The Society of Actuaries in Ireland

Press Release

Defined Contribution Pension Plans – contributions fall way short of levels needed to secure financially safe retirement

Most people will not have sufficient funds for pension of even 50% of pre-retirement income

People saving for retirement under Defined Contribution (DC) pension plans are taking their future seriously, but should not be complacent about the value of their funds, as most people who are members of such schemes will not have sufficient funds at retirement to provide themselves with the recommended pension minimum of 50% of pre-retirement income, unless they start to make additional contributions. This is according to a new position paper on Defined Contribution plans and PRSAs released today (19 February 2003) by the Society of Actuaries in Ireland.

Defined Contribution plans (which include the impending Personal Retirement Savings Accounts) do not provide a pension that is defined in relation to salary and service. Instead, both the individual and employer pay a fixed rate of contribution. These contributions, along with investment returns, accumulate in a fund that is used to provide pension benefits at retirement. Defined Benefit (DB) pension schemes on the other hand define the income provided at retirement by reference to the employee's final salary.

Whereas 10 years ago membership of Defined Contribution plans accounted for less than 15% of the total membership of occupational pension schemes in Ireland, this percentage is now approximately 32% according to the latest figures published by the Pensions Board, and is close to 50% if public service employees are excluded. Over this period there has been a gradual reduction in the number of Defined Benefit schemes and virtually all new schemes have been set up using a Defined Contribution approach. In addition many employers, whilst maintaining their Defined Benefit scheme for current employees, have included new employees in a Defined Contribution plan. The trend towards Defined Contribution is likely to accelerate with the imminent introduction of the flexible PRSAs, which are effectively individual Defined Contribution arrangements.

The rise in the number of Defined Contribution plans, however, means that unless individuals plan adequately for retirement, there is a strong risk that they will face a substantial fall in their level of income at a time when it is too late to replace that income. In addition, many Defined Contribution plans do not reflect individuals' own circumstances or are established with contribution rates that do not compare favourably with Defined Benefit schemes. The prospect of lower investment returns also means that contribution rates must increase, while

falling interest rates and improving life expectancy have made it more expensive to purchase a pension at retirement.

The Society's position paper shows the recommended contribution rate that should be paid to target a post retirement income from age 65 (including the state pension) of 50% of pre-retirement income for a range of salary levels and starting ages. For example, a 30-year-old currently earning €30,000 a year (and/or their employer) needs to be making a contribution of 10% of earnings in order to target a post-retirement income of 50% of pre-retirement wage, including the then State pension, from age 65. Alternatively, if a 45-year-old on a current annual wage of €50,000 wants a post-retirement income of 50% of pre-retirement earnings, then the required contribution amount needs to be 30% of earnings.

Historically, the majority of pension schemes have aimed to provide post retirement income greater than 50% of pre-retirement income and this would require higher contribution rates. Accordingly, the position paper shows the rates recommended where the target is 67% of pre-retirement income and also points out that substantially higher contributions would be needed if one's pension was to start prior to age 65. A recent survey carried out by the Irish Association of Pension Funds (IAPF) showed that on average contributions to Defined Contribution schemes only amounted to around 10% of salary. This means that the basic target of securing 50% of gross pre-retirement income, including the State pension, would be out of reach for most contributors to Defined Contribution plans.

Commenting on the release of the Society's position paper, Eamonn Heffernan, President of the Society of Actuaries in Ireland, stated that the trend towards Defined Contribution means that increasingly the risk and uncertainty associated with pension provision has been passed from employers to employees. There was, therefore, a need to create a greater awareness among employees in Defined Contribution plans and the self employed of the requirement to set contributions at realistic levels and to regularly review their saving requirements if their pension plans were to meet their expectations. The Society's paper was designed to help in this process.

"There are a number of factors at play, ranging from the prospect of lower investment returns to the improvement in life expectancy, which are likely to impact negatively on the pensions emerging from Defined Contribution plans" said Mr. Heffernan. "Unless contributors responded by making greater contributions than currently is the case, they would not be able to fund the retirement income needed to maintain their living standards in retirement. Indeed, not alone will earlier retirement be an unattainable objective for the majority, but the need to work beyond age 65 will become the norm."

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