Response of the Irish Association of Pension Funds to the OECD Review of the Irish Pension System– April 2013

Overall the OECD review of the Irish pensions is a well-researched paper with extensive examples from other countries, which gives various options as well as some recommendations for improving the Irish pension system. However, there are key areas of weakness in the analysis and recommendations.

- The report is wide ranging with a number of options across diverse areas. It is very likely that policy makers could select particular items from the report without reference to the holistic review.

- It is also the case that those same policy makers will be required to make decisions on issues that will affect their own pension provision. The perception of conflict of interest that this presents could be addressed by having further independent involvement in the process.

- Another weakness is that the report does not contain any costs (as the OECD were not asked to cost any of the options), or recommended income levels, for the replacement state pension for example. It is very difficult to support or reject principles without some idea of their actual implications for income levels.

- There is a lack of cohesion between some points such as reporting that there is a higher incentive for high income earners to save for retirement but failing to highlight the connected point that such people make a higher contribution to a flat rate state pension.

The report points out a number of key observations/recommendations which are to be welcomed:

- It highlights that DB members' protection under Irish legislation is weak and in particular there is a serious inequity in the level of priority between active members and pensioners in payment on windup.
- Irish legislation should be changed to strengthen the protection of DB plan members when plans windup. Some degree of risk sharing should be allowed and the funding ratio should be calculated on a prudent standard actuarial valuation.
- There is a division between public and private sector workers due to defined contribution plans being prevalent and increasing in the private sector and defined benefit plans being prevalent in the public sector.
- The report notes that charges on large occupational DC schemes are not high by international standards but are expensive on smaller occupational and personal arrangements. It doesn't analyse this further but addressing the complexity in the system and the difference between different products and options would help greatly.
- The state pension scheme should be modernised to give greater flexibility for people to choose their retirement age.
- The complexities and inequities in the calculation of the state pension entitlement (in particular relating to the number of contributions paid) should be removed.

- Strong support for appropriate default life-cycle investment strategies in DC schemes (while also providing choice between investment options) in particular to protect those close to retirement against extreme negative outcomes.
- Government should allow withdrawals from pension savings strictly only in the event of significant financial hardship. This would be in line with the principal of pension savings being "locked away".

However, there are a number of areas that the report appears to overlook:

- While a root and branch reform of the Irish pension is probably necessary, some account must be taken of the existing entitlements. One of the disadvantages of a pay-as-you-go scheme for the state pension is that there may be no money for future cohorts of pensioners when they come to retire, despite having made contributions to the scheme for many years. In particular, the proposal around option to which is a single means tested state pension, fails to take account of the need to meet workers legitimate expectations around their future state pension.
- While the report notes that existing private schemes need to be subjected to the same rules as any new proposed schemes under auto enrolment or compulsion, it does not highlight the complexity and contradictions in a variety of existing pension savings arrangements as a reason for low take-up or high cost of advice.

Universal Basic State Pension versus Means-Tested Pension

Overall, one of the key questions posed of whether a universal basic state pension or a means tested pension is preferable, is difficult. Firstly, this question is not abstract but in the context of existing expectations. This means transition measures, if any, are relevant. However, in the absence of further information, a universal basic state pension might be preferable as PRSI is effectively a redistribution of wealth and as such all contributors have a legitimate expectation to some form of state pension. In addition, there would be less incentive to hide wealth or to avoid saving for retirement, as well as being more in line with existing pension provision. While the options are presented as one or the other, they are quite far apart. Some consideration should be given to other options that might ensure the basic state pension can achieve its aim of keeping pensioners out of basic poverty while being sustainable.

Mandatory versus Auto-Enrolment

The other key question is whether to increase pensions coverage by introducing mandatory pensions or auto-enrolment (mandatory enrolment but with an option to opt-out). The OECD expresses a preference for mandatory and describes auto-enrolment as second-best. They believe auto-enrolment establishment and management costs may be higher although many of the costs they list would also be present in a mandatory system.

There has been little detailed analysis of the “unpensioned” population that would be enrolled in any new system. It is important that this is done and that the objectives of the system are very clear. It would be easy to increase coverage with a mandatory system but, if contributions were particularly low, it might only marginally improve people's retirement. It may also be the case that a mandatory system is conceptually preferable but not politically deliverable. Australia's mandatory system has taken a long time to achieve reasonable contribution rates (currently 9% but moving to 15%) but these are employer contributions. Any employee contributions are voluntary. Initial experience in the UK suggests opt-out rates are much lower than anticipated. However only larger employers are enrolling employees at the moment and the contributions required are low.