at age 67 with a retirement fund of €500,000

Managed spend-down: €15,000 p.a.

Total pension income €25,000 p.a.



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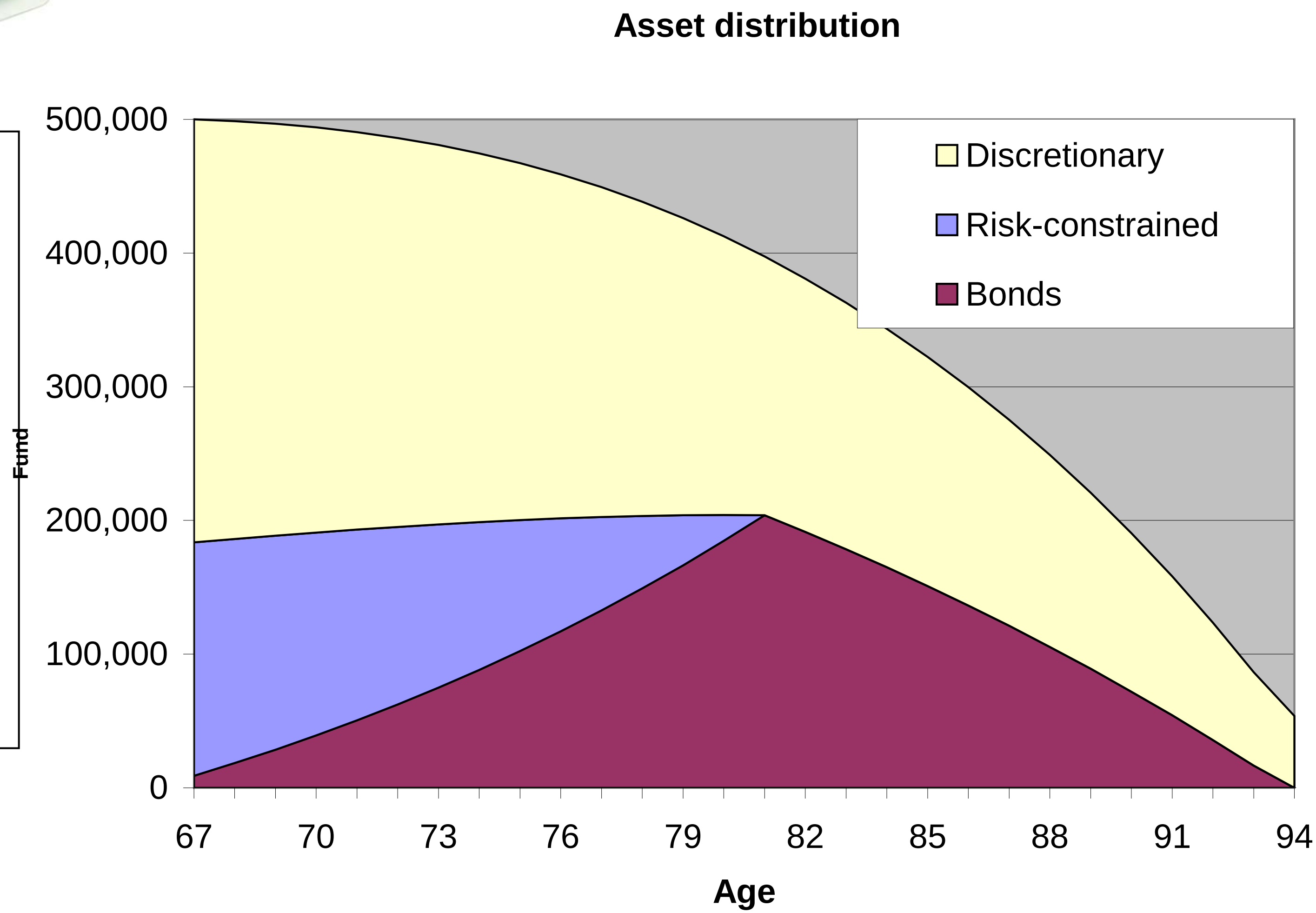

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Through the lens of the Mercer Point of View – risk sharing

- Two aspects: Who bears risk? Who manages risk?
- Current arrangements tend to be bi-polar
- Risk sharing applies to both spend-down and accumulation
  - What's a "near" guarantee?
  - Potential risk sharing approaches for DB plans in Ireland:
    - Proposal outlined in Section 5 of the National Pensions Framework – similar to the Dutch "conditional" system
    - Section 50/50A
    - Sovereign annuities or individual managed spend-down instead of current guaranteed lifetime income

Through the lens of the Mercer Point of View – risk sharing

- Risk sharing is closely connected to governance issues
  - Who do you trust to manage your retirement benefits to a successful outcome over 60+ years?
    - The government?
    - Your employer?
    - Yourself?
    - A financial institution?
  - There are limits on what can be achieved and should be expected in this area

THANK YOU

Bob Moreen, Mercer