Review of the Irish Pension System

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Outline of the Presentation

- Terms of Reference for the Review and process
- Focus on findings and recommendations on private pensions:
  - Expand private pensions coverage and retirement savings
  - Improve the design of DC arrangements
  - Enhance benefit security in DB schemes

The Review: Starting Points

- It takes into account existing Government commitments in the pensions area and economic developments since the *Green Paper* and *National Pensions Framework*
- It adopted an international perspective: lessons to be learned from international comparisons
- Focus of the review is the <u>long-term impact</u> of the planned changes in pensions in achieving the objectives of: financial sustainability; adequacy; modernity of pension systems; and equity.

EXPAND PRIVATE PENSIONS COVERAGE AND RETIREMENT SAVINGS

Coverage of Funded Pensions is Inadequate

- 58% of workers aged 30-65 covered by an occupational or personal plan in 2009 ➔ Below the unofficial “target” of 70%
- Coverage is very uneven across sectors and workers
- Existing tax deferral structure provides higher incentives to save for retirement to high-incomes ➔ Misalignment with the policy goal of increasing coverage, especially for mid-to-low incomes

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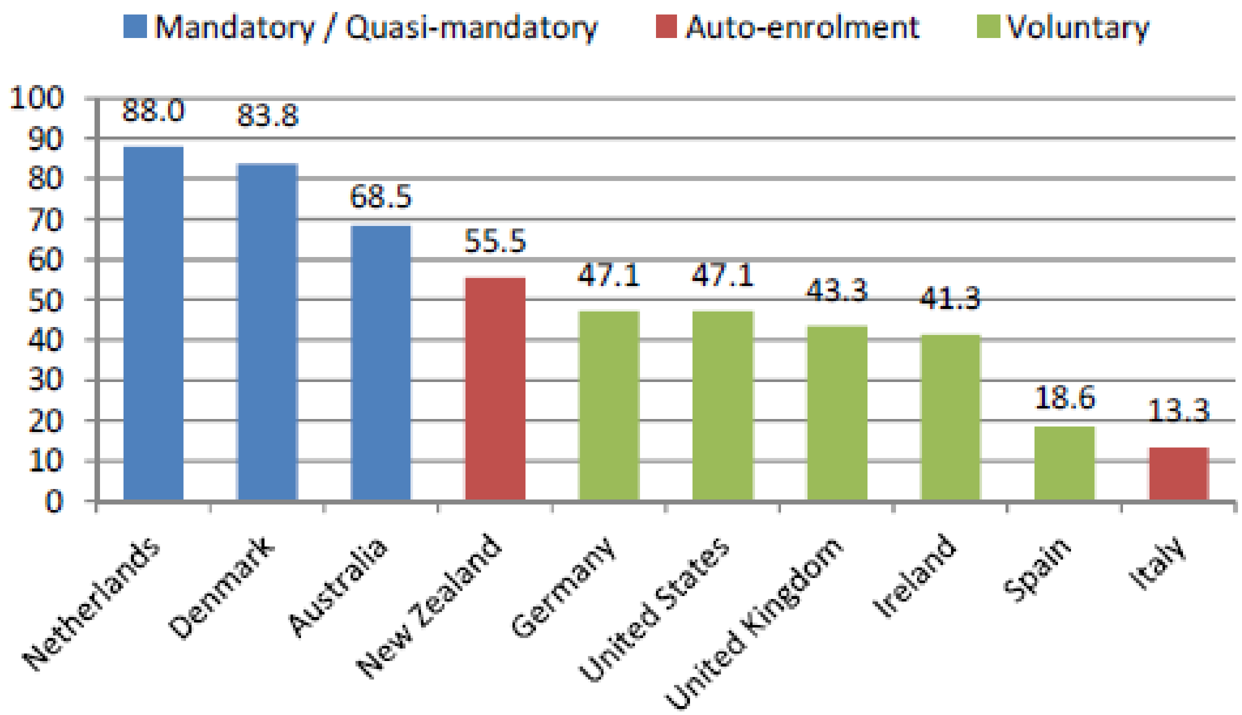
Voluntary Systems Lead to Lower Coverage Rates

(% of working-age population)



Three Options to Increase Coverage

1. **Compulsion**: The less costly and most effective approach to increase coverage of private pensions
2. **Automatic enrolment**: Second-best option. Its success depends on how it is designed and on its interaction with incentives in the system. The cost of establishing and managing AE may also be higher
3. **Improving the existing financial incentives**: Flat subsidies and matching contributions could help increasing incentives to save for retirement for middle to low incomes

Compulsion

- Both mandatory and quasi-mandatory solutions can ensure high coverage rates
- Less efficient if many workers outside formal economy
- Limitations:
  - May divert funds from other necessary expenses
  - May be perceived as a tax
  - May lead to a ratcheting down effect if target set too low
  - May not be necessary for all individuals

Automatic Enrolment (AE)

- Has already been introduced in Italy and New Zealand with different levels of success
- Increased popularity in the US
- In 2012, the UK also saw the introduction of a nation-wide auto-enrolment
- Chile also introduced auto-enrolment starting in 2012 for self-employed

KiwiSaver System in New Zealand

- New system introduced in 2007
- Minimum contribution rate: 3%
- Financial incentives: 3% employer contribution + government matching + government “kick-starts”
- End 2011, KiwiSaver plans cover 64% of the w.a.p.
- Declining trend in the number of opt outs

TFR Reform in Italy

- Auto-enrolment introduced in 2007 based on existing system
- Contribution rate: 7%
- No financial incentives
- Increase in coverage significant (+1.4m workers, from 8.5% to 11.9% of the w.a.p.)
- ... but below expectations, mainly because the TFR is highly valued by both employers and employees

Main Parameters to Design AE

- Target population
- Opting-out window
- Contribution rate
- Financial incentives
- Contribution holidays

➔ AE requires monitoring, accurate record-keeping, fiscal incentives and careful design. Implementing a centralised institution would add to the costs

Financial Incentives

- Tax incentives benefit high-income people most
- Flat subsidies have a positive effect on coverage for low-income people (e.g. *Riester* in Germany)
- Matching contributions encourage higher contribution levels among low-income people (e.g. voluntary co-contributions in Australia)
- New Zealand combines AE, flat subsidies & matching contributions

IMPROVE THE DESIGN OF DEFINED-CONTRIBUTION (DC) ARRANGEMENTS

Improve the Design of DC Schemes

- The OECD Roadmap for the Good Design of DC Pension Plans provides relevant elements to improve the design and institutional set-up of DC pension plans
- Establish appropriate <u>default</u> investment strategies for those unable or unwilling to make investment choices
- Establish <u>life-cycle</u> investment strategies as a default option to protect those close to retirement against extreme negative outcomes

Improve the Design of DC Schemes (cont'd)

- Encourage partial annuitization as a protection against longevity risk (e.g. combining programmed withdrawals with a deferred life annuity)
- While still keeping the principle of pension savings being locked away, withdrawals could be allowed strictly only in the event of significant financial hardship

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Address High Charges in Some DC Schemes

- Currently, the Irish pension industry charges are not too high compared with other countries' benchmarks for large occupational DC schemes
- But they are high for small occupational schemes and personal pension schemes
- Specialized private institutions (e.g. pension funds, asset managers) should manage the assets, even under compulsion or AE. The establishment of an autonomous public option could be envisaged to provide competition, lower costs, and a default pension fund

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ENHANCE BENEFIT SECURITY IN DEFINED-BENEFIT (DB) SCHEMES

Enhance Benefit Security in DB Schemes

- Large impact of the crisis on DB schemes: 80% are in deficit and assets are still below their 2007 level
- The guarantee schemes (IPS & PIPS) only provide a partial protection to DB plan members’ benefits in case of sponsor insolvency
- The priority currently given to pensioners before other members if a scheme winds up creates large inequalities and should be eliminated
- Healthy plan sponsors should not be allowed to “walk away” from DB plans unless assets cover 90% of pension liabilities

Enhance Benefit Security in DB Schemes (cont'd)

- Offering strong incentive for pension funds to invest in Government bonds, in particular sovereign annuities, may create new risks for pensioners
- Consider introducing more flexible DB plans to allow some degree of risk-sharing between plan members and pensioners, as well as plan sponsors
- Establish a clear framework to facilitate domestic investment in infrastructure projects without distorting capital allocation