Society of Actuaries in Ireland

Universal Retirement Savings System

Response to Universal Retirement Savings Group Consultation

May 2015

A Preface

A1 The Society of Actuaries in Ireland ("Society") is the professional body representing the actuarial profession in Ireland. Many of our members work in the pensions field, in a range of roles, as Scheme Actuaries, advisers to trustees, employers and individuals, investment consultants and employees of or advisers to pension product providers. We can therefore draw on a wide range of expertise when we contribute to debate on pension matters.

A2 We welcome the opportunity to submit this response to the Universal Retirement Savings Group (URSG) consultation on the potential parameters of a universal retirement savings system (URSS). We would also welcome an opportunity to discuss our thoughts with the URSG in due course.

A3 It is encouraging to hear that our position paper *"Review of Policy Options to Expand Private Pensions Coverage in Ireland"* was circulated to the URSG. We recommend that the contents of this paper be considered fully. We re-iterate the view stated in this paper:

> *The Society believes that a mandatory regime is a better solution than an auto-enrolment regime for Ireland and recommends that it is introduced from outset, with the planning phase starting immediately. This decision is based on (a) the complexity of auto-enrolment, (b) the overall aims of increasing coverage immediately and improving adequacy over the longer-term and (c) the scale of the implementation effort that will be required.*

B Response to consultation questions

1. A Universal Retirement Savings System

a. What do you believe the broad policy goals of a universal retirement system should be?

i. The broad policy goals should be to achieve a high level of coverage and adequacy of benefits over a realistic timescale, through a framework that is stable over time.

- As we indicated in our 2014 position paper "*Review of Policy Options to Expand Private Pensions Coverage in Ireland*" [1], analysis is needed to confirm sustainability concerns about the State pension (see 1.a.ii), quantify the retirement savings gap (based on current private provision), substantiate the need for a URSS and inform decisions on the design of such a system.

- In principle we consider that a URSS should include all workers, both employees and the self-employed. However, we recognise that further analysis is needed to identify and find solutions for any issues specific to the self-employed sector.

- The system should be underpinned by financial education initiatives – including school programmes, to improve the financial literacy and awareness of future generations. An indicator of success will be the extent to which people appreciate that saving for retirement is a good thing.

ii. For the broad policy goals to be achieved, there needs to be clarity in relation to State pensions (and, indeed, other State benefits). Concerns have been expressed about the sustainability of the State pension. The Society has commissioned research on this topic and will be happy to share it with the URSG later this year. In the meantime, our view is that the State pension needs to be set at a level that is sustainable over time. This will probably involve reducing the real value of the State pension over a period of time once the URSS has evolved and become a meaningful secondary pillar. If the political parties agree and commit to a credible policy and plan in this regard, policymakers and individuals will then be able to make realistic assessments of what further private pension provision is needed.

iii. There also needs to be clarity and stability in relation to taxation of retirement savings, levies, benefit thresholds for taxation purposes, etc., and access to efficient, low-cost savings vehicles, to generate confidence in private pension provision and any new URSS established.

[1] https://web.actuaries.ie/sites/default/files/story/2014/02/140206%20Review%20of%20Policy%20Options%20to%20Expand%20Private%20Pensions%20Coverage%20in%20Ireland.pdf

b. **Should the system be mandatory for all workers without supplementary pension provision or should people be auto-enrolled with an option to opt out within a certain window?**

We believe that a mandatory regime is a better solution than an auto-enrolment regime for Ireland and we recommend that a mandatory approach is adopted from the outset. This recommendation is based on (a) the complexity of auto-enrolment, (b) the overall aims of increasing coverage immediately and improving adequacy over the longer term and (c) the scale of the implementation effort that will be required. For more details, please see our position paper "*Review of Policy Options to Expand Private Pensions Coverage in Ireland*"[1].

c. **Who do you think should be included / exempt? Please give views in what you believe the parameters of membership should be (for example income level, age, occupational status or other parameters)?**

i. The system should be as broad-based as possible. To achieve the policy goals of high coverage and adequacy of benefits, and in the interests of administrative simplicity and cost-effectiveness, exemptions should be kept to a minimum.

ii. However, we would agree with excluding employees earning less than a certain level of income, e.g. those earning less than the State pension. Other possible limits for consideration: employees earning less than €12,012 p.a. - USC exemption limit; employees earning less than €18,304 p.a. - PRSI exemption limit.

iii. Although most mandatory / auto-enrolment systems do not include the self-employed, we recommend that careful consideration be given to including them. Based on 2009 statistics, pension coverage for the self-employed was only 36%. Some of those without pension provision may see selling on their business as their pension. However, rather than assume that this is generally a viable strategy, analysis needs to be completed to get a sound understanding of the self-employed and the adequacy of their pension provision.

iv. It will also be important to consider and review the interaction with existing pension arrangements. Employer-sponsored schemes with contributions of at least the level required under the mandatory system could be certified and excluded. This may be important in order to ensure that good quality schemes that are already in place are not undermined, notwithstanding that it would increase the monitoring required and the complexity of the URSS.

v. Consideration should be given to including public sector employees in the URSS, as well as the private sector.

d. **Do you believe a new system should be phased in over time, and if so, what criteria would you consider appropriate for the phase in process? (E.g. Employer size, occupational sector)**

i. The design and planning of a new system is critical, as is good communication of what the system will entail for individuals and for their employers. Whatever system is ultimately introduced by the State, we believe that an important part of the communication process is to set out a pre-defined progression of contribution rates, participation and development over time. This will give employers and individuals time to plan and prepare for the new regime.

ii. In terms of the time-frame for the actual implementation of the system, this will depend on the approach taken to contribution collection, record keeping and investment. Whichever approach is taken, the timing of implementation needs to take into account the capacity and readiness of providers and employers. Also, it needs to take into account the complexity of the system in terms of eligibility, opting out (if available), etc.

iii. There are merits to the new system coming into force for all workers/employers at the same time. It would cause less confusion for the public, and it could be workable as long as employers and product providers are given a sufficiently long period to make preparations for implementation. On the other hand, a phasing in period would allow systems and processes to evolve in response to lessons learned in the initial phase. We have an open mind on the question. In the time available, we have not considered possible phasing-in criteria in any detail.

e. **What target % coverage rate should the scheme aim for?**

i. This depends somewhat on the target % of pre-retirement income replacement rate and the extent to which this will be covered by the State pension.

ii. If employees who are on low salaries and are entitled to the State pension are included in the scheme, they may feel they are being required to save for too high a level of benefit, and that their disposable income could be better utilised for other purposes.

iii. A mandatory system will by definition give a coverage rate of 100% of all non-exempted employees.

f. **What target % of pre-retirement income replacement rate should be aimed for (combining the State and universal pension)?**

i. The target % of pre-retirement income replacement rate needs to be considered in conjunction with the contribution rate needed to sustain any such target, which needs to be at an affordable level. One approach may be to set an initial target that is relatively modest and then over time, as the system becomes more established, increase the target (and the contribution rates).

ii. A target such as 50% of pre-retirement income might be a reasonable initial target to consider. We understand that such a target has also been referenced by the OECD in relation to the UK. We estimate[2] that this would require a contribution rate of the order of 8% of earnings for a 30 year old, assuming current earnings of €35,000 p.a., a retirement age of 68 (which will be the State pension age from 2028) and that the State pension will increase in line with average earnings (see, however, our comments at 1.a.ii. regarding the sustainability of the State pension).

- It should be noted that, for a given contribution rate, the replacement rate is influenced by the relative value of the State pension compared to the individual's salary. If, in the example above, the current earnings were €20,000, the replacement rate would be approximately 75%.

- It should also be noted that the contribution rate required to meet a given target is sensitive to the age at entry. For example, given current earnings of €35,000 p.a. and other assumptions as set out above, we estimate[2] that, if payment of contributions starts at age 50, a contribution rate of the order of 19% would be required for a target pension from age 68 of 50% of pre-retirement income.

iii. As stated at 1.c.iv., interaction with other private pension provision needs to be allowed for.

iv. While the system might be designed with a target % replacement rate in mind, experience has shown that (unless they are close to retirement) individuals find it difficult to engage with this concept. A better approach might be to talk about the amount of retirement savings that a person should aim to have accumulated at certain milestones along the road to retirement – e.g. x times salary after 5 years, y times salary after another 5 years, etc. The person can then focus on a near-term target, rather than on a very long-term target that is difficult to comprehend.

g. What should the role be of the State in establishing and operating the system?

Mandating that individuals must participate in the URSS would place a responsibility on the State to monitor payments and providers and ensure that the overall operation of the system is appropriate. A clear governance framework must be adopted with the objective of monitoring the various parties operating and managing the system, including:

- Employers (to ensure timely payment of contributions, if they are to be remitted through employers); and
- Providers (member record-keeping, investment managers, benefit statements, technology etc.).

Whether providers are private sector, State-run or a combination, it will be important to ensure that they have sufficient capacity and expertise. Note that it will also be necessary for some (State) body to keep a central register of all people in the URSS and those exempt from it.

[2] Assumptions: Inflation 2% p.a.; salary and State pension increases of 3% p.a.; investment return of 5% p.a.; post-retirement interest rate of 1% p.a.; mortality basis: 52% PNMA00.

h. If you consider that the system should operate on the basis of auto-enrolment with opt-out, should there be a requirement for automatic re-enrolment and if so, after what period of time?

i. As indicated above, we believe that a mandatory system is the best solution.

ii. If an auto-enrolment system with opt-out was introduced, it would be a critical feature of such a system to have a requirement for automatic re-enrolment. Three years would seem to be a reasonable time period - any shorter would probably put undue administrative pressure on the system while much longer would start to put adequacy of benefits at risk.

2. Operational Matters

a. What are your views on who should collect contributions and who should administer the system?

i. The tasks of collecting contributions, investing them, keeping records, communicating with members and paying benefits do not necessarily have to be done by the same body. That said, there would be efficiencies if at least some steps are handled by the same service provider. The system put in place should allow for good, clear administration and the legislative framework and other elements of the system should provide contributors with confidence in the security of their assets.

ii. A State agency could be charged with collecting contribution and administering the system:

- The State has considerable experience in administering deductions from salary (via Revenue).
- In theory at least, costs may be reduced by having one centralised collection agent.
- It might be possible to integrate collection of contributions with a reduction in Universal Social Charge, if required.
- It would mean that the State would not have to regulate and monitor private providers' work in this area.

iii. However:

- Systems and processes are not currently in place within the public sector which could facilitate the large-scale administration of individual accounts. It is imperative that the URSS gets off to a very strong start on all fronts and, as such, it might be risky to entrust the administration and investment duties to any State agency as they do not have a track record in this area. With many monthly cashflows, we know from years of experience within the private sector that a seamless and experienced team is required, allied to the correct administration systems and an appropriate governance framework, to ensure that any errors are kept to a minimum.
- Using a State agency might reduce confidence in the system as there may be a perceived risk that assets could be used for other purposes, or a view that the system represents additional taxation.
- It may result in reduced choice for individuals.
- It would be important to manage investments in such a way that the allocation to each individual in respect of that individual's contributions can be clearly identified. The State does not have a track record in this area.

iv. On balance, we think that it is likely to be more effective to avail of the relevant experience and expertise that exists in the private sector:

- This would include both the current pensions industry and wider regulated financial bodies.
- There are a number of financial services entities that have considerable experience in administering deductions from salary and investing in line with instructions.
- Economies of scale may still apply if the number of administrators responsible is relatively small. "Master trust" type arrangements could be used to promote economies of scale, and these would also support the Pensions Authority's stated aim to reduce the number of defined contribution trusts. In addition, unless only one provider is involved, including a range of regulated bodies should lead to increased competition and, in turn, better pricing structures. (Note that if a contract was awarded to only one provider, it may be very difficult to switch provider in the future).
- There are a number of financial services entities with considerable experience in communicating with persons saving for retirement, which will be key to ensuring that individuals have a strong sense of ownership of their pension funds and do not regard the payment of contributions as simply another tax.
- Using private sector entities rather than a State agency is likely to increase the choice available to members.
- There will be lower initial implementation costs for the State.
- It may create jobs in the private sector.
- Note that, although the URSS should be designed in such a way as to be cost-effective for consumers, it will also be important to attract multiple players to the market, to stimulate competition. If low caps are placed on the maximum level of charges that may be applied, it may not be attractive for providers to enter the market and some other solution may need to be found for potentially uneconomic contracts.

v. Whatever approach to administration is taken, if employers are required to collect contributions through payroll, they will need to be monitored to ensure compliance and checks will need to be carried out to ensure that are employers are remitting the correct contributions.

vi. Payroll providers should be involved at an early stage in discussions to ensure that there is a streamlined and administratively effective way of recording contributions and dealing with the requirements of the URSS. Payroll providers in the UK have struggled with the complexity of the auto-enrolment system put in place, leading to increased costs.

vii. If exemptions are kept to a minimum, a mandatory system should be easier to run than an auto-enrolment system. Opt-out and opt-in issues will not arise and this should make the collection of contributions and overall administration of the system easier. However, where employer schemes with contributions of at least the level required under the mandatory system are certified and excluded, this will add some complexity to the regime.

b. Who should be responsible for record keeping?

i. Whatever record keeping arrangements are put in place will need to be streamlined and efficient. It will be important that individuals trust the administrator and have confidence that data will be accurate, up to date, accessible and used only for the purposes of the URSS.

ii. Intuitively, a centralised system has some appeal.

iii. However, record keeping needs to be linked to collection of contributions, and a mandatory system with centralised collection of contributions through a State agency (e.g. Revenue) may be perceived as an extension of taxation.

- This can be mitigated somewhat by ensuring that individual accounts are maintained, to give personal ownership.
- While existing government departments, such as Revenue, may have existing facilities for collecting contributions centrally, they do not currently have systems and processes to maintain individual defined contribution records and all that entails (investment in funds, allocation of fund units to individuals, switching unit holdings between funds etc.).
- Therefore, consideration should be given to using existing pension industry expertise for record keeping.

iv. From the outset, the record keeping methods should be set up to support pension tracking. The introduction of a unique pension tracking number may be required.

v. To get member buy-in, including a strong sense of personal ownership and responsibility, the record-keeping needs to go beyond the pure mechanics of recording details. It must also incorporate the mechanisms needed for communicating to members of defined contribution arrangements, such as annual benefit statements and online availability of information and tools to help people plan for their retirement.

vi. If the system is implemented using private bodies, the Pensions Authority (or some other public body) could maintain membership details from all private URSS providers and from other pension arrangements that have received exemptions. This central list would be compared against Revenue lists to ensure all people in employment are saving for retirement. The list could be updated on a regular basis, perhaps annually.

c. Who should have responsibility for paying benefits?

i. The options here perhaps are linked to the form of the benefits that may ultimately be drawn.

ii. A (tax free) lump sum at retirement could be administered by either a State agency or a private sector provider. If administered by Revenue, checks could easily be made to determine whether any previous lump sums had been paid to that individual.

iii. If an annuity was to be purchased, the most appropriate paying agents would seem to be the insurance companies currently operating in the market as they have appropriate systems/pricing bases/payment structures in place, and competition between them should be to retirees' advantage. However, the alternative of State-backed annuities administered by a State agency could also be considered. If the State offered guaranteed terms for conversion of retirement savings to pension, payment of resulting benefits could be combined with State pension payments, providing synergies as payment systems are already in place. There is, however, a risk that this may result in the state effectively taking on further unfunded pension liabilities if the conversion prices set do not reflect the true cost of the pensions.

iv. If, at retirement, the individual had the option to invest in an Approved (Minimum) Retirement Fund, the most appropriate paying agent for that benefit is likely to be a private sector provider. However, if the State (via the NTMA) is the primary investor of the pension assets pre-retirement, it may wish to offer continued investment via the NTMA post-retirement. This would require new product structures to be set up.

v. Decisions on this question need to be made in the context of decisions on other aspects of administration of the URSS. Any processes established need to be streamlined and efficient.

3. Investment Management Structure

a. What do you believe should be the key objective/s?

i. The key objectives should be:

- Simplicity;
- Competitive returns (after charges);
- Transparency; and
- The provision of appropriate default investment structures.

ii. There is evidence that applying a low-risk investment strategy initially has benefits, as psychologically investors are more likely to continue paying contributions if they do not make losses in the first few years. Such an approach has been adopted in the US and UK for pension provision. If this idea is adopted, the investment mandate should incorporate an initial low-risk investment strategy, followed by a period with a higher return (and higher risk) objective, tapering to less risky assets as retirement approaches. Any such approach could be reviewed after a few years, with a view to encouraging a more long-term investment perspective where appropriate. Note that the intention to revise the investment strategy as described should be clearly communicated from the outset.

b. What are your views on how investment should be structured and managed?

i. Contributions should be aggregated and invested in pooled funds (according to contributors' investment instructions), with each contribution purchasing a number of units of the chosen fund(s). Contributors should be given regular (e.g. yearly) updates on the number of units in their account and the value of the units. This will encourage a feeling of ownership.

ii. Pension providers and certain other regulated financial services providers have expertise in managing large pooled funds invested in a range of asset types and managing the allocation of units within the funds to individual investors, and it would make sense to avail of their experience and expertise.

iii. The Pensions Authority could set criteria that URSS funds must meet and could monitor compliance. Criteria might have regard to factors such as asset price volatility, liquidity, diversification, level of charges, transparency of charges, frequency of investor communication, etc.

c. What are your views on default investment structures?

i. Default investment structures would be desirable. They should be relatively low risk overall, and within that constraint, they should provide for relatively higher growth and risk at younger ages, moving into safer assets closer to retirement ("life-styling").

ii However, it should be noted that designing a default investment structure for a "typical" contributor is not straightforward. Moreover, investment experience will probably diverge from the expected experience on which the default structure was initially based. So, investing in a default investment structure should not be confused with passive investment. Thus, the rationale for and workings of the default structure, and the risks associated with it, need to be communicated clearly, and investors need to be aware that the investment strategy, and the rate of contribution, may need to adapt over time in order for their retirement goals to be achieved. For more on this subject, see "*Default Investment Strategies and Life-Styling*"[3] by Johnston *et al*, which was presented to the Society of Actuaries in Ireland in 2011.

d. What range of investment choices should be available?

i. The range of investment choices should be limited. The aim of the URSS is not to facilitate investment in exotic vehicles – it is to increase coverage and adequacy of pensions saving, and this goal is best achieved through a simple approach.

ii. The range of investments should include cash, bond, equity and property options and some sort of multi-asset fund. Further analysis should be carried out to determine whether a variety of bond/cash/equity/property/managed funds are required using varying levels of risk (e.g. corporate bonds, emerging markets, foreign markets).

iii. The investments open to standard PRSA products could be used as a good starting point.

[3] https://web.actuaries.ie/sites/default/files/event/2009/09/Default%20Inv%20Strat%20and%20Lifestyling.pdf

4. Scheme Design

a. What do you think the contribution rate should be and how should it be structured (between employer/employee/State) and phased in over time?

i. So as to give people time to adjust to the new system, and still address coverage, contribution rates could be set at low levels initially. Adequacy of provision could then be addressed later by increasing contribution levels (with this intention being clearly signalled from outset).

ii. It is difficult to select the correct contribution level that will encourage people not to opt out (if this option is included) and yet provide adequate coverage. Perhaps the system could have a default contribution percentage but could also include further options and/or information that the default level of contributions is not appropriate in all cases. For example, there could be "Bronze, Silver and Gold" contribution levels. This could also help to stop a race to the bottom, by encouraging employers to provide a pension scheme that achieves a higher rating, rather than reduce contributions to the minimum permissible. Thus, it would help address concerns that individuals or companies who are currently making contributions at a level above the default setting of any URSS could inadvertently be encouraged to reduce contributions to this level.

iii. The National Pensions Framework published by the Government in March 2010 discussed a possible contribution rate of 8% of income (split 4% for employees, 2% for employers and 2% from the exchequer).

- From our analysis above (see 1.f.ii.), this level of contributions is likely to be suitable for an employee who starts to contribute at age 30 and is targeting a relatively low retirement pension. Note that the replacement ratio will be higher for lower earners (see 1.f.ii).

- However, rather than immediately impose this contribution rate (under a mandatory arrangement – or propose it under an auto-enrolment arrangement), greater support for the URSS might be garnered by starting with a total contribution rate of, say, 4%, building up to 8% - 10% over, say, 10 years. A review could be carried out after 5 years to determine target contribution levels after year 10.

- Other options that could be considered include exempting employers from contributing in the first year (as they will probably have to bear set-up costs), and/or providing a once-off special contribution from the State in the first year to kick-start the scheme.

- Consideration should also be given to allowing individuals to make additional voluntary contributions above the minimum employee level.

iv. The progression of the contribution rates over time should be set out at commencement. The Australian mandatory regime allowed for the initial contribution rate to be quadrupled by stepped increases on a regular basis over a period of 25 – 30 years. Ideally the 'phasing in' period adopted in Ireland would be shorter than this.

b. **What are your views on State incentives for universal retirement savings (e.g. tax relief, direct subsidy, etc.)?**

i. From the perspective of simplicity and ease of engagement with the individual, a matching structure (as outlined in the National Pensions Framework) might seem most attractive. This would equalise the State subsidy across standard and higher rate tax payers.

ii. However, there are a number of consequences that would need to be considered before this could be adopted, including:

- The implications this would have on contributions paid by higher rate taxpayers, who would now have a disincentive to save for retirement beyond a certain level (as they may also be taxed at the higher rate on their eventual pension income).
- Additional complexity and the possibility of a two-tier approach where members of certain arrangements or members who joined a pension scheme before a certain date receive tax relief while others receive subsidies.
- Whether the same level of tax subsidy should be applied if members are making additional voluntary contributions.

iii. We draw your attention to the merits of the tax relief system, as outlined in the research report titled "*Analysis of Fiscal Incentives for Retirement Savings – models and redistributive effects*"[4], which was published by the Society and publicpolicy.ie in October 2012. The report demonstrated the progressive nature of the Irish pension system and the greater incentive to save as an employee gets closer to retirement age. It also showed that the State pension system is redistributive, from high earners to low earners and from the working to the non-working population. Any moves to change fiscal incentives for existing retirement arrangements would need very careful consideration and wide consultation with stakeholders. It may be preferable to extend the current tax relief regime to the URSS. Whichever approach is adopted should be simple to operate in practice.

c. **Should universal retirement savings be established using a trust or contract based model or should both be offered?**

i. Either approach is valid so long as the correct governance structures are in place.

ii. Trust models may allow for greater flexibility in investment choices and may allow for greater involvement by members/employers if they act as trustees (though this raises its own issues, e.g. around training, expertise, conflicts of interest). However, the Pensions Authority has previously stated that it believes there are too many small pension scheme trusts in Ireland. One way to address that would be via the establishment of master trusts. A master trust is a multi-employer, single trust arrangement where all governance, legal, consulting and administration services are centralised. This type of

4 https://web.actuaries.ie/sites/default/files/story/2012/10/121012%20Fiscal%20incentive%20for%20retirement%20savings.pdf

approach may be targeted towards particular employer/occupational groups where the individual businesses/companies may be too small to appropriately set up a standalone pension scheme.

iii. Contract arrangements may be seen to be more flexible/portable and individuals may feel more comfortable with having a standalone policy. They can lead to reduced investment choices and more administrative/payroll complexity if employees choose different contract providers (if the option to do so exists). In the UK, contract providers have independent governance structures in place to review the contract terms periodically. A similar structure should be put in place to ensure that the investment choices and charges remain appropriate. Due to economies of scale, contracts may have higher charges associated with them.

iv. An SSIA-type contract model may also be considered. The high take up of SSIAs might suggest that a similar system of matching contributions for pension savings could help to improve the level of pension coverage. However, it could be argued that the success of the SSIA model was due to its short-term nature and the initial deadline for setting up a policy. It is unclear that such a model would have a lasting impact on improving pension coverage.

d. Should members be allowed to take 'contribution holidays' and if so under what circumstances and for how long?

Contribution holidays would add to IT systems complexity and administration workload. Under a mandatory approach, contribution holidays ideally should not be permitted (and should not be necessary if access to funds is provided for – see next question). If auto-enrolment is adopted, then members would presumably be able to opt out at any particular point. In this event, there should be a maximum period before the member is automatically re-enrolled (or asked if they want to re-enrol).

e. Should members be able to access part of their funds and if so, in what circumstances and to what extent?

This is counterintuitive to the purpose of universal retirement savings but may increase attractiveness to individuals. Some measures could be introduced to allow access to a limited amount of the accumulated fund in the event of a particular circumstance occurring (for example, house purchase, serious illness, other extraordinary financial pressures). A maximum drawdown amount should be set (perhaps 30%, in line with the recent AVC initiative). The costs of administering such a payment (and its taxation treatment) would also need to be considered. The individual should be informed of the likely impact on the ultimate retirement benefits (and interim goals – see 1.f.iv.).

f. Should additional incentives (or disincentives) be utilised to encourage individuals to stay in a scheme and keep retirement savings intact (ie not to opt out/not to seek early access to funds)?

i. If the approach adopted is a mandatory scheme, this will not be an issue.

ii. If an auto-enrolment approach is adopted, we suggest that opt-out should not be allowed for a minimum period of, say, 6 months (and similarly in respect of any subsequent automatic re-enrolment).

g. What are your views/suggestions on the provision of benefit options at the decumulation stage?

Similar to the current regime, individuals should be able to take a tax free lump sum (which is a strong incentive for retirement saving) and should be allowed to choose from a range of options (annuity, Approved Retirement Fund, taxable lump sum depending on limits) for the remainder of the fund. The provision of advice (both at retirement and in the years preceding retirement) should form a crucial part. Options to take benefits in phases should also be made available, especially in light of the increases to State pension age (individuals may have pensions from varying sources coming into payment at different ages).

5. Other

a. How would you ensure that a new universal retirement savings system would not operate to the detriment of existing voluntary pensions arrangements?

i. It is quite likely that the introduction of a new universal retirement savings scheme would have a negative impact on existing voluntary pension arrangements as well as potential future voluntary pension arrangements. There is a very real danger that private voluntary arrangements could be viewed as unnecessary if there is a universal scheme in place. There is also a significant risk that contribution/benefit levels in new and existing arrangements would converge upon the rates set in the URSS (if they are set at a lower level). Neither of these consequences is desirable and measures should be taken to tackle these.

ii. The new system must be designed to encourage existing voluntary pension arrangements to continue at current (or higher) contribution levels as well as encouraging the establishment of such arrangement in the future.

iii. It is likely that a range of measures would be required to achieve this goal. Careful consideration should be given to this issue, with possible solutions including:

- Maintain tax relief available to existing arrangements (note: see comments at 4.b.iii. above);

- Ensure that exemptions are given from the URSS if adequate voluntary arrangements exist. A certification system would need to be in place around this with a central database checking membership etc.

- Introduce a new rating system whereby voluntary pension arrangements are given an official rating that ranks the level of benefits/contributions given. This would give employers and employees a clear way of recognising (and indeed advertising) the benefit of their voluntary pension arrangements. This would mean that the removal of these benefits would be less likely in future and it would also make it easier for employees to realise if their benefits are being reduced as the rating of the scheme would be downgraded.

    - The State pension could be seen as a basic level of provision.

    - The State pension plus URSS could be ranked as a “bronze” level of retirement saving.

    - Different categories above this level of provision could be defined such as silver/gold etc.

- Provide an incentive to employers to provide higher pension contributions/benefits. This could be provided through reductions in employer’s PRSI or through other means.

iv. It is worth noting that the level of tax relief available would be critical to the continuance of any existing voluntary arrangements. See 4.b.iii.above.

b. What would you see as the likely costs and broader economic impacts of such a system?

i. Answering this question fully would require detailed analysis and careful consideration. We recommend that the URSG carry out such analysis.

ii. Although it is not feasible to comment adequately on the costs and broader economic impacts of such a system in this submission, we list below some potential consequences that might be considered. This should not be viewed as an exhaustive list and more detailed analysis would almost certainly produce more considerations and possibly eliminate some of the potential consequences raised here:

- There would be a deferral of money flowing through the economy and less spending, which may reduce economic growth in the shorter term.

- The costs to employers might be passed on to consumers, leading to inflation. Alternatively, employers might have less discretionary money, reducing spending and inflation.

- Higher labour costs could reduce employment levels and national competitiveness.

- Any such impact would be eased by a phasing-in of the URSS.

- Any URSS fund will most likely invest a large portion of the assets outside Ireland. This means the assets will not be available to support Irish growth.

- Depending on how the system is designed, some of the invested money could be reinvested in Ireland to help Irish growth. However, the true aim of the URSS should not be undermined or constrained by separate and potentially conflicting aims of investing in Irish assets to boost economic growth. These constraints should not exist on the system. If necessary, alternative mechanisms for incentivising investment in Ireland should be developed (though integrating these with the URSS may be feasible).

- Existing savings levels will be impacted. One school of thought is that existing voluntary savings would be reduced/diverted into the new mandatory or auto-enrolment regime. Overall savings levels would increase but additional voluntary savings could decrease. Another opinion is that this new regime would raise awareness and that private savings levels could rise.

- The cost of tax relief or any tax incentives would also need to be considered.

- Set-up costs are likely to be large. If a new public body is required, the cost of establishing it could be high, as evidenced in the case of Irish Water. There will not be the same operational issues as at Irish Water (such as installing meters) but there could be a large spend on systems development as the required administration systems will arguably be more complicated. If existing private sector infrastructures can be utilised, set-up costs may be lower.

- If the current pay-as-you-go regime is changed to a funded scheme (through mandatory or auto-enrolment pensions), there will be a double burden placed upon individuals, in that they will (through the taxation system) be providing for the current generation of pensioners while at the same time they are providing for their own pension.

iii. Although there are many economic impacts to the introduction of the URSS, some of which may be negative (such as reduced economic growth in the shorter term), the alternative of not introducing such a scheme and leaving future generations with insufficient provision for retirement is, we believe, far less desirable. In the short to medium term, there may well be impacts on savings levels and economic growth. Ultimately, however, as this first cohort of savers become pensioners, there should be decreased pressure on the State to provide supports and the additional income in retirement may support economic growth.

e. Do you have other suggestions/comments you would like to add to the considerations around universal retirement savings?

<u>Choose between a Mandatory or Auto-enrolment system</u>

i. The answer to many of the questions in the invitation for submissions on a Universal Retirement Savings Scheme differ somewhat depending on whether a mandatory or auto-enrolment regime is selected.

ii. Given that the implications of this decision could last for many years (and generations) to come, it is critical that an informed decision is taken on whether a mandatory or auto-enrolment system is more suitable. Detailed analysis should be carried out to aid in this decision.

iii. This work should be carried out promptly, as the earlier a decision can be taken on which system is preferred, the easier it will be to implement that system. Once the decision is made, all efforts can be focused on considerations specific to this regime, cutting the workload significantly.

<u>Tax relief vs matching contributions</u>

iv. The best approach for providing government support/incentives to the scheme should be considered in depth. There are several options, open such as the current regime of tax relief at a marginal rate, some form of matching contributions or variations on these approaches. The 2013 OECD report on "Review of the Irish Pension System" flagged that tax incentives for pension provision should be reviewed. Subsidies and matching contributions appear to be preferred to tax relief at the marginal rate. However, the Society has previously raised the issues with such an approach and shown that the current tax relief system has some significant benefits over a matching contribution system. See paragraph 4.b.iii. of this submission.

v. One of the main advantages of a matching contribution system is that it is easier to understand and market to the public. The URSS could be designed to effectively retain the tax relief system in place but display the benefit of tax relief as a matching contribution rather than pension contributions being a 'gross of tax' figure.

DC Simplification

vi. The current defined contribution (DC) landscape in Ireland is complicated and the rules and approaches can vary depending on the type of arrangement used. The success of any future URSS will be heavily influenced by the state of the DC pension system in Ireland. The DC system should be reformed and simplified in order for the URSS to be successful, as the complexity of the current system is a major impediment to engagement. Any potential future reform of the DC system should be borne in mind in selecting the design features of the URSS. This review should consider not only contribution limits, investment options, tax treatment and the ultimate form of benefits, but also a simplified advice structure where members can make decisions without the need for costly individual advice and where members' focus can be on ensuring adequacy of benefits. For more on this topic, please see our October 2013 response to a Pensions Authority consultation on the future of DC pensions[5].

Future certainty of the URSS

vii. The vision for the URSS is that it will last for many years. The implementation will need to be carefully considered and worked through and changes to minor details could have a significant impact on the success of the URSS. A clear road-map for the URSS should be set out to help all stakeholders involved.

viii. There is a risk posed by future governments unnecessarily changing the structure of the URSS (or even abandoning it). This risk should be mitigated as far as is possible. Cross-party agreement on the high level aims and design features of the URSS would be ideal and an independent mediator (possibly the Society in tandem with other organisations) could be used to facilitate such an agreement.

Safety of assets

ix. Whatever system and design features are selected, the safety of assets should be a key consideration. Guarantees around investment returns are not necessary but the risk of default of any private provider or the risk that the assets are used for other government aims (as happened the National Pensions Reserve Fund) should be guarded against. Strict controls should be put in place, including ring-fencing of assets.

Please refer any questions on this paper to:

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5 https://web.actuaries.ie/sites/default/files/story/2013/10/131030%20Pensions%20Board%20DC%20Consultation%20-%20FINAL.pdf

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