



Securing Retirement Income

National Pensions Policy Initiative
Report of The Pensions Board
to the Minister for Social, Community
and Family Affairs

Published by



An Bord Pinsean Teach Holbrook Sráid Holles Baile Átha Cliath 2

The Pensions Board
Holbrook House
Holles Street
Dublin 2

Teileafón/Telephone: (01) 676 2622

Fax: (01) 676 4714

Email: pb@pensionsboard.ie

www.pensionsboard.ie

Price: £15

ISBN: 0 9533 171 02

The Pensions Board

Board Members

Eamonn Heffernan (Chairperson)

Kay Brophy

Alan Broxson

Rosheen Callender

Deirdre Carroll

Pat Delaney

Caroline Jenkinson

James Kehoe

Raymonde Kelly

Maria Kinlan

Ciarán Long

Stephen McCarthy

Veronica McDermott

Joe Mooney

Robert Woods

Donal McAleese (served until January 1998)

Board Executive

Anne Maher (Chief Executive)

Tom Dunphy

Mary Hutch

Adrian Smith

Ian Woods

Consultants

Peter Bacon and Associates, Economic Consultants

National Pensions Policy Initiative Committee Members

Eamonn Heffernan (Chairperson)

Kay Brophy

Alan Broxson

Rosheen Callender

Deirdre Carroll

Pat Delaney

Caroline Jenkinson

James Kehoe

Raymonde Kelly

Maria Kinlan

Ciarán Long

Anne Maher

Donal McAleese

Stephen McCarthy

Veronica McDermott

Joe Mooney

Brendan O'Leary

Clive Slattery

Anne Vaughan

Ian Woods

Robert Woods

To Mr. Dermot Ahern, T.D. Minister for Social, Community and Family Affairs

On 30 October 1996 the National Pensions Policy Initiative was launched. This was jointly sponsored by your Department and The Pensions Board. The objective of the Initiative was to facilitate national debate on how to achieve a fully developed national pension system and to formulate a strategy and make recommendations for actions needed to achieve this system.

The Initiative was progressed in two stages. The first stage involved the publication of a Consultation Document on 13 February 1997. The purpose of the Consultation Document was to provoke discussion by setting out background information, listing the main issues and possible ways forward. The Document was set out against an international background in which many countries are reforming or reviewing their system of providing for older people. It took account of the ESRI Report on Occupational and Personal Pension Coverage 1995 together with other published material, including the Final Report of the National Pensions Board. 3,650 copies of this Document were distributed.

There was a very wide response to the Initiative from many different sources, showing a recognition of the importance of pensions and making use of the opportunity to influence future national pension policy. 143 submissions were received, ranging from detailed and research based documents to individual submissions. The range and scope of the submissions ensured that key issues of concern to organisations and individuals could be reflected, as far as possible, in what is, in effect, a national debate on the proposed way forward for securing future retirement provision. A National Pensions Conference was held on 2 July 1997 in Dublin Castle and all those who had made submissions came together to present and discuss them. This provided a further major contribution to the consultation process.

In July 1997, The Pensions Board commenced work on the second stage of the Initiative. The second stage involved analysis of the responses to the Consultation Document, further investigation and discussion of specific ways forward leading to a report and recommendations from The Pensions Board to you. In order to assist us, we appointed Consultants to support and facilitate the preparation of our Report. We have held many internal workshops over a nine month period in which we have discussed and debated issues raised in the consultation process, objectives, strategic approaches, practical alternatives to achieving these objectives and associated issues of implementation which would arise. These workshops were informed by the results of the Actuarial Review of Social Welfare Pensions published in September 1997 and other economic forecasts, further analysis of data from the ESRI, and inputs by expert practitioners on specific matters. Various meetings were also held with representative groups which proved very helpful.

We set out our strategy for a fully developed national pension system in this Report. We believe that securing adequate provision for retirement income in the future will require both improvements to the basic Social Welfare old age pension (which itself should provide adequate minimum income guarantee for the avoidance of poverty) and development of the supplementary pension provision system to provide much more simplified access than exists at present. In our view, this should result in wider coverage, not only in terms of numbers covered but also in terms of the types of employment covered, with a particular objective of bringing into supplementary pension coverage groups hitherto not covered such as younger people, lower paid and atypical workers. These developments in the supplementary pension system will need to be supported by robust institutional arrangements to build confidence in supplementary schemes and an educational and information drive to convince people of the need to make sufficient retirement savings. If these do not prove sufficient, further steps, including mandatory contributions, should be considered in the context of a progress review to be undertaken as proposed in the Report.

We believe that this Report provides the framework in which the key concerns in relation to securing future retirement income can be addressed. The broadly representational nature of the Board has ensured that, in general, this framework has been developed on the basis of a broad consensus on a future direction (for some particular concerns on specific issues see Chapter 5, Sections 5.1 and 5.2). In essence, the framework covers the following key elements:

- planning for future provision in a changing demographic context;
- addressing poverty concerns for the retired sector, and in particular aiming to provide a minimum adequate pension in retirement;
- ensuring that funding arrangements take account of financial sustainability in the longer term;
- recommending a range of important innovations which will enable the potential of an established voluntary funded Second Pillar system to be developed and extended considerably;
- setting specific targets both for the quality and extent of pension coverage in the future;
- providing a strong institutional framework for the above developments and ensuring a review mechanism to monitor progress achieved.

A key aspiration underpinning the Initiative is that progress should be achieved in the context of National Partnership mechanisms through which Government and the social partners can discuss and agree a way forward on key national issues.

The Board is grateful to the organisations and individuals who participated in the consultation process. We would particularly like to thank the Consultants who gave such invaluable and tireless support to us in our deliberations. We would also like to thank the non-Board members who made specialist inputs. Finally, we would like to acknowledge the considerable help and support we received from the staff of the Board.

At the start of the Initiative we had many different views on the issues involved. We are very pleased that we are now presenting you with a Report signed by all Board members. It is our hope that this will provide you with a plan for development of the national pension system for the coming decades. We recommend it to you for consideration and we believe that it provides a clear, convincing and evolutionary approach to future policy in this area and should provide a firm basis for implementation.

Chairperson

Board Members

Table of Contents

			Page
1	Exec	cutive Summary	3
2	Purp	pose, Scope and Process of Initiative	
	2.1	General	35
	2.2	Purpose	35
	2.3	Scope	37
	2.4	Process Involved in Initiative	37
3	The	Current Pensions Environment and Issues Arising	
	3.1	Existing Types of Pension Provision	43
	3.2	Extent of Coverage	45
	3.3	Adequacy of Coverage	48
	3.4	Personal Sector Savings and Wealth	50
	3.5	Replacement Rates in Practice	51
	3.6	Market Development of Supplementary Pension Provision	51
	3.7	Consumer Protection	56
	3.8	Financial, Operational and Market Issues Highlighted in the Consultative Phase	57
	3.9	Summary of Issues	59
4	Dem	ographic and Economic Prospects: Long-term Considerations	
	4.1	Introduction	63
	4.2	Population and Labour Force Trends: International Context	63
	4.3	Projections of the Irish Population and Labour Force	65
	4.4	Implications for the Funding of Pensions: The International Context	67
	4.5	Actuarial Review of the Irish Social Welfare Pension System (First Pillar)	71
	4.6	International Competitiveness	77
	4 7	FMII	79

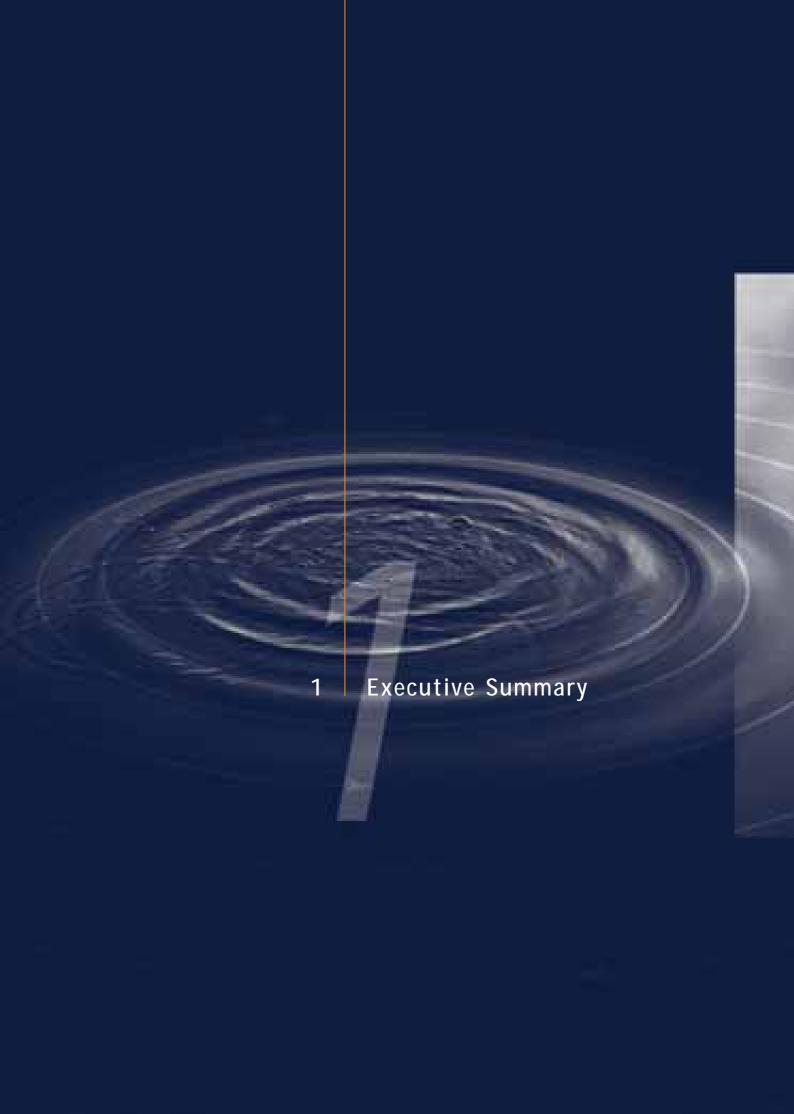
			Page			
5 Stra		tegies to Expand Provision for Retirement Income in First and Second Pillars				
į	5.1	The Reform Strategy	83			
!	5.2	The Social Welfare Old Age Pension: The Avenue for Providing the Minimum Retirement Income Guarantee	99			
į	5.3	Effect of First Pillar Proposals on Second Pillar	119			
į	5.4	Tax Environment for Second Pillar	119			
į	5.5	Improving Voluntary Private Provision	124			
į	5.6	Other Mandatory Provision	130			
į	5.7	A Graduated Plan	132			
6 1	Propo	osals to Improve Supplementary Pension Provision in Second Pillar				
(6.1	Overview	135			
(6.2	Product Innovation: The Personal Retirement Savings Account (PRSA)	138			
(6.3	Simplifications and Changes to Tax Rules	146			
(6.4	Improving Access to Pensions Coverage	153			
(6.5	Establishing Quality Measures	157			
(6.6	Annuity Purchase and Index-Linked Securities	164			
(6.7	Proposed Reforms Specific to Occupational Schemes	168			
(6.8	Regulation	171			
(6.9	Integration	175			
(6.10	Education and Awareness	183			
7	Asso	ciated Current and Future Issues				
-	7.1	Adult Allowances and Individualisation (First Pillar)	189			
-	7.2	Other Aspects of First Pillar Design	190			
-	7.3	Position of Women (Second Pillar)	190			
-	7.4	Transitional Arrangements (Second Pillar)	191			
-	7.5	Effects on Existing Schemes and Parties to Pensions Coverage	194			
-	7.6	Implications of Achieving Coverage Objectives	196			
-	7.7	Other Second Pillar Policy Issues	198			
-	7.8	Death and Disability Benefits (First and Second Pillars)	198			
-	7.9	State Involvement in Second Pillar Pension Provision	200			

		Page
8	Implementation	
	8.1 Putting the New Regime in Place	203
	8.2 Workload and Resource Pressures	203
	8.3 Risks	204
	8.4 Role of The Pensions Board	205
	8.5 Monitoring and Measurement	205
	8.6 Framework for Implementation	206
Gloss	ssary	211
Appe	endices	
Α	Summary of Submissions	219
В	Earnings Distribution of Employees	228
С	Alternative Estimates of Minimum Adequate Income, Single Person, 1994, 1995 and 19	96 229
D	Net Replacement Rates at Retirement	230
E	Projected Growth in Labour Force and Coverage Numbers	232
F	Estimated Revenue Implications of Increased Coverage	233
G	Illustrative Operation of Proposed Fund	234
Н	Comparative Statistical Profile: Ireland vis-à-vis Selected Other Countries	236
1	General Schema for Supervision of PRSAs	239
J	Additional Coverage Data	240
K	Comparison of Terms of Different Types of Individual Pension Provision	241
L	Terms and Conditions for PRSAs	244
М	Levels of Social Welfare Benefits	245
N	The Poverty Line	246
0	Percentage of Households Receiving/Relying on Social Welfare Schemes below Relative Income Poverty Lines, 1994 (and 1987)	247
Р	Increases in Social Welfare Pensions, Prices and Earnings	248
Biblio	iography	251

List of Tables and Charts

		Page
Table 3.1	Overall Occupational and Personal Pension Coverage Results from ESRI Survey 1995	46
Table 3.2	Risks of Relative Poverty for Households Headed by an Elderly Person	49
Table 3.3	Number of Occupational Pension Schemes	52
Table 3.4	Number of Members of Occupational Pension Schemes	55
Table 3.5	Summary of Market Research Findings into the Reasons for Non-coverage	58
Chart 4.1	Employment - Population Ratios in Selected Countries	65
Table 4.1	Ratio of those in Dependency Ages to Working Age (20 to 64)	66
Chart 4.2	Labour Force Participation Rates 1983-1997	67
Table 4.2	Expenditure on First Pillar and Public Sector (Second Pillar) Pensions under Various Scenarios	69
Table 4.3	Net Present Value of First Pillar and Public Sector (Second Pillar) Pension Contributions, Payments and Balance	70
Table 4.4	Updating of Costs in 1998 Constant Price Terms	73
Table 4.5	Illustration of the Sensitivity of Migration Assumption	74
Table 4.6	Illustration of the Sensitivity of Growth (GNP) Assumptions	76
Chart 4.3	Typical Social Insurance Contribution Rates (Percentage of Salary) - Ireland and Other EU Countries 1995	78
Chart 4.4	Old Age and Survivor and Disability Benefits as Percentage of GDP - Ireland and other EU Countries 1995	79
Table 5.1	Supplementary Pension Coverage: Ultimate and Interim Targets by Employment Status and Gender for 5 and 10 Years after Implementation of Proposals	93
Table 5.2	Projected Changes in Life Expectancy of Men and Women at Age 65	96
Table 5.3	Effect of Change in Retirement Age on First Pillar Pension Costs	97
Table 5.4	Summary Comparison of Costs Associated with the Board's Proposal to Raise Old Age Pensions to 34 per cent of Average Industrial Earnings in 2003 with stated Government Policy of Raising Pensions to £100 per week in 2002	100
Table 5.5	Illustrative Financing Scenarios of the Board's Proposal Relative to the Benchmark of Current Government Policy of Raising Old Age Pensions to £100 per week by 2002	101
Table 5.6	Illustrative Examples of Alternative Approaches to realising Additional PRSI Income Receipts Required to part finance the Board's Proposal to Adjust Pensions to 34 per cent of Average Industrial Earnings	102

		Page
Chart 5.1	Old Age Contributory and Non-Contributory Pensions 1977-1997	105
Chart 5.2	Old Age Pensions, Earnings and Consumer Prices 1987-1997	106
Table 5.7	Comparative Increases in Pension Levels, Prices and Earnings, 1977-1997	106
Chart 5.3	Comparison of Exchequer Contribution for Price and Earnings Indexation 1998-2056 (Percentage of GNP)	108
Chart 5.4	Comparison of Exchequer Cost of Earnings Indexation - with Funding and PAYG (Percentage of GNP, 1998-2046)	111
Table 5.8	Total Pension Costs as percentage of GNP Showing Effect of Funding First Pillar Benefits	113
Table 5.9	Estimated Value of Tax Reliefs 1994/95	120
Table 6.1	Expected Impact of PRSAs	143
Table 6.2	Changes in Fund Values and Annuity Rates 1994-1998	165
Table 6.3	Comparison of Integration between Public Sector and Private Sector	179
Table 6.4	Impact of Adjustment in Social Welfare Pensions on Integrated Schemes (1/60ths Accrual Formula)	180
Table 7.1	Implications of Achieving the Board's Targets for Coverage	197
Table 8.1	Framework for Implementation of the Board's Proposals	207
Table B1	Summary Data from Department of Social, Community and Family Affairs based on 1995/96 PRSI Returns	228
Table B2	Earnings Distribution PRSI Class A, Age 31-65	228
Table D1	Replacement Rate - 1998 Tax and Social Welfare Benefit Levels - Married Couple, One Earning	230
Chart D1	Net Replacement Rates from Adequacy Test for Income after Retirement	231
Table F1	Estimated Revenue Implications of Increased Coverage	233
Table G1	Illustration of Proposed Funding Mechanism	234
Table H1	Specimen Replacement Rates - Net Pension as percentage of Net Earnings	236
Table H2	Typical Employer Costs of Mandatory and Voluntary Benefits as percentage of Salary	237
Table H3	First Pillar and Public Sector Pension Expenditure (Percentage GDP in 1994 Prices)	237
Table H4	Second Pillar Coverage Levels of Private Sector Employees	238
Table J1	Coverage Rates for Various Segments of Private Sector Workers	240
Table J2	Coverage by Income Decile	240



1 Executive Summary

Purpose, Scope and Process of Initiative (Chapter 2)

- 1. The overall objective of the National Pensions Policy Initiative (the Initiative) is to facilitate national debate on how to achieve the aim set out in the Final Report of the National Pensions Board on Developing the National Pension System (the Final Report of the National Pensions Board) and to formulate a strategy and make recommendations for actions needed to achieve this aim. The aim is to have a fully developed national pension system which enables all residents in the State to acquire an income which allows them to maintain their established standard of living on attainment of retirement age, in long-term incapacity and, in the case of dependants, on the death of the income provider.
- 2. The issue of adequate and comprehensive pension cover has been under consideration in Ireland for over 20 years. During that time there has been a Green Paper on a National Income Related Pension Scheme in 1976 and the Final Report of the National Pensions Board in 1993. The Irish debate is set against an international background in which many countries are reforming or reviewing their pension systems. The most prominent reasons for this are the so-called demographic "time-bomb" and the fact that many existing systems are facing severe financing difficulties. However, while similar problems could arise in Ireland, the timing is much different from that in other countries.
- 3. In 1995 the Economic and Social Research Institute (the ESRI) was commissioned by the Department of Social Welfare and The Pensions Board (the Board) to undertake a survey of occupational and personal pension coverage in Ireland. According to the survey, less than 50 per cent of the workforce have supplementary pension cover. This means that significant segments of the workforce and their dependants are at risk of experiencing a sharp drop in living standards when they become pensioners.
- 4. Against this background the Initiative was launched in October 1996 and, in addition, it was formally incorporated by Partnership 2000 in early 1997. The Initiative was progressed in two phases including the following steps:
 - publication of a Consultation Document which invited submissions from interested parties;
 - receipt of 143 submissions;
 - a National Pensions Conference;
 - Board workshops and development of options.
- 5. This Report, from the Board to the Minister for Social, Community and Family Affairs, is the culmination of the Initiative. It contains the Board's assessment of the current situation regarding pension provision in Ireland. It sets out a strategy for future development, and it contains a number of major proposals and recommendations for change to give effect to the strategy.

6. In shaping and evolving the strategy proposed for future development of the pension system the Board considered a number of criteria. Among these, a particularly important issue is considered to be the capacity of any new policy departure to improve the extent and adequacy of existing pension coverage. However, achievements must be balanced against the likely impact on cost competitiveness and employment needs, the sustainability of the new system and Exchequer costs. Any tendency for taxes, or employers' payroll costs, to rise must be taken into account, as must any impact on the Exchequer as regards tax revenue or public expenditure.

The Current Pensions Environment and Issues Arising (Chapter 3)

- 7. At present, the pension system in Ireland comprises principally two main Pillars. The First Pillar is the Social Welfare system, and the Second Pillar consists of voluntary supplementary pensions.
- 8. The First Pillar comprises:
 - contributory benefits for those who satisfy the PRSI contribution conditions;
 - non-contributory benefits, subject to a means test, for those who do not qualify for contributory benefits.
- 9. Of the 387,400 people in the State aged over 66, approximately 316,600 are recipients of Social Welfare pensions. Among this group an additional payment is made in respect of 25,500 qualified adults. Therefore, coverage of recipients and dependants is almost 90 per cent of the relevant age cohort. Apart from certain categories of public service employees, the vast majority of those in the labour force will qualify at retirement age for a Social Welfare pension based on PRSI contributions.
- 10. The Second Pillar comprises three main types of pension arrangement:
 - public service pension schemes run on a pay-as-you-go basis. Those covered include civil servants,
 Gardai and Defence Forces, local authority employees, teachers and health workers;
 - funded occupational pension schemes set up by, or negotiated with, employers to provide benefits for their employees. These include funded schemes set up by commercial State entities and agencies;
 - personal pensions arranged by individuals, generally the self-employed.

All of these arrangements are voluntary in the sense that there is no legal obligation for an employer to establish or maintain a scheme, or for individuals to provide for their retirement. The schemes are established either as defined benefit, defined contribution, or personal pension arrangements.

- 11. The ESRI Survey of Occupational and Personal Pension Coverage 1995 (the ESRI Survey 1995) is the most comprehensive recent investigation of Second Pillar pension coverage. The overall results of the ESRI Survey 1995 show occupational and personal pension coverage as follows:
 - 52% of employed;
 - 27% of self-employed;

- 46% of total at work:
- 7% of total not at work.

A principal finding of the ESRI Survey 1995 is that Second Pillar coverage, as a percentage of the labour force, is fairly static or declining slightly, despite an active and well developed pensions industry in Ireland. The pattern of coverage is broadly similar in size and trend to that found in countries with a similar pension structure such as the United Kingdom or United States.

- 12. The ESRI Survey 1995 identified characteristic features of where coverage amongst employees is strong or weak. Some relevant findings were:
 - high coverage in financial institutions and low rates in retail distribution, among agricultural workers and those employed in personal services;
 - high coverage of permanent full-time employees and low coverage of atypical workers;
 - high coverage of employees of large firms and low coverage of employees of small firms;
 - coverage increases significantly with age and coverage of men at the overall level is higher than of women;
 - coverage varies enormously by income level.
 - 13. The Board takes the view that a determination of adequacy of living standards in retirement should be based on a person's total resources, not just the level of formal pension provision. Having said this, the fact remains that the areas where retirement income is likely to be most inadequate are at lower income levels or for those with most fragmented employment histories and these are also likely to be the groups with the lowest level of non-pension assets. (Rec. 1 S.3.4)
- 14. Pension schemes have existed in Ireland for many years but the growth in occupational schemes accelerated in earnest after the Finance Act 1972 which set up a clear legal and fiscal framework for them. Up to the mid-1980s, schemes were set up on a defined benefit basis. However, it is now a matter of fact that there are few new defined benefit schemes being set up and this trend has been evident for several years. Almost all new schemes are being set up as defined contribution schemes for the reasons of predictability of cost, fewer regulatory requirements, transparency, and influence of United States companies locating in Ireland. There is, however, continuing growth in defined benefit coverage as a result of new employees joining existing schemes. Also, the incidence of switching existing defined benefit schemes to a defined contribution basis is low. The 1997 breakdown of membership of different types of occupational schemes shows that of approximately 520,000 members of occupational pension schemes 419,000 are in defined benefit schemes, of whom 207,000 are in the public sector and 212,000 in the private sector. 101,000 are in defined contribution schemes, almost all of whom are in the private sector. Also, approximately 65,000 self-employed have personal pension plans.

- 15. The Board recognises the different merits of various types of provision and the right of employers and workers to choose and negotiate the best approach to meet their own circumstances. (Rec. 3 S.3.6)
- 16. The Consultation Document outlined some practical issues and difficulties associated with pension provision. In the submissions received in response, many commented on the importance of achieving adequacy of First Pillar benefits and the need to ensure that they retained their real value measured against prices or, frequently, general earnings levels. Furthermore, addressing First Pillar benefit levels is seen to be the simplest way of ensuring improvements of living standards in retirement across the whole of society. In terms of Second Pillar provision, the submissions received highlighted several issues as being of particular significance.
- 17. In summary, the major issues to be dealt with in relation to the current pensions environment are to:
 - establish the appropriate level for Social Welfare pensions balancing the need for adequate incomes for all with the associated effect on employment costs and/or taxation;
 - raise people's awareness of their need for retirement incomes and the necessity to plan for it;
 - enable people to understand the options open to them so that decision-making can be simpler and made with confidence;
 - modernise supplementary provision to be better suited to present and anticipated employment patterns;
 - fill any gaps which may exist in the statutory protection of members of various types of pension arrangements;
 - simplify the operation of supplementary provision for both employers and employees;
 - widen access to supplementary provision;
 - underpin trust and confidence in the whole pension system;
 - facilitate greater choice and competition;
 - identify and remedy any shortfall in consumer protection which arises.

Demographic and Economic Prospects: Long-term Considerations (Chapter 4)

- 18. The evolution of the population and its age structure are key issues in the planning of pension provision. Economic trends such as the growth of output and of employment also have a very important bearing on this issue.
- 19. The population of the world's advanced economies is already relatively elderly but is still ageing rapidly. The broad picture of the future depicted by various international projections is generally accepted. It is not sensitive to variations in the underlying demographic assumptions such as future mortality or fertility rates, provided these are kept within realistic ranges. Although the timing, the exact magnitudes, and the regional patterns are uncertain, it can be accepted with a high degree of confidence that the general demographic pattern summarised in this Report will materialise.

- 20. An Expert Group convened by the Central Statistics Office prepared a set of projections of the Irish population and labour force covering the period 1996-2026. The availability of these recently published projections is of great value in the context of examining the prospects for pension provision in Ireland. The central projection shows that the elderly dependency ratio will decline slightly between 1991 and 2006, and then rise rapidly.
 - 21. The Board notes the important conclusion that Ireland alone has the opportunity of preparing for a high level of elderly dependency over a period of relatively low dependency. The opportunity presented by this relatively favourable demographic backdrop will be enlarged if the recent buoyant economic performance is sustained. (Rec. 4 S.4.3)
- 22. The international demographic developments, combined with the fact that most western countries have relied on "pay-as-you-go" funding of State pensions, has led to widespread fears of a looming crisis in public pension systems. Moreover, the adverse implications for the public finances are heightened by the consideration that most European countries rely primarily on publicly provided pensions to cater for their populations in their retirement and old age.
- 23. The relatively favourable position of Ireland emerges very clearly from international comparison of the prospects facing the public pension system in this country. This reflects three principal facts:
 - the Irish Social Welfare pension system is at present relatively limited in terms of replacement ratios;
 - the demographic situation in Ireland is expected to evolve more favourably than that in other countries during the early decades of the coming century;
 - Ireland has a well-developed funded occupational pension scheme sector.

It might, at the same time, be noted that many European countries have been experiencing difficulties in sustaining their public pension systems and have been implementing cost containment measures including in some cases moves to curtail traditionally high benefit levels. Other countries (e.g. United States) have had the advantage of buoyant economic growth.

- 24. An Actuarial Review of Social Welfare Pensions was published in September 1997 (the Actuarial Review). The most important conclusions contained in the Actuarial Review are:
 - the proportion of those over 65 relative to those of working age will initially reduce slightly and then decline steadily to the end of the projection period (1996-2056);
 - if pensions are indexed to prices, spending on the Social Welfare pension system will fall relative to GNP, from 4.8 per cent in 1996 to 2.6 per cent in 2056;
 - if pensions are indexed to wages, spending on the Social Welfare pension system will rise relative to GNP, from 4.8 per cent in 1996 to 8.0 per cent in 2056;
 - if the Exchequer subvention to the Social Welfare pension system is frozen at its present level of 5 per cent of total contributions, contribution rates would have to increase by 19 per cent if pensions were indexed to prices, or by 227 per cent if pensions were indexed to wages.

- 25. These conclusions derive from the assumptions used in the Actuarial Review. The core assumptions are:
 - real GNP will grow at an annual average rate of 5 per cent between 1996 and 2006, falling to 3 per cent over the following ten years and finally to 2 per cent between 2016 and 2056;
 - unemployment will fall to 6 per cent (on International Labour Organisation definitions) by 2007 and stabilise at that rate;
 - net migration will be zero after 1996;
 - the labour force will grow in line with the Central Statistics Office's projections. In particular, this
 assumes continuing large increases over the period to 2006 in participation rates for married females
 especially those aged up to 40.
- 26. Analysis, undertaken in the Actuarial Review and subsequent to its publication, provides estimates of the impact of variations in the assumptions contained in respect of migration and economic growth. The high degree of sensitivity of the results to changes in key variables was also examined. In particular, any one of the following possible favourable developments would significantly reduce the cost of public pension provision; a combination of them would have an even more dramatic effect:
 - that the rate of growth of Irish GNP will be maintained at or above its long run average;
 - that the increasing scarcity of workers in the younger age groups could significantly raise our employment/population ratios, which are low by international standards.
- 27. In a comparison of total annual costs of all public and private pensions it is estimated that, in Ireland, these currently amount to a little over 9 per cent of GNP. With the proposals contained in the strategy set out in this Report, this cost can be contained to 11.8 per cent of GNP at most in the period up to 2046. By comparison, the same costs in many other European countries are presently greater than this. For example, in Germany the figure for old age pensions alone is already in excess of 11 per cent of GDP, while in Italy it is over 12.5 per cent. It should be noted that the figures for Germany and Italy both exclude the costs of private sector Second Pillar coverage. Furthermore, in nearly all cases, a strong increase will occur over the next 25 to 40 years especially in countries in continental Europe.

The Strategies to Expand Provision for Retirement Income in First and Second Pillars (Chapter 5)

- 28. The major underlying goal of the Initiative is to ensure adequate provision for retirement income for all.

 The underlying public policy issues which need to be addressed in determining an optimal strategy for pensions development are of three distinct types:
 - firstly, there is a poverty issue. It is a commonly shared aspiration appropriate to the scope of this
 objective that sufficient resources should be available to elderly and retired people to allow them to
 live in dignity. This means transferring resources to those who cannot afford to provide for themselves,
 and to those who reach old age without making adequate provision from their lifetime earnings.
 However, if the concept of poverty is clear-cut its measurement is not. It is complicated by the fact
 that it is relative, both in time and across places;

- secondly, there is the problem that, without active policies encouraging them to save for retirement, many people are imprudent, short-sighted or reluctant to do so. Thus they reach old age with fewer resources than they need and should have, given their lifetime income, and as a consequence they can suffer a sharp drop in their living standards. They need to be encouraged to save more, and facilitated in doing so, notably by making better informed decisions. At the same time, just as there are people whose means make it impossible for them to save for retirement, it is important to recognise that there are also people who have adequate resources to live out their lives in the style in which they wish, without having recourse to formal pension provision. Therefore, it is most important that initiatives and their associated targets should be established clearly and focused closely on those segments of the population where pension provision can play a beneficial role, i.e. where prospective retirement income will not be sufficient to sustain people with an adequate standard of living;
- thirdly, there are macro-economic, public finance and national savings objectives to be borne in mind.
 Growth and future national prosperity, including social development and cohesion depend on sufficient amounts being saved and invested in fixed and financial capital to take advantage of productive opportunities and to generate the national resources that will be needed for future social spending especially bearing in mind the prospective long-term trends in elderly-dependency ratios.
 This means that the public finances need to continue to be managed in a way which facilitates saving, investment and sustainable economic growth.
- 29. The quantified expression of the Initiative's strategic goals bears these three policy dimensions in mind. Thus it makes provision both for a minimum income guarantee and for better smoothing of lifetime income into retirement (through pension-type saving). These in turn are designed to reach specified objectives in terms of adequacy (of facilitating individuals in achieving a desired level of retirement income) and coverage (of achieving targeted levels of coverage of the relevant populations for retirement income provision).
- 30. The Government published a National Anti-Poverty Strategy in April 1997. This is aimed at addressing the most serious issues of poverty facing society and in a manner which will not encourage dependency. It is appropriate that, in framing objectives for pension policy, there is recognition of the aims of this broad strategy and consistency with proposals contained in the Initiative.
- 31. The Commission on Social Welfare, in its 1986 Report, used seven different approaches to inform and estimate in monetary terms the level of income which would represent a minimally adequate level at that time. They recommended £50 £60 per week in 1985 terms. More recently, the ESRI has conducted a Review of The Commission on Social Welfare's Minimum Adequate Income. It concluded that the minimum adequate income for a single adult in 1996 terms lay in a range of £68 £96 per week. It should be noted that these rates refer to Social Welfare payments generally and not to a particular customer group.

- 32. In deciding on the appropriate roles for the First and Second Pillars, the issue of efficiency of delivery also needs to be considered. Regardless of the method chosen to deliver the pension, the costs of providing each £1 of pension will be £1 plus the administrative and other costs associated with the payment of the pension. The Actuarial Review estimated that the expenses of administering Social Welfare pension payments represented approximately 5 per cent of such payments. Within this, the cost of administering the contributory pension payments would be around 2 per cent. It is an indisputable fact that the administrative cost of funding and paying a small pension through a funded private scheme would be considerably greater. Since those on lower pay are, at best, only likely to be in a position to fund a small pension this additional expense is likely to fall most heavily on those on lower incomes and those working in small employments.
- 33. A further role for the First Pillar, in addition to the avoidance of poverty, must be the provision of an adequate total retirement income for those in the lowest income deciles i.e. those for whom the provision of a pension through a private scheme is likely to be inefficient and for many unaffordable. Clearly any judgement as to what constitutes low pay is an arbitrary one but a gross pension of approximately £99 per week would provide a pension equal to at least 50 per cent of gross income for the 30 per cent lowest paid employees in the private sector between the ages of 30 and 65.
- 34. Having considered the issues raised in relation to both adequacy and coverage, recognising that both the level of pension and the approach to indexation need to be borne in mind, and conscious of the fact that there is no "right answer" about a rate which could be objectively agreed, the Board considers that the best strategy in order to, firstly, minimise the risk of poverty and, secondly, provide coverage to lower income people in the most efficient way is to set the target pension rate at the upper end of the range estimated by the ESRI i.e. £96 per week (in 1996 terms). For reasons of practicality, the Board considers that this target should be expressed as a percentage of average industrial earnings which would equate to around 34 per cent, which seems a "reasonable" percentage in terms of what a minimum income should be.
 - 35. Having reviewed the issues raised in relation to both adequacy and coverage and bearing in mind the difficulties, discussed above, of determining a target based on objective criteria, the Board nonetheless considers that a target rate of 34 per cent of average industrial earnings, vis-à-vis the post Budget 1998 rate of 28.5 per cent, should form a backdrop to the achievement of the Government's £100 per week target and that this achievement should be accelerated, insofar as possible. In any event, the Board considers that the target which it proposes should be achieved within a 5 to 10 year period, effectively seeing achievement of this target rate as moving along an income continuum of what the Board regards as desirable. Related to average industrial earnings of £291 per week (based on estimated earnings data for 1997) meeting the Board's proposed target rate of 34 per cent would result in a current weekly pension of around £99. Moreover, the Board considers that this figure should be updated to reflect earnings increases over the 5 to 10 year period envisaged by the Board for the full implementation of its proposed target rate. (Rec. 6 S.5.1.5)

- 36. The employers' representatives on the Board, while recognising the aspiration of the Board contained in the above recommendation, point out that defining a precise target level for First Pillar pensions for the purposes of achieving such objectives as the avoidance of poverty in old age and assisting with ensuring adequacy of pension provision, is a complex and difficult issue. Accordingly, they do not give unconditional support to the Board's recommendation in this regard.
- 37. While the avoidance of poverty in retirement is considered by the Board to be a necessary objective for an initiative of the kind embarked upon, it is by no means sufficient. However, it is acknowledged from the outset that framing quantitative objectives for adequate levels of income in retirement is fraught with difficulty. Yet it cannot be avoided.
 - 38. The Board has come to a judgement that it would be reasonable to measure adequacy of gross retirement income from all sources (including lump sums and gratuities and other accumulated assets) against a benchmark of 50 per cent of gross pre-retirement income subject to a minimum of 34 per cent of average industrial earnings together with any associated Adult Dependant's Allowance. (Rec. 9 S.5.1.7)
- 39. Adequacy of retirement income and the extent of pensions coverage are closely interrelated for most of the community. However, coverage by formal supplementary pension provision, even for the employed, is less than the desirable level. Furthermore, coverage varies enormously by sector and as between full-time and part-time employees. Prospective long-term economic trends seem to favour types of employment where coverage ratios are currently relatively low, so these effects will tend to reduce aggregate coverage.
 - 40. In summary, the Board considers that comprehensive achievement of an adequate level of income over a lifetime would involve an ultimate goal of some 70 per cent of the total workforce over age 30 making, or having, supplementary pension provision. However, it will clearly take many years to reach that goal. Therefore, it is essential to set interim target percentages for five and ten year horizons, and to differentiate the targets by sector. (Rec. 11 S.5.1.8)
- 41. The proposed ultimate and interim supplementary coverage targets for five and ten years by employment status and gender are set out in this Report. The Board has set lower targets for those aged below 30 but the targets for those over age 30 represent desired ultimate targets. The overall targets for all at work aged 30-65 are:
 - 62 per cent after 5 years;
 - 66 per cent after 10 years;
 - 70 per cent ultimately.

- 42. The costs involved in making the proposed transition to 34 per cent of average industrial earnings (including the costs of changes in associated rates of Social Welfare pensions) have been considered by the Board. Financing options and overall macro-economics implications within a 5 year time frame have been used for illustrative purposes. As there is an explicit statement of policy by Government to raise the level of old age pensions to £100 per week over five years (to 2002), it is considered that the Board's proposals would be most appropriately compared to this benchmark of stated Government policy. The projected incremental costs of the Board's proposals by 2003, compared with this alternative benchmark, is £440 million in current prices, or less than 0.7 per cent of GNP if the Board's proposals are implemented over the minimum period envisaged (5 years).
- 43. In overall macro-economic terms, the estimated impact of meeting the incremental costs of the Board's proposals would not be significant, in terms of adverse aggregate output or employment consequences. However, it has to be acknowledged that there are cost implications associated with the already announced Government policy of raising old age pensions to £100 per week, by 2002. In the context of the Government's stated expenditure policies it is useful to express these additional annual costs as a percentage of total current Government expenditure and to illustrate their impact on the Government's target limit of 4 per cent per annum in the rate of growth of aggregate net spending on non-capital services. On the basis of official post Budget estimates of expenditure to 2000 and on the basis of growth of 4 per cent per annum thereafter to 2003, it is estimated that the incremental cost of the Board's proposals would contribute approximately 0.7 per cent per annum on average to the 4 per cent per annum target.
- 44. The Board sets out an illustration of a possible financing scenario with respect to the incremental costs that would be involved in implementing the Board's proposal. It incorporates the principle of partnership, in that it involves contributions being made to the additional cost by Government, employers, employees and self-employed, although not in the proportions which apply at present. As an illustration, the impact of financing the balance from higher rates of PRSI on employers, employees and the self-employed is shown. However, the trend in recent years has been for these rates to be reduced. The employers' representatives on the Board believe that this policy is necessary to the support of cost control (including public expenditure), competitiveness and employment growth. Of course, if there was reluctance from any one major grouping to participate in a sharing of any additional costs associated with the Board's recommendations, this would be likely to result in resistance from other parties. Accordingly, while the Board considers that the matter of how the additional costs should be shared ought to be considered by the social partners and other relevant groups, it is, of course, ultimately a decision for Government.
 - 45. The Board believes that achievement of its proposed target for First Pillar pensions of 34 per cent of average industrial earnings would not entail significant downside risks to the current macroeconomic projections for the next five years or so of continued rapid economic growth with strong overall increases in employment. (Rec. 12 S.5.2.1)
- 46. The Board supports the inherent features of social insurance and its extension to date especially in a pensions context. Social Insurance payments mean that enterprise and thrift are not penalised, which can be one of the main outcomes of a fully means-tested system.

- 47. The Board recommends that the entitlement component of Social Insurance should be retained.

 To underpin the capacity of this system to withstand additional budgetary pressures associated with its proposals in this regard, the Board considers that explicit consideration should be included in budgetary planning to smoothing mechanisms including an explicit fund that would minimise the additional burden on future generations of taxpayers from these proposals. (Rec. 14 S.5.2.1)
- 48. The Board considers that, with the attainment of the prescribed minimal acceptable level of Social Welfare pensions necessary for the avoidance of poverty in old age, substantial efforts should be made to preserve their real level, unless the economy was to enter a period of very high inflation, or a recession or both.

A basic goal such as this would simply ensure that minimally acceptable income levels, judged by contemporary standards, would be preserved in the future. Therefore, the Board views price indexation as a minimum for a society where there is a broadly based commitment to the attainment of social inclusion. It considers that higher goals should be aimed for. In this context, the Board considers that it would be desirable to aim, over the medium-term, to increase Social Welfare pensions, in real terms, in line with growth of earnings in the economy, as has effectively happened over the past 20 year period although not to the same extent over the past 10 years. (Rec. 15 S.5.2.2)

- 49. A guarantee of contemporaneous indexation to real earnings growth into the long-term future would mean assigning a priority to the living standards of one group above others in society. Accordingly, the discretion of elected Government over a significant proportion of national resources that could be applied to meeting other priorities which it might decide upon e.g. improvements in the living standards of lower paid employees; measures to improve greater equality; tax reforms aimed at improving the environment for enterprise development would be constrained.
 - 50. The Board does not recommend that a guarantee can be given to full automatic indexation to real earnings growth. (Rec. 17 S.5.2.2)
- 51. The analysis contained in the Actuarial Review reinforces the Board's view that the proposed commitment to price indexation should be regarded as a minimal one. There can be little doubt that a mechanism which resulted in Social Welfare pensions outlay falling to 2.6 per cent of GNP by 2056 from 4.5 per cent at present, or the value of these pensions falling to approximately 9 per cent of average earnings from 28.5 per cent, while the numbers in receipt of old age/retirement pensions rise from 239,000 in 1996 to a projected 759,000 in 2056, would not only fail in avoidance of poverty amongst those in retirement and dependent on Social Welfare pensions but would actually result in an increase in poverty by the middle of the 21st century.

- 52. As compared with the past, the Board foresees two channels that are capable of being used to achieve a more certain evolution in the real value of Social Welfare pensions in the future that reflects ongoing and prospective development in the economy. It recommends that the full scope for using these should be developed. (Rec. 18 S.5.2.2)
- Firstly, with effect from 1998, budgetary policy is being formulated and implemented on a three year rolling basis. Accordingly, there is the scope for Government to articulate, in the context of its priorities and the prospective constraints on financial resources, real growth over a three year budget cycle, rather than for a twelve month period, as in the past. Secondly, there is a sophisticated process of social partnership agreements covering a wide range of economic and social issues, as well as pay. It would be worth including discussion of the scope for real growth in First Pillar pensions on the agenda of such agreements in the future. This would promote wider understanding and acceptance by all the parties involved of the implications of including or excluding Social Welfare pensioners from participating in the prospective real growth of the economy, to a particular extent, over the period covered by such agreements.
 - 54. In relation to the development of the First Pillar, the Board recommends that steps should be taken now to establish an explicit mechanism to fund, at least partially, the prospective substantial growth that is projected to occur in Social Welfare old age pensions, if they grow in line with real earnings. (Rec. 19 S.5.2.3)
- 55. Preliminary calculations indicate that, while providing a level of benefit equal to 34 per cent of average industrial earnings with some increase in the PRSI ceilings, it might be possible to cap additional Exchequer contributions at 3.8 per cent of GNP from about 2011 until 2046 from a base level of 1.7 per cent in 1998. By contrast, the additional Exchequer contributions would have risen to 6.8 per cent of GNP by 2046 if the benefit level were increased to 34 per cent of average industrial earnings and a pay-as-you-go basis were retained.
- 56. These estimates are based on the following assumptions in relation to the development and growth of the fund:
 - an annual contribution of £250 million for the first five years, i.e. 1999-2003;
 - an annual contribution of £500 million in the next five years, 2004-2008;
 - followed by, an annual contribution equal to 50 per cent of projected PRSI contribution income
 allowing this to grow with income until withdrawals were needed to maintain "additional Exchequer
 contributions" at 3.8 per cent of GNP;
 - the fund's assets earn a rate of return of 5 per cent in real terms on average.

- 57. This would yield a fund in 2031 of £30 billion or about 26 per cent of GNP. Thereafter the fund would be depleted as it is used to meet the growing pension payments and would finally be extinguished in 2046. The major requirement here would be for a substantial increase in the Exchequer contribution to pensions, from 1.7 per cent of GNP in 1998 to 3.8 per cent by 2011, which would be maintained until 2046. In practice, the funding level would need to be reviewed regularly and may be adjusted upwards over the later years in order to continue the benefits of funding over a longer period.
 - 58. In the opinion of the Board this additional financial outlay by the Exchequer could be met, at least in the earlier years, from realised or other Exchequer gains and by exploring the potential of this and other avenues in future years. (Rec. 20 S.5.2.3)
- 59. The effect of the proposed funding mechanism would, of course, be largely nullified if it led to additional borrowing by the Government. In that case the mechanism would in effect not lead to any additional national saving by the current working generation, and would not resolve the issues of fairness and risk. In order to ensure that the additional funding was not cancelled out by additional borrowing it is proposed that the funds should be invested under specific rules limiting the assets to be held so that no Irish Government securities are allowed.
 - 60. The Board recommends that a clearly stated mechanism for determining flows in and out of the fund is established and published to ensure that uses for the fund cannot be subject to any inappropriate pressures.
 - Furthermore, the fund should be set investment criteria which allow it to be managed competitively and with the clear goal of maximising long-term real rates of return. (Rec. 21 S.5.2.3)
- 61. In summary, the recommendations to raise the level of First Pillar pension benefits to 34 per cent of average industrial earnings over a 5 to 10 year period, to establish a funding mechanism to underpin the indexation of that benefit to earnings increases and to raise the level of coverage of supplementary pensions, will require substantial resources to continue to be allocated towards retirement savings. However, the funding mechanism means that the total proportion of GNP so used will change only gradually and in a way which enables any necessary adjustment to be made in good time and with minimal disruption.
- 62. The Board's recommendation on the future target level of pensions is based on the related issues of both adequacy of pension payment and level of pension coverage. A potentially important knock-on effect that needs to be borne in mind is the possible impact on other Social Welfare benefit rates. The Board considers that in addition to the underlying rationale for the target rate, it would be inappropriate to link increases in retirement and related pensions directly with other Social Welfare payments.

63. The Board considers that it is reasonable to draw a distinction between the short-term and longterm groups of beneficiaries and that there would be justification in continuing to differentiate between these different types of benefit.

The widow's/widower's pension is a primary benefit in its own right and it is recommended that it should be treated in the same way as the basic old age pension. (Rec. 22 S.5.2.4)

- 64. The Board also recommends that consideration be given to separating the part of the Social Insurance Fund corresponding to short-term and long-term benefits, together with the associated contribution income, from the rest of the Fund. (Rec. 23 S.5.2.4)
- 65. The representative of the Minister for Finance qualifies his approval of the strategy outlined for the Social Welfare old age pension. While accepting the Report's assessment of the various criteria which should govern the future development of the pension system as correct, he is of the view that the target rate for Social Welfare old age pensions put forward fails to strike an appropriate balance between the relevant factors. He considers that the target rate indicated may prove to be incompatible with the prudent evolution of both the public finances and of the wider economic and employment needs of the country in the longer term and, consequently, is unable to support the rate proposed (or any rate which is explicitly linked to earnings). In arriving at this position, he states as his considerations:
 - the possible mismatch over the longer term between the inevitability of substantially higher pension costs and the uncertainty that the resources can be secured to meet these costs;
 - the serious consequences for the public finances which would arise from the implementation of the target rate, coupled with the possible pre-funding requirement, having regard to the Government's expenditure target and taxation commitments and EMU requirements. In current terms, it is estimated that the additional annual cost at the end of the projection period of achieving the target rate of pension is equivalent to 13 per cent of total tax take;
 - the emerging scenario of increased reliance on the Exchequer despite substantially wider supplementary pension coverage;
 - a concern that the target rate could undermine the incentive to take up supplementary cover among the priority groups identified;
 - the absence of compelling evidence that the avoidance of poverty among pensioners requires that
 rates should be increased as far as the proposed target rate, having regard to the significant
 improvement which would be involved in moving rates to the level set out in the Government's
 "Action Programme for the Millennium";
 - the adverse public expenditure and labour market incentive effects of potential knock-on improvements in other Social Welfare payments.

- 66. Special tax treatment of the different elements of cash flows in pension funds is long established and the tax reliefs available have been one of the most powerful incentives to effect pension provision. Since the tax treatment of occupational pension schemes has been examined and reported on by the National Pensions Board in the relatively recent past, the Board has not re-examined in detail the issue, or the conclusions of the National Pensions Board report within the context of the Initiative. In this Report, the Board has set out a number of proposals which it believes will lead to a significant increase in supplementary pension coverage on a voluntary basis.
 - 67. It is the view of the Board that any uncertainty in the overall tax regime will act as a major deterrent to private pension provision and could seriously undermine the strategies proposed in this Report for improving supplementary pension cover. (Rec. 27 S.5.4.3)
- 68. One change to the tax regime that was considered by the Board in the context of the Initiative and which it believes would not run counter to the objective of extending pension coverage was the imposition of an earnings "cap" whereby contributions and benefits, on earnings in excess of the "cap" would not qualify for the current tax reliefs. Having considered the matter, the Board decided not to recommend the introduction of an earnings "cap" at this stage for a number of reasons. However, the representatives of the Minister for Finance and the Minister for Social, Community and Family Affairs on the Board consider that the introduction of an earnings "cap" should be examined in detail by a group comprising the appropriate authorities including Revenue Commissioners, Department of Finance and Department of Social, Community and Family Affairs, in consultation with the Board and with relevant interest groups.
- 69. The major barriers identified to an expansion of coverage under the Second Pillar system, consisting of voluntary occupational and personal pension schemes, fall under the headings of:
 - access to pension provision;
 - information gaps;
 - running cost with respect to small and personal pension plans;
 - control of investment and annuity risks; and
 - problems of design to meet the needs of a more mobile workforce.

Each of these problems can be alleviated by measures which are proposed in the Initiative. By improving the arrangements for the delivery of low-cost, value for money and secure provision for pension saving in a simple, transparent and well-understood manner, the Initiative intends to create a platform for substantial expansion in the effective demand for pension plans. In addition, the need for a programme of increased education and awareness is considered to be an essential element for ensuring the success of the Initiative.

70. Although occupational schemes and personal pension plans are often seen as quite different avenues and are, to some extent, treated differently by tax and prudential regulations, a salient feature of the recommendations is that much applies in common to both avenues.

- 71. Recommendations of the Board contained in this Initiative aim to encourage further convergence to the point where at least for defined contributions schemes the structures will be not only similar but so close as to allow for continuity of retirement saving throughout a career in which the beneficiary moves in and out of employment or self-employment.
 - As a major vehicle for achieving this, the Board recommends the introduction of a Personal Retirement Savings Account (PRSA). It is considered that its introduction will facilitate a major simplification of the regulatory and legal structures that exist at present. It would facilitate other developments also, such as umbrella schemes, which could contribute to increased coverage. Furthermore, the introduction of the PRSA will provide a platform for a major information and education drive that will help increase awareness and promote retirement saving. (Rec. 29 S.5.5.3)
- 72. The specific improvements proposed by the Board that are common to occupational and personal pension schemes are in the following areas:
 - meeting ownership and information gaps;
 - reducing costs;
 - simplification of regulation;
 - avoidable risks related to investment returns and annuity value.
- 73. Improvements proposed in the Social Welfare old age pension and in the voluntary provision of occupational and personal pensions represent a development and intensification of existing policy measures and recent trends. On their own they may not go far enough to achieve the goals set. More compulsion may also be needed. A degree of compulsion in terms of the design of schemes and the behaviour of the pensions industry is already involved in elements of the Initiative as they relate to occupational and personal pension plans. But so far as beneficiaries and employers are concerned, at present the PRSI system is the major mandatory element. Additional elements of compulsion could be extended in any of four different ways:
 - (a) mandatory provision of access by all employers to coverage for all employees;
 - (b) mandatory contributions by employees;
 - (c) mandatory contributions by self-employed;
 - (d) mandatory contributions by employers.
 - 74. The Board recommends that the first of these (i.e. (a)) should be implemented in the short run.

 Additional increased coverage could certainly be achieved by going further down the list
 (at (b) to (d)), but this would entail costs that should not be incurred unless necessary.
 - Therefore, the Board recommends that these additional options should be held in reserve. Further consideration should be given to these only when it can be ascertained that insufficient progress has been made towards the targets set out in this Report. The first meaningful opportunity for such a review would arise five years after implementation of the proposals. (Rec. 30 S.5.6)

- 75. The Board recommends the introduction of universal access via payroll deductions by the employer, with employer/employee discussion to decide which provider should be chosen. It also recommends (in Chapter 6) that, from their introduction, PRSAs would not be subject to a requirement for employers to meet one-sixth of the cost, and that trust schemes would be treated similarly in this respect. (Rec. 31 S.5.6)
- 76. The design of the Initiative is governed by the need to balance the likely ability of the reforms to achieve what is being sought with the costs of the reforms and the practical constraints involved.
 - 77. The recommended Second Pillar package is at the limit of what could be introduced feasibly with confidence over a relatively short timescale. However, it cannot be guaranteed to achieve the coverage objectives. That is why the Board has also outlined further measures to be held in reserve for the present, but which could be introduced following a review of the effectiveness of the measures actually adopted. It is recommended that this review should take place five years after the implementation of the proposals. (Rec. 35 S.5.7)

Proposals to Improve Supplementary Pension Provision in Second Pillar (Chapter 6)

- 78. Numerous recommendations are made to improve the extent and quality of coverage. For the most part, the changes proposed are interdependent. If implemented as a whole these would entail a major and fundamental, but manageable, change to the existing basis of pension provision. As well as recommendations to support the growth of pension provision, other fundamental objectives are addressed, namely:
 - ensuring that the customer has access to coverage which is understandable;
 - allowing the customer to make informed decisions;
 - recognising the reality of customer circumstances;
 - offering good value for money;
 - generating greater trust in the system;
 - providing a robust and flexible platform within which the pension system, in future, can adapt with relative ease;
 - recognising the current position of individuals, employers and the pensions industry;
 - building from that which already exists in a way which is realistic.

In addition to improving the extent of pension coverage, the Board is aware that there are many other aspects of pension provision where quality or delivery could be improved and it believes that addressing these would help materially to achieve the primary coverage goals.

- 79. However, the Board is aware and acknowledges that there are many aspects of current pension provision which are very valuable and sound and that the overall pensions environment in Ireland is well regarded generally. Therefore, in framing recommendations the Board has been careful to ensure that measures which are proposed would support and complement existing quality provision rather than undermine it. This recognition has led the Board to take an approach which might be summed up as evolutionary rather than revolutionary. It has also framed its recommendations deliberately in a way which allows a platform to be built which will be capable of considerable further extension if the mandatory aspects of the graduated approach are called for in the future.
- 80. The Board's detailed recommendations for improvement and extension of supplementary pension provision can be grouped under a number of different headings, namely:
 - Introduction of a new type of pension vehicle, the Personal Retirement Savings Account (PRSA). This is aimed at meeting the needs of the flexible labour market of today without undermining existing good provision, especially in defined benefit schemes. Because of its expected simplicity, it is likely that it would supplant some existing defined contribution and additional voluntary contribution arrangements, but would not result in an inferior quality of pensions product. By facilitating new distributors to enter the market, who could tap previously untouched customer sectors, it would become available to more people than existing arrangements. It would have a degree of simplicity and cost-effectiveness which has not been available in the past from existing arrangements. These features should add significantly to its attractiveness;
 - Simplifications and changes to tax structures. The purpose of the Board's recommendations is to reduce complexity which increases cost and makes it more difficult for employers and individuals to understand and commit themselves to making pension provision;
 - Steps which will widen access to pension provision. These relate to allowing access for all
 employees to coverage through their employer, equal treatment for part-time, seasonal and other
 atypical workers, allowing those not actually working to make provision, and facilitating the
 establishment of umbrella schemes:
 - Establishment of a norm for what would be regarded as a good quality product. It is recommended that products which meet the standards of flexibility, scope and information which make up the norm should be allowed show a kitemark so that customers can have confidence that they meet common needs. Part of the purpose of this is to help customers to make the best long-term decisions in relation to their future needs, especially in terms of investment. Another objective is to ensure that with increased simplicity, customers can be sure that the product has the characteristics that are required;
 - Improvements to existing pension arrangements. These measures, such as improved vesting and
 preservation provisions, generally entail little additional cost to the schemes involved and are geared
 more at improving value and flexibility for those already covered;
 - A regulatory regime suited to the new environment. Generally the proposals make use of structures which already exist or involve additional steps which are considered to be needed in any event.

- 81. A PRSA is an investment account which is owned by an individual. It holds units in investment funds which are held with and managed by an approved PRSA provider. Key features of PRSAs are considered to be:
 - their availability to individuals irrespective of employment status;
 - a flexible retirement age, with benefits determined purely by reference to the fund accumulated and without any reference to a planned retirement date;
 - a deferral option allowing an owner of a PRSA to draw a certain level of income from his/her fund but postpone the time when he/she must eventually buy an annuity for life (age 75 at the latest);
 - better information and greater consumer protection as a result of the kitemarking arrangements;
 - a standard minimum set of terms and conditions:
 - the development of investment mandates so as to help owners to understand and accept an appropriate level of risk, in order to maximise their long-term benefits;
 - the potential for a wider range of pension providers extending to banks, building societies, credit unions etc.
 - 82. The Board has come to the conclusion that PRSAs should be able to be used as collateral but only to the extent of 25 per cent of the fund built up, and subject to a cap of £25,000 and possibly other restrictions. This would mean that a lender could have resort in due course to the tax-free cash element of the PRSA but not to the remaining pension. (Rec. 36 S.6.2.1)
- 83. Currently, there are two different legal frameworks which apply to pension provision, one based on contract law relating to retirement annuity contracts and the other based on trust law which governs occupational schemes. These systems are the cornerstones for the protection provided to members. The Board considers that PRSAs would be a preferable vehicle for small defined contribution arrangements where the employer acts as trustee. It also believes that PRSAs would represent a significant improvement to personal arrangements, particularly in their attractiveness to sectors which have low coverage at present. In this context, the Board has examined the effects which the introduction of PRSAs could have on the legal basis under which coverage is usually provided.
 - 84. The Board recommends that new pension coverage should consist of either occupational schemes, set up under trust, or of PRSAs. "Small Self-Administered Schemes" which often operate on a one-member basis but are subject to close scrutiny would also be permitted as at present. The options of retirement annuity contracts and buy-out bonds should not be available any longer. The Board will keep the question of the employer acting as trustee of its own pension scheme under review. (Rec. 37 S.6.2.2)

- 85. The Board recommends that it should remain permissible for an employer who is contributing to a pension scheme to have or make it a condition on taking up employment, that employees join the pension scheme. (This would include arrangements where the employer agrees to contribute toward a PRSA). (Rec. 40 S.6.2.5)
- 86. The Board considered the specific tax rules which should apply to PRSAs and to other existing types of pension arrangement which are to continue under the proposed reforms. It has borne certain principles in mind in considering the broad thrust and detailed application of future tax rules. The principles which the Board recommends are as follows:
 - the existing tax regime should not be diluted;
 - the tax regulations should be simplified to the extent possible;
 - the tax system should not favour new products at the expense of existing arrangements or vice versa;
 - tax treatment should be neutral in regard to one's employment status (e.g. as an employee or self-employed);
 - the benefit of tax relief should accrue as far as possible to the person making the provision.
- 87. In considering tax issues the Board believes that specific consideration should be given to the following areas:
 - transitional and administrative arrangements need to be practical and cost-effective and prevent abuse or manipulation;
 - self-assessment should apply to new pension arrangements in ways which minimise unnecessary administration;
 - potential tax leakage from other forms of savings should be considered;
 - the continuation of immediate relief against tax and PRSI in respect of pension contributions paid by deduction from salary.
 - 88. The Board recommends that contribution based tax limits should be adopted for PRSAs. (Rec. 42 S.6.3.2)

89. The Board recommends that yearly limits for contributions should be adopted, but that these should be higher than those currently available to contributors to retirement annuity contracts at older ages in order to enable better funding of pensions at these older ages.

The Board recommends limits equal to 0.5 per cent of earnings for each year of age, subject to a minimum of 15 per cent and a maximum of 30 per cent.

In addition, each person should have a minimum eligibility to tax relief of pension contributions of £1,200 per annum, which may not be transferred to a spouse.

The Board recommends that individuals should be allowed to continue to contribute after they have started to take benefits, based on their continuing earned income (excluding pension) and within their limits. This would be in line with the concept of phased retirement.

The limits should apply to the total contributions made by self-employed persons. For employees, the PRSA limits should apply in respect of the combined employer/employee contributions. (Rec. 43 S.6.3.2)

- 90. A major question arises as to whether it is practical in fact to have a single system applying to all pension provision or whether other types of existing arrangements should have different limits to allowable contributions than would apply to PRSAs.
 - 91. The Board recommends that a twin track tax approach should be pursued for pension provision. (Rec. 45 S.6.3.3)
- 92. It is the responsibility of Revenue to monitor tax relief available for pension provision and to police the limits set. However, the Board believes that there is scope for a good deal of simplification and that achieving this would be very important for realising the objectives of the Initiative.
- 93. In relation to a number of tax proposals, in advance of a decision being taken, the Board recommends that an examination of the detail should be undertaken by a group comprising the appropriate authorities including Revenue Commissioners, Department of Finance and in consultation with the Board and relevant interest groups.
- 94. Looking at gaps in coverage, the specific segments of the employed sector which have the lowest incidence of coverage are those in smaller companies, the lower-paid, atypical workers, and those outside the main urban areas. These are precisely the sectors which have been the least attractive for commercial providers or distributors to reach in the past.

- 95. The Board recommends the introduction of universal access to pensions via payroll deductions by the employer with discussion to decide which PRSA provider should be chosen; this requirement to apply to all employers where an occupational pension scheme is not already being operated. Accordingly, it is proposed that such employers should be obliged to make salary deductions and remit them to the chosen PRSA provider. This would mean a joint employer/employee decision where the employer is making contributions, but one made solely by the employees if no employer contribution is being made. The employer should be obliged to ensure that annual communications are made to all employees about the features and operation of the facility being provided, although, as previously stated, the employer should be under no obligation to contribute. (Rec. 49 S.6.4.1)
- 96. Permanent part-time workers represent an important and growing category of workers generally with low levels of pension coverage. An EU Directive for equal treatment of such employees in respect of employment conditions in general was adopted at end 1997 and is to be implemented not later than 20 January 2000.
 - 97. In the context of the EU Directive relating to part-time work and any other relevant EU Directives being implemented in national law, the Board recommends that consideration of the workers to be covered in the national legislation should include part-time, seasonal and other atypical workers. (Rec. 51 S.6.4.2)
- 98. The Board considers that it has made several recommendations which should go a considerable way towards making it easier for organisations to establish viable umbrella schemes designed to bring a standardised pension offering to a large number of potential participants in a simple and cost-effective way.
 - 99. The Board recommends that umbrella schemes should be encouraged to develop in the normal commercial way but that Government should also make use of National Agreements or other structures such as Joint Industrial Councils and Joint Labour Councils whereby they invite employers and unions to discuss the establishment of umbrella schemes. (Rec. 52 S.6.4.3)
- 100. While the Board recommends many steps which should improve pension provision, especially through the introduction of the PRSA, it is setting a framework within which providers can develop products rather than setting out a standard design to be adopted by all providers. In particular, the Board recommends that the concept of kitemarking should be adopted and also makes various recommendations on value for money and cost aspects, charges and commissions.

101. It is recommended that all charges should be explicitly stated and that only charges which are expressed as a percentage of contributions and/or a percentage of fund should be permitted (except for any per capita fee to be payable under the Pensions Act). However, providers should be allowed to have charges which vary over time in an explicit way.

In particular, the effect of early discontinuance or of transferring to another provider should be required to be shown.

It is recommended that the Board should be required to review the actual costs charged by PRSA providers from time to time.

Charging is an area where there is potential for abuse. In order to minimise such practices, it is recommended that a professional obligation should be placed on the Appointed Actuary of the PRSA provider to disclose the details of illustration methods and to certify that actual practice accords with what is stated. (Rec. 59 S.6.5.4)

- 102. The Board is aware that the Department of Enterprise, Trade and Employment is in discussion with industry and customers in relation to a disclosure regime for life assurance policies. In particular, the Board is aware of the ongoing debate about whether the commission content of life assurance should be disclosed separately.
 - 103. While the Board's position is that it would not favour attempts to control levels of commission or require that they be approved or be disclosed separately, it believes it is not useful to have a second debate on these issues. The Board also recognises that there would be advantages in aligning the pension requirements with the requirements for life assurance and for this purpose it recommends that the Board and the Department of Enterprise, Trade and Employment maintain contact on this issue. (Rec. 60 S.6.5.5)
 - 104. The Board recommends that the principles for disclosure of commission for PRSAs should follow that adopted for life assurance. In the event of commission costs being disclosed, the Board recommends that all providers including those who are not life assurers, must make equivalent disclosure. (Rec. 61 S.6.5.5)
- 105. The Board is aware of the considerable comment on perceived poor experience with a number of aspects of annuity purchase in defined contribution schemes and retirement annuities. Particular issues are the rigidity of having to purchase an annuity from life assurers, the rapidly falling annuity rates and how it would have been much more beneficial if people could simply draw income from their own portfolios. These same issues would arise with PRSAs.

106. The Board recommends that the following steps should be pursued:

- flexibility to defer the purchase of an annuity payable for the rest of the pensioner's life;
- promotion of investment funds designed to reduce the risk posed by the timing of annuity purchase.

In all cases, an annuity should be illustrated which escalates at a fixed rate, of say 3 per cent, although level annuities may also be shown. Illustration should be given also of a dependant's pension. There may not be a need always for a dependant's pension, for example, if the dependant has an independent pension entitlement.

It is considered that a small expert group should be charged with looking at any other ways whereby the value for money could be improved or at alternative forms of annuity including a potential role for the State in facilitating better choice for those with smaller benefits. Also, a booklet dealing with annuities and explaining the issues should be published by the Board. (Rec. 65 S.6.6.1)

- 107. Many occupational schemes include a vesting period during which there is no entitlement to benefit from an employer's pension contribution in the event of leaving service.
 - 108. The Board recommends that the maximum period of reckonable service required to qualify for preserved benefit should be reduced from 5 years to 2 years. This change should apply to those leaving after 1 January 2001. (Rec. 67 S.6.7.1)
- 109. Preservation and revaluation of benefits in respect of pre-1991 service is widely regarded as a desirable extension of the current preservation and revaluation requirements for benefits in respect of post-1991 service.
 - 110. The Board recommends that for those leaving after 1 January 2001, preservation of benefits for pre-1991 service should be introduced by 1 January 2001, revaluation by 1 January 2006, and that funding standards in respect of these must be fully met by 1 January 2011. (Rec. 68 S.6.7.2)
- 111. At present, those leaving service have the right, generally, to a preserved benefit or may be able to transfer their benefit to another scheme, a buy-out bond or, if introduced, a PRSA. Currently the choice as to which option to take must be made within two years of leaving service and there may be some confusion about the possible forms of benefit which can be taken.
 - 112. The Board recommends the introduction of a provision allowing such transfer at the discretion of the member at any time after leaving service and that the member be given the same freedom in choice of benefit that would apply to owners of PRSAs. (Rec. 69 S.6.7.3)

113. It is recommended that all employees who do not currently have the right to make additional voluntary contributions should be permitted to do so by deduction from salary to a single PRSA provider chosen by the employees.

If so desired, any employee should have the right to make additional voluntary contributions to a different provider of his/her own choice but he/she would not have the right to have contributions deducted from salary. (Rec. 70 S.6.7.4)

- 114. The appropriate supervisory regime for PRSAs would be very different from that which currently applies to occupational schemes. The main features required would be that a PRSA provider would be subject to regulation of its pension activities by the Board and would specifically have to:
 - satisfy the Board that it has appropriate professional and administrative experience and expertise in place to ensure that it could meet its obligations;
 - submit annual returns to the Board including directors' certificate that it has sufficient funding available to ensure its continued viability;
 - have each of its products designated as either meeting kitemark standards (or not);
 - have an Appointed Actuary who would be required to certify each year (under professional guidance notes) that it has operated in line with kitemark requirements or to whistleblow if in breach;
 - ensure that each of the main financial aspects of the operation (e.g. investment or insurance) are
 carried out by properly authorised entities and that these demonstrate solvency and satisfaction of
 other prudential requirements to the appropriate regulator (e.g. Department of Enterprise, Trade and
 Employment or Central Bank);
 - report annually on investment performance against mandates;
 - ensure that any intermediary with which it transacts business is properly authorised.
 - 115. In this regard the Board considers that it should retain responsibility for all pension aspects and for overall supervision of PRSA provision.
 - However, it should rely on other regulators in respect of the functions normally carried out in respect of their existing functions and any new functions that would arise as a result of further developments. (Rec. 72 S.6.8.1)
- 116. Many occupational pension schemes are integrated with the Social Welfare pension. In particular, the vast majority of defined benefit schemes have their benefits integrated with Social Welfare pension entitlements. A result of the Board's recommendation that the Social Welfare pension be increased to 34 per cent of average industrial earnings will be that the scheme benefits under integrated occupational pension schemes will be reduced consistent with retaining the overall pension at its promised level. This will occur in circumstances in which the interaction of integration and other factors (such as lower pay, integration treatment of part-time/atypical workers) are already a cause of dissatisfaction. It is clearly important that these issues be dealt with in any proposed reforms of the overall national pension system.

- 117. A number of the submissions received by the Board expressed dissatisfaction at the impact of integration on occupational pension schemes. In integrated schemes, account is taken of the person's PRSI entitlements, so that the occupational pension effectively "tops up" the Social Welfare pension to provide the total pension specified in the scheme's rules. However, if the person's pensionable pay is very low, the Social Welfare entitlement may comprise a very large component of the total pension, perhaps even all of it. The main factors which give rise to difficulties and dissatisfaction are:
 - lower pay;
 - the way in which integration applies to part-time and other atypical workers;
 - some design features;
 - inadequate information.

Other contributing factors, which can cause individual problems, include the definition of "pensionable pay".

- 118. The Board recommends that annual statements must be provided automatically which, in addition to giving personal benefit information, would address as many of the relevant points relating to Social Welfare pensions as is possible. Standard wording describing integration should be prepared by the Board for inclusion in such statements, member booklets etc. Also, a booklet dealing specifically with integration and explaining the issues should be published by the Board. (Rec. 77 S.6.9.1)
- 119. The Board also recommends that in cases where there is a change in terms of employment which may lead to a reduction in pension entitlement (for example, a reduction in pay or a change in the pay that is pensionable), the employer must ensure that the relevant information is supplied to each person affected, showing the effect of the change, prior to its implementation.
 - This recommendation would involve a requirement additional to that in Section 5 of the Terms of Employment (Information) Act, 1994. (Rec. 78 S.6.9.1)
- 120. Integration in public sector pension schemes, and in particular its impact on lower-paid employees, is one of the issues being examined by the Commission on Public Service Pensions. As this Commission is due to report to Government during 1998 the Board did not consider it appropriate to make any specific recommendations in relation to integration in the public sector, other than the general recommendations made under the heading of information.
 - 121. The Board recommends that contributory defined benefit schemes should be required to provide minimum benefit levels whose value equates to 120 per cent of the member's ordinary personal contributions, with interest thereon. The interest rate, if any, should be the same as that which applies to refunds of contributions on leaving service. (Rec. 79 S.6.9.4)

- 122. The Board recommends that reductions in occupational pensions already in payment, arising from increases in Social Welfare pensions, should be prohibited. (Rec. 80 S.6.9.5)
- 123. The level of understanding and awareness of pensions among the general public appears to be low.

 The recommendations contained in the Initiative will need to be supported by an effective education and awareness programme if they are to have the maximum desired effect.
 - 124. The Board recommends a Government driven pension awareness campaign to be conducted in conjunction with the relevant public and private sector bodies. (Rec. 81 S.6.10)

Associated Current and Future Issues (Chapter 7)

- 125. Under the Social Welfare system, the qualified adult allowance is the additional amount payable when a person receiving the primary benefit has a dependent spouse. The Board considers that taking account of the Social Welfare customer group in question and the aim of many to move towards a pension on an individualised basis, the current relationship between the qualified adult allowance and the personal rate of payment should at least be maintained.
 - 126. The Board recommends that available resources should be used, firstly, to target the basic pension and, secondly, to maintain, at its current level at least, the relationship between the qualified adult allowances and the personal rate of pension. (Rec. 82 S.7.1)
- 127. The introduction of PRSAs and simplified access to them will inevitably raise questions about the impact on the attractiveness of other types of pension provision. The Report examines the implications of changes, in terms of legal form and other aspects, notably commercial ones.
 - 128. It is the Board's view that additional protection stemming primarily from increased disclosure requirements is sufficient to provide reasonable protection to the different parties currently involved in pension provision and such protection will ensure that the providers are not undermined. (Rec. 91 S.7.5.7)
- 129. Achieving the Board's targets for pension coverage will result in the following increases in the numbers covered compared with the ESRI Survey 1995:
 - an increase of 270,000 in the first 5 years;
 - an increase of 394,000 in the first 10 years.

Estimating the Revenue implications of achieving the Board's targeted levels of coverage requires assumptions to be made about the quality of coverage for those with new coverage and about their salary levels and rates of tax and PRSI contributions. The most straightforward way of quantifying the effect of this Initiative is to estimate the Revenue effects which would arise if coverage in 1995 had been at percentage levels set out in the coverage objectives rather than at the levels found by the ESRI Survey 1995. The actual future Revenue effects would of course be larger on account of the expected continued growth of the labour force from its 1995 level. Based on the anticipated additional numbers covered, it is estimated that this would mean an overall adjustment (over that 5 year period) in tax revenue of a little over £34 million per annum and a loss of PRSI income of less than £3.9 million per annum assuming the objectives for the first 5 years were achieved. In other words, an Exchequer loss of about £7.6 million would need to be taken in each year for five years. The estimated amounts of tax relief foregone may be lower than expected at first sight - the reason is that the average income and contribution level of those taking up cover for the first time is expected to be well below the level for those who already have cover.

130. The responses to the Consultation Document generally held the view that the State should not be a direct provider of occupational pension benefits although it could facilitate some aspects. The Board concurs with this view (Rec. 92 S.7.9)

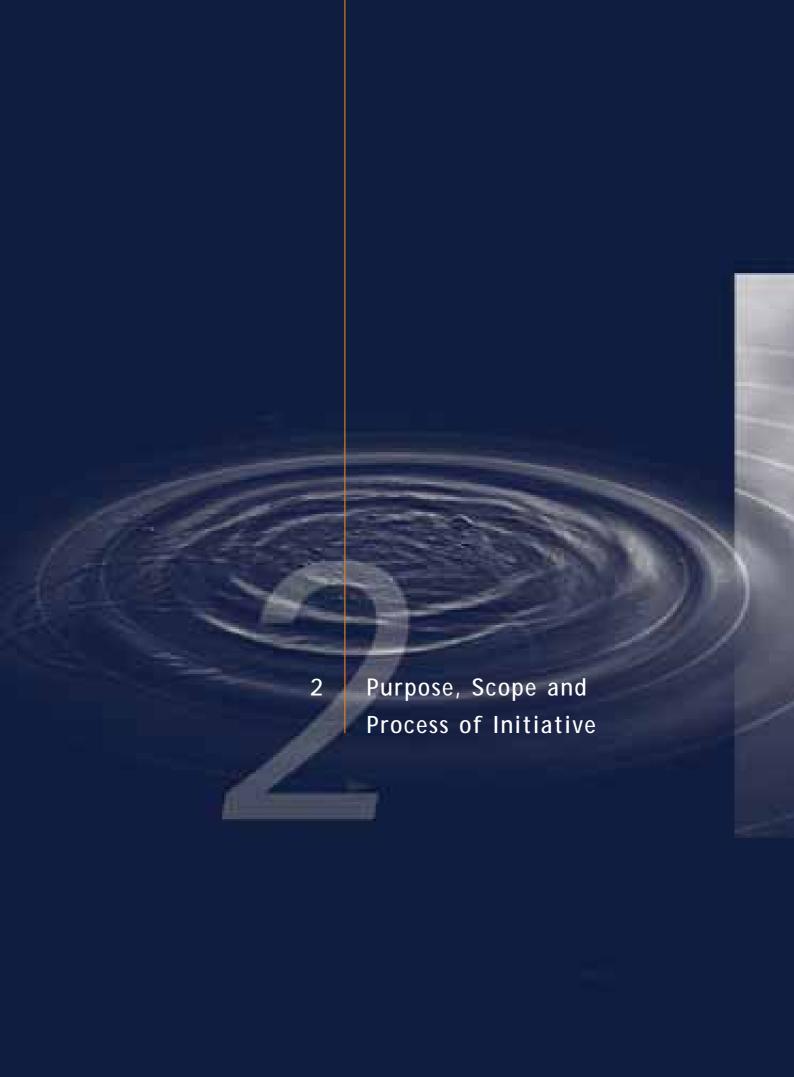
Implementation (Chapter 8)

- 131. The Initiative contains a wide-ranging and complex set of proposals regarding the legal and practical environment for pension provision. The Board believes that it has set out principles which need to be followed to achieve successful reform of pension provision. However, it recognises also that much specialist work will have to be carried out to fill out the detail for translation into legislation, regulation, professional guidance etc. Consequently the project management of the whole change process will be extremely important.
- There will be considerable need to ensure that the recommendations in this Report which are adopted are implemented in ways which are sensible and efficient as well as meeting the objectives. This will require exchanges of views and perhaps different approaches between the parties involved, i.e. Government, employers and labour and industry practitioners. This will present a challenge of effective communication while the changes to the framework are being put in place.
- 133. Clearly, there are risks to the achievement of the objectives of the Initiative arising from different sources:
 - technical complexity;
 - resources;
 - timescales.
- 134. The objective of the Initiative goes beyond the existing scope of the Board in that it covers all Second Pillar pension provision, i.e. including personal pension provision, whereas the current statutory role of the Board has focused primarily on occupational schemes.

- 135. As the Board's role would be extended substantially as a result of the recommendations in the Initiative, a further recommendation is that the formal remit, operation and financing of the Board should be reviewed on foot of the Initiative. (Rec. 94 S.8.4)
- 136. This Initiative contains proposals for the most comprehensive reform of pension provision in Ireland for a generation. Already, pension provision plays a very important role in the economy and in the welfare of people. Consequently, it is essential that appropriate steps are taken to monitor the outcome of the Initiative.
 - 137. The Board recommends that it would be appropriate for a long-term monitoring and measurement strategy to be drawn up by the Department of Social, Community and Family Affairs and the Board. (Rec. 95 S.8.5.1)
- 138. If the proposed strategy is adopted by Government, the Board considers that it would be appropriate to have a critical time path for the implementation of the reform programme drawn up and agreed in consultation with relevant agencies and Government Departments.
 - 139. When an implementation time path has been agreed, it is proposed that the Board would report on progress annually and highlight whether key reforms are being implemented according to the time path. (Rec. 96 S.8.5.2)
 - 140. For the purpose of monitoring changes in extent of quality and coverage the following recommendations are made:
 - pensions coverage should be measured in a consistent fashion using surveying techniques on a regular basis;
 - the current practice whereby employers make returns of income data to the Revenue on the basis of pay less pension contributions should be amended possibly on a phased basis to provide both gross pay and the actual contributions deducted - these data are produced as part of any payroll process and would allow better measurement of pension savings;
 - information collected from pension providers should also be standardised and form part of the ongoing supervision;
 - particular attention should be paid to monitoring coverage by industry sector;
 - membership information collected by the Board could also be used. (Rec. 97 S.8.5.3).

- 141. It is not possible to establish at this stage the precise timetable for implementation of the proposals in this Report. This will depend, inter alia, on:
 - timing of Government decisions on the proposals;
 - allocation of time for the necessary legislative provisions within the Government's ongoing legislative programme;
 - consultation with third parties, for example, on operational and technical aspects.

The Report includes a matrix which indicates how the main components of the proposals might be implemented and the main inter-connections between them.



2 Purpose, Scope and Process of Initiative

2.1 General

In this and subsequent chapters, the national pension system is taken to consist principally of:

- First Pillar Social Welfare pensions, both contributory and non-contributory, which together form the basic provision; and
- Second Pillar occupational and personal pension provision, established by employers/employees and the self-employed on a voluntary basis, to supplement the benefits available under the First Pillar.

The various detailed arrangements under these two Pillars are set out in Chapter 3.

The Third and Fourth Pillars (see Glossary) are not given an extensive treatment in this Report.

To assist the reader, the Glossary contains an explanation of various technical and other terms used throughout this Report. Certain other terms are defined where they first appear in the text.

2.2 Purpose

The overall objective of the National Pensions Policy Initiative (the Initiative) is to facilitate national debate on how to achieve the aim set out in Developing the National Pension System: Final Report of the National Pensions Board¹ (the Final Report of the National Pensions Board) and to formulate a strategy and make recommendations for actions needed to achieve this aim.

In that report, the aim was stated as follows:

"Ideally, a fully developed national pension system is one which enables all residents in the State to acquire an income which allows them to maintain their established standard of living in the following circumstances:

- attainment of retirement age;
- long-term incapacity;
- in the case of dependants, on the death of the income provider.

This ideal is subject to the resources available for pension provision.

At a minimum, the national pension system should ensure that any resident, in any of the above circumstances and who has no other income, should receive a State pension which is sufficient to maintain a basic standard of living." (Page 93 of Final Report of National Pensions Board).

¹ Developing the National Pension System: Final Report of the National Pensions Board, The Stationery Office Dublin, December 1993.

The issue of adequate and comprehensive pension cover has been under consideration for over 20 years. In 1976 the Department of Social Welfare published a Green Paper on a National Income Related Pension Scheme. This included proposals for the introduction of such a scheme under Social Insurance. It was not proceeded with mainly because of the economic difficulties and growing levels of unemployment in the 1980s. Instead, the priority has been to increase the level of flat-rate Social Welfare payments, including pensions, up to minimally adequate levels and to extend compulsory Social Insurance cover to all categories of the paid workforce. This overall approach is in line with the recommendations of the Commission on Social Welfare which reported in 1986.

The Final Report of the National Pensions Board examined in detail the nature of the pension promise under both Social Insurance and Social Assistance, which it considered should continue to be the base of the national pension system. That report recommended, inter alia, that actuarial reviews of the projected costs of Social Welfare pensions should be carried out at least every 5 years. The first such review, entitled the Actuarial Review of Social Welfare Pensions² (the Actuarial Review), was completed in 1997. Its results have been used by The Pensions Board (the Board) to facilitate projections and discussion as to what levels of Social Welfare pensions should be provided for in the decades ahead.

Debate in Ireland is set against an international background in which many countries are reforming or reviewing their systems of providing for retired and older people. Most prominent amongst the reasons for this are:

- the so-called demographic "time-bomb", arising where the proportion of older people is set to increase rapidly relative to the proportion at work; and
- the fact that existing systems, in particular Social Welfare pensions paid out of current revenue, are facing severe financing difficulties due to demographic pressures and/or previously made pension "promises" which are difficult to meet as they mature.

While similar concerns could arise in Ireland, the timing is very different from that in other countries. Because of the younger age profile of the Irish population compared with that in many other developed economies, demographic pressures on pensions will not arise until after the early decades of the next century. Thus, the present review of policy is not a response to a crisis, as is the case in many other countries, but a timely consideration of policy options to ensure that in the longer-term this country will not face similar difficulties to those being experienced or in prospect elsewhere.

Furthermore, there is a need to consider whether a continuation of existing arrangements will meet the needs of income provision in retirement which society would regard as desirable, while at the same time remaining affordable. First and Second Pillar pension provision are clearly not the only source of retirement income provision, given, for example, the ownership of non-pension assets. However, a key element of social policy is to ensure that the overall pension system results in a reasonable standard of provision for all older people.

² Actuarial Review of Social Welfare Pensions, The Stationery Office, Dublin, September 1997.

2.3 Scope

The scope of the Board's deliberations includes pension provision for older people, their dependants and survivors. It excludes detailed consideration of parts of the Social Welfare system other than pensions; it also excludes pension entitlements in the public sector. In regard to the latter, in mid-1996 a Commission on Public Service Pensions started to carry out a review of public service occupational pension arrangements and is expected to report in 1998. By and large, the Board assumes these arrangements will remain as at present.

This Report does not deal with arrangements for permanent health insurance and long-term care; while these were considered by the Board in relation to the scope of its deliberations, the view taken was not to consider them in detail in this Report. The Board recognises that these matters would need separate consideration in the light, inter alia, of their relevance to national health policy.

2.4 Process Involved in Initiative

In 1995, on foot of a recommendation in the Final Report of the National Pensions Board, the Economic and Social Research Institute (the ESRI) was commissioned by the Board and the Department of Social Welfare to undertake a survey of occupational and personal pension coverage in Ireland. According to the survey, less than 50 per cent of the workforce have supplementary pensions cover. This means that significant segments of the workforce and their dependants are at risk of experiencing a sharp drop in living standards when they become pensioners.

Other features of Second Pillar coverage were identified. These included the fact that the proportion of contributions that goes towards meeting administrative and marketing costs can vary widely depending on the type of pension arrangement. There is also a higher level of risk attached to some arrangements, in terms of the pension amounts ultimately payable, as compared with the level of contributions. For example, pensions may not be indexed adequately to maintain their value in real terms, no pension cover may be provided for surviving dependants, and those who change employment in the course of their career may lose out significantly in terms of the final pension they receive.

Against the background set out above, the Initiative was launched in October 1996. In addition, Partnership 2000, the current programme of the social partners which was agreed and ratified early in 1997, formally incorporates the Initiative and contains reference to specific pensions issues, such as the application of Revenue regulations, the abolition of front-end commission, indexation of pensions in payment, offering the choice of fixed or indexed pensions and provision of certificates of reasonable expectation.

The Initiative was progressed in two phases including the following steps:

- publication of a Consultation Document;
- invitation of submissions from all interested parties;
- a National Pensions Conference; and
- Board workshops and development of options.

The first phase of the Initiative consisted of the preparation and publication of a Consultation Document. That was launched in February 1997 and some 3,650 copies were distributed to a wide range of organisations, professionals and members of the general public. The Consultation Document contained a description of the current environment within which pension provision takes place, the main issues arising and the broad options along which development might take place. Responses were invited to these or other aspects considered to be of importance.

By the end of May 1997 a total of 143 submissions had been received, roughly half from professional bodies or organisations and half from individuals. Submissions ranged from descriptions of individual experiences in relation to pension planning and provision to comprehensive analyses of both First and Second Pillar provision. A Summary of these submissions and of the responses given to key issues raised in the Consultation Document is given in Appendix A.

The second phase of the Initiative commenced with analysis and consideration by the Board of the submissions. A National Pensions Conference was convened in July 1997 which was organised around a number of themes, aimed at stimulating debate on the key issues to emerge from the consultative process of the Consultation Document and responses received by way of submissions. All those who made submissions were invited to attend. Representatives from 16 organisations were invited to address areas of key concern. Half of the speakers came from the pensions industry or represented associated professions; the other half included employer bodies, trade unions and the Retirement Planning Council of Ireland. The latter took account of the main issues raised in submissions received from individuals. The debate which took place was very valuable to the Board and provided added perspective and practical experience of issues raised in written submissions.

Since then, the Board has held a series of internal workshops in which it has discussed and debated issues raised in the consultative phase, objectives, strategic approaches, practical alternatives to achieving these objectives and associated issues of implementation which would arise. The Board has been assisted by external consultants in this process. The workshops were informed by the results of the Actuarial Review and other economic forecasts, further analyses of data from the ESRI and by inputs from expert practitioners on specific matters.

In shaping and evolving the strategy proposed for future development of the pensions system, the Board has paid particular regard to the following criteria:

- Effect on Coverage.
 - The need to ensure as wide as possible a coverage of the population for pension provision;
- Adequacy of Pension Provision.
 - The need for provision to be adequate, by reasonable standards, for those covered;
- Protecting Existing Good Pension Provision.
 - The need in proposing reforms, to ensure that what is good in present arrangements is protected;
- Cost and Efficiency.
 - The need to ensure that the non-benefit costs of pension provision, and its efficiency of supply and delivery, are at the optimal level;

Fiscal and Economic Impacts.

The need to ensure that the fiscal and economic impacts of proposed reforms are kept to an acceptable level relative to overall conditions;

Robustness and Flexibility.

The need for any proposed new structures to be robust and durable over future years while being sufficiently flexible to accommodate changing employment, social and other circumstances;

Solidarity.

The need for the overall pension system to achieve an acceptable measure of solidarity (i.e. sharing of costs and benefits) between all its participants, both current and future;

Fairness.

The need for the overall pension system to be equitable in the main aspects of the design and operation of its provisions;

Labour Market Implications.

The need for any proposed reforms to, at least, not hinder the efficient operation of the labour market and, desirably, to facilitate or promote a labour market conducive to social and economic development; and

Simplicity.

The need for the system and, in particular, any proposed new structures, to improve the simplicity of pension arrangements so as to optimise efficiency and take-up.

However, among these, the most important issues are considered to be the capacity of any new policy departure to:

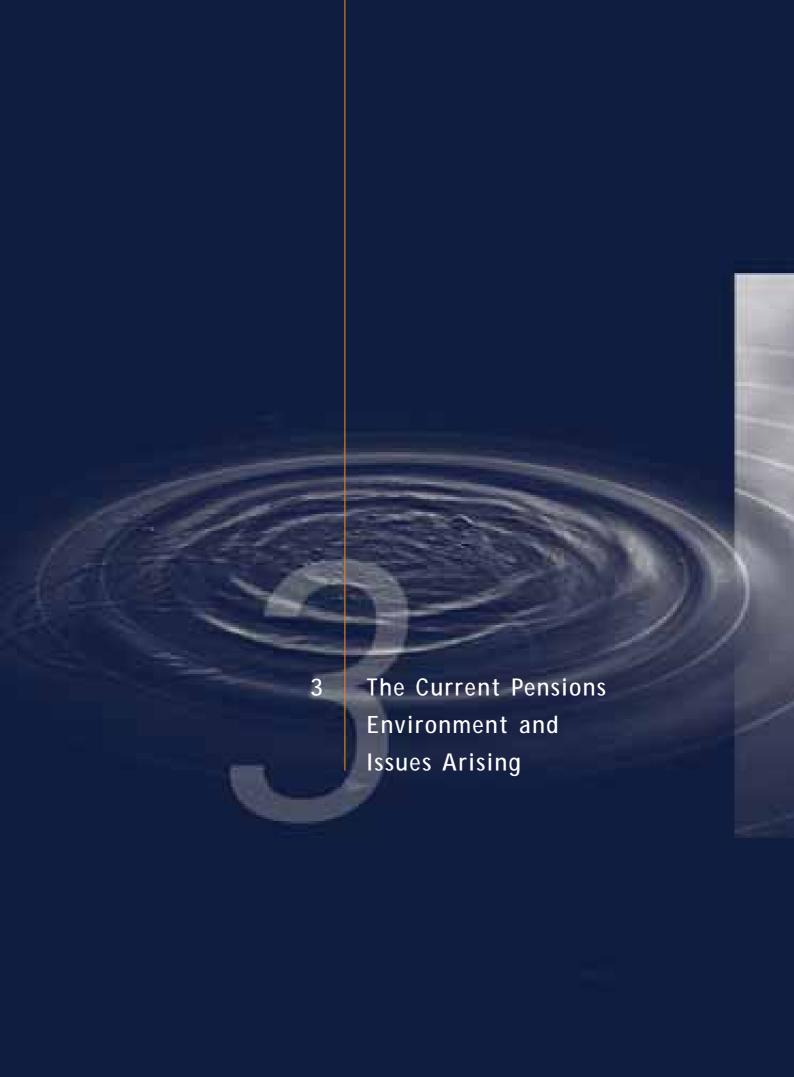
- extend coverage;
- improve adequacy;

balanced against the likely impact on:

- cost competitiveness and employment needs;
- the sustainability of the new system; and
- Exchequer costs.

Any tendency for taxes, or employers' payroll costs, to rise must be taken into account under this heading, as must any impact on the Exchequer as regards tax revenue or public expenditure.

This Report of the Board to the Minister for Social, Community and Family Affairs is the culmination of the second phase of the Initiative. It contains the Board's assessment of the current situation regarding pension provision in Ireland. It sets out a strategy for future development in relation to both the First Pillar and Second Pillar. It contains a number of major proposals and recommendations for change to give effect to the strategy.



3 The Current Pensions Environment and Issues Arising

3.1 Existing Types of Pension Provision

3.1.1 First Pillar Benefits¹

At age 66 there are two benefits available under the Social Welfare pension system administered by the Department of Social, Community and Family Affairs:

- an old age contributory pension for those who satisfy the PRSI contribution conditions; or
- an old age non-contributory pension, subject to a means test, for those who do not qualify for the contributory pension.

A retirement pension of the same amount as the contributory pension is payable from age 65 if the claimant has actually retired and has sufficient PRSI contributions.

Additional weekly allowances are payable in respect of qualified adults, child dependants, living alone, and/or if aged 80 or over. Pensioners may also be eligible for allowances for electricity, telephone rental, TV licence and fuel in the winter months. Free travel on public transport is available to all people aged 66 and over.

Disability benefit (usually short-term) and invalidity pension (long-term) are payable in the event of incapacity for work, and widow's, widower's and orphan's pensions are payable in the event of death.

Of the 387,400 people in the State aged over 66, approximately 316,600 are recipients of Social Welfare pensions payable to those aged over 66. Among this group an additional payment is made in respect of 25,500² qualified adults. Therefore, coverage of recipients and dependants is almost 90 per cent of the relevant age cohort. The remainder do not qualify for a contributory pension or have not met the means test for a non-contributory pension, or have not applied, for whatever reason.

Apart from certain categories of public service employees, the vast majority of those in the labour force will qualify at retirement age (65/66) for a Social Welfare pension. Over time, on foot of the extension of Social Insurance³, there has been a shift in the composition of the recipients of Social Welfare old age pension payments. In 1996, of the total number of people receiving these payments, 58 per cent were in receipt of a contributory pension (i.e. based on their PRSI contributions) compared to 47 per cent in 1986. Similarly, of the total number receiving old age pensions for the first time in 1996, over 60 per cent received contributory payments compared to 50 per cent in 1986.

The role of contributory (PRSI related) payments will increase further in the future, as indicated in Appendix D of the Actuarial Review. For example, it is projected that by 2016, 86 per cent of recipients of old age pensions will be in receipt of a contributory payment, compared to 58 per cent in 1996.

¹ Rates of payment are set out in Appendix M.

² This figure is lower than might be expected and reflects the fact that where each of a couple is over age 66 and qualifies for an old age non-contributory pension, each receives a pension in his/her own right.

³ Social Insurance was extended to the self-employed (1988), part-time employees (1991) and new civil/public servants (1995)

3.1.2 Second Pillar - Types of Provision Available Currently

The Second Pillar comprises three main types of pension arrangement:

- public service pension schemes run on a pay-as-you-go basis. Those covered include civil servants,
 Gardai and Defence Forces, local authority employees, teachers and health workers;
- funded occupational pension schemes set up by, or negotiated with, employers to provide benefits for their employees. These include funded schemes set up by commercial State entities and agencies; and
- personal pensions (including retirement annuity contracts) arranged by individuals, generally the self-employed.

All of these are voluntary in the sense that there is no legal obligation for an employer to establish or maintain a scheme. However, once established, schemes are subject to certain legal requirements and regulation.

There are three principal ways in which pension arrangements can be designed:

- defined benefit:
- defined contribution; and
- personal pension plans.

Defined Benefit Schemes

These have specific rules setting out entitlements to benefit under various circumstances (retirement, death etc.). Benefits are usually expressed in terms of "pensionable salary" and years of service. "Pensionable salary" often means basic salary averaged over a period and reduced by an amount to take account of Social Welfare pension benefits. As the benefits to which members are entitled are defined, any uncertainty regarding the level of their cost falls largely on the employer.

In the typical funded defined benefit scheme, employees may contribute a set amount while the employer makes contributions, based on the scheme actuary's recommendation, which should be sufficient to meet the liabilities in due course. Normally, contributions are made to an investment fund operated for the scheme as a whole, rather than for individual members. Benefits are met by withdrawals from the fund.

A number of public service pay-as-you-go schemes provide for payment of employee contributions, which are credited to current income, while notional employee contributions are deemed to be made in the remaining schemes when setting salary levels. While there is no formal employer contribution, the employer is liable to pay all benefits and meets the cost of such benefits out of current revenues.

Defined Contribution Schemes

In these schemes, the employer makes a specific level of contribution in respect of each member. The member often contributes to these schemes at a similar level. The amounts available for benefits at retirement, on death or leaving service, are based on the value of the investment fund accumulated for the member. As such schemes are based on a specified level of contribution, any uncertainty regarding benefit levels falls on the member.

Personal Pension Plans

These are individual pension arrangements which operate on a money purchase basis; in all other respects they are similar to a defined contribution scheme. Invariably they are effected with an insurance company. Group personal pension schemes have been arranged by professional bodies which effectively use their buying power to provide better terms for their members.

3.2 Extent of Coverage

3.2.1 First Pillar Coverage

First Pillar coverage is now virtually universal with the vast majority of paid workers participating in PRSI which provides benefits for them and their dependants.

3.2.2 Second Pillar Coverage

The remainder of this section is concerned with voluntary supplementary provision.

The ESRI Survey of Occupational and Personal Pension Coverage⁴ (ESRI Survey 1995) is the most comprehensive recent investigation of Second Pillar pension coverage. The overall results of the ESRI Survey 1995 are summarised in *Table 3.1*.

In this survey, pension coverage means entitlement to retirement benefits. A person entitled only to benefits on death or disability is not regarded as being covered.

A principal finding of the survey is that Second Pillar coverage, as a percentage of the labour force, is fairly static or declining slightly, despite an active and well-developed pensions industry in Ireland. The pattern of coverage is broadly similar in size and trend to that found in countries with a similar pension structure such as the United Kingdom or United States.

⁴ Occupational and Personal Pension Coverage 1995, The Economic and Social Research Institute, 4 Burlington Road, Dublin 4

Table 3.1 Overall Occupational and Personal Pension Coverage Results from ESRI Survey 1995

	Total in Category (000)	With Pension Coverage (000)	Pension Coverage %
	(555)	(333)	
Economically Active			
Employed			
Private Sector			
Manufacturing and building	256.8	117.7	46
Distribution	125.4	24.0	19
Services	258.6	104.5	40
Total Private	640.8	246.2	38
Public Sector			
Commercial Public Sector	55.6	45.7	82
Non-Commercial Public Sector	220.4	184.6	84
Total Public Sector	276.0	230.3	83
otal Employed	916.8 ⁵	476.5	52
Self-Employed			
Agriculture	118.5	14.7	12
Other	146.6	57.5	39
otal Self-Employed	265.1	72.2	27
Total at Work	1181.9	548.7	46
Not Economically Active (aged 15 or m	ore)		
Jnemployed	217.7	7.1*	3
Retired	222.9	68.4*	31
Home Duties	637.9	15.2*	2
Others Not Economically Active	410.5	8.6*	2
otal Not at Work	1489.0	99.3	7

Source: ESRI Survey 1995, Tables 2.1,3.1,4.14 and 4.18.

In financial terms, pension provision is continuing to grow quite rapidly since the ESRI Survey 1995, as evidenced by the growth of well over 25 per cent in 1997 in new pension contributions reported by many life assurers and the cash flows into occupational pension schemes reported by The Irish Association of Pension Funds (the IAPF). However, the number of people covered has probably moved much more slowly with total numbers in occupational pension schemes under the remit of the Board increasing by 4 per cent in 1997. Furthermore, the areas of relative strength and weakness in coverage appear to be the same as reported in the ESRI Survey 1995.

More recent comprehensive data suggest that coverage levels in the non-commercial public sector may be higher than found by the ESRI Survey 1995.

The main findings of that survey are summarised below.

3.2.3 Coverage of Employees

Characteristic features of where coverage among employees is strong or weak can be summarised as follows:

Coverage by Industry Sector and Occupational Group

The overall coverage rates shown in *Table 3.1* apply to broad sectors. There are significant variations for example, there are very high coverage rates in financial institutions and low rates in retail distribution, among agricultural employees and those employed in personal services⁶;

Coverage by Employment Status

The proportion of permanent full-time employees with pension coverage is 60 per cent and a further 5 per cent will become eligible for benefits when they complete a qualifying period. By contrast, about 10 per cent of atypical (i.e. non-permanent, part-time and seasonal) workers are covered;

Coverage by Size of Firm

Smallest firms (i.e. less than 5 employees) have coverage rates of below 10 per cent whereas coverage is nearly 80 per cent for those with over 500 employees;

Coverage by Age and Sex

Coverage increases significantly with age. Coverage of men at the overall level is higher than that of women. To a large extent, this reflects the higher incidence of women in low coverage sectors such as part-time employments or in industries with lower pay levels. There is little difference between male and female coverage for full-time employees aged up to 40 but women over 40 have significantly lower coverage rates than their male counterparts, probably reflecting employment practices of twenty years ago or more⁷;

Coverage by Income Level

Coverage varies enormously by income level with coverage levels of nearly 90 per cent in the top two salary deciles but only 3 per cent in the lowest⁸. This may be because those in the lowest earning deciles consider that the Social Welfare pension will allow adequate replacement of income during retirement and/or because these are the groups which have particular difficulty obtaining coverage;

Gaps in Coverage of Employees

As already noted, the incidence of coverage is especially low amongst atypical workers in the smallest firms. At the same time, despite such evident gaps, it is striking to note that three guarters of those employees not covered are in full-time permanent employment and significant numbers of them are employed by firms of 50 or more employees. This reflects the continuing predominance of the employee workforce by full-time as distinct from atypical employments.

See ESRI Survey of 1995, p.44 and references Appendix J, Table 1.

Appendix J, Table 2.

3.2.4 Coverage Amongst the Self-Employed

Turning to the self-employed, there is a marked difference between coverage in the agricultural sector (12 per cent) and the rest (39 per cent), although the latter varies from 17 per cent for those in service occupations to 53 per cent in professional occupations.

Research undertaken by the IAPF⁹ shows that a very high proportion of the self-employed expect to rely on the Social Welfare benefits or the proceeds of business for income in retirement.

3.2.5 Coverage of Other Groups

As would be expected, only a small proportion of the unemployed and those carrying out home duties have any pension entitlement and usually no current contributions are being made. Others not economically active, 410,000 in total, include over 300,000 students. Many of the remainder are believed to be disabled and the implied pension coverage of this group of 110,000 or so, appears to be about 7 per cent.

3.3 Adequacy of Coverage

3.3.1 First Pillar and the Avoidance of Poverty

Risk and Incidence of Poverty for Older People

Research indicates that over the period 1973-1987 the position of the elderly with regard to poverty improved considerably. This was mainly the result of significant increases in the real value of Social Welfare old age pensions which rose by about 47 per cent over this period, with particularly high increases in 1980 and 1982. This compares with an increase of 25 per cent in real per cent average industrial earnings over the same period.

By contrast, during the period 1987 to 1994 Social Welfare payment rates for pensioners were increased by about 6 per cent above the rate of price inflation but declined by about 7 per cent by reference to earnings increases.

During this time there was a shift in the profile of households generally below relative income poverty lines or adequacy standards¹⁰ (see Appendix O). A key factor in explaining the trends in poverty is the changing relationship between the standard chosen and the rates paid under different Social Welfare programmes. A significant proportion of the single adult households below the 50 per cent standard in 1994 comprised an older or widowed person. This reflects the fact that the rate paid under the noncontributory old age and widow's pensions prior to the July 1994 increase was just below the 50 per cent adequacy standard for a single person whereas after the increase it was just above that level. In 1987, by contrast, the payment rates were significantly higher than the 50 per cent standard at the time and therefore nearer the 60 per cent standard. This was the result of the strategy adopted in the latter period of giving priority to increasing the lowest rates of Social Welfare payment, such as Unemployment Assistance and Supplementary Welfare Allowance. This highlights the sensitivity of the adequacy standards which are chosen in measuring poverty.

Irish Pensions at the Cross Roads: Submission of the IAPF to The Pensions Board on the National Pensions Policy Initiative

Income poverty standards or lines are based on the view that poverty should be examined in relative (not absolute) terms and this relates to standard of living of the society in question. In this discussion these standards are based on the 1987 and 1994 ESRI surveys of some 4,000 households. Average household disposable income is estimated from the sample and then converted to average disposable income per adult equivalent. The relative income poverty line/standard is then derived at 40 per cent, 50 per cent and 60 per cent of this income - the choice of standard is totally arbitrary. For further discussion see Appendix N.

A summary of the trend in the risk of relative poverty for older person households overall (i.e. the percentage of the group that are below the relative standard) during the 1973-1994 period is contained in *Table 3.2*.

Table 3.2 Risks of Relative Poverty for Households Headed by an Elderly Person

	1973 HBS*	1980 HBS*	1987 ESRI+	1994 ESRI+	
Relative Poverty Line	%	%	%	%	
40%	12.9	7.1	3.6	3.2	
50%	30.9	24.4	7.2	9.8	
60%	44.0	46.6	20.9	41.5 [†]	

Source: ESRI (1996), page 93.

- * Household Budget Survey.
- + ESRI Living in Ireland Surveys.

3.3.2 Adequacy of Second Pillar Coverage

For those in defined benefit schemes, including those in the public sector, the likely level of pension at normal retirement for those with full service is good. Many private sector schemes provide a pension of one sixtieth of final salary per year of service inclusive of Social Welfare old age pension (usually at the single rate only) with retirement at 65 or a little earlier. Overall, this would provide good replacement rates for those with unbroken service.

Typically, total contribution rates in defined benefit schemes equate to about 11-12 per cent of salary, with the employee meeting about a third of the cost. By contrast, in defined contribution schemes, average contribution levels run at 9-10 per cent of salary divided evenly between employer and employee.

For younger employees, this level of defined contributions may provide good overall replacement rates. However, as it is not known to what extent contribution rates vary by age, the position of many older employees is unclear. For all members of defined contribution schemes there is a degree of uncertainty about the amount of the eventual benefits. Social Welfare old age pension will be payable in addition to occupational pension, subject to the PRSI contribution record of the scheme member.

Additional Voluntary Contributions

Over 90 per cent of schemes permit members to make additional voluntary contributions. The actual extent of take-up was not covered by the ESRI Survey 1995, but is likely to be concentrated amongst the better paid.

[†] The increase between 1987 and 1994 relates to the position of the relevant Social Welfare payment rates vis-à-vis the 60 per cent standard.

Pension Increases

About 80 per cent of larger defined benefit schemes regularly increase pensions in the course of payment. In recent years, the rate of increase has been reasonably close to the Consumer Price Index. There is no such practice in defined contribution schemes unless a member has decided to use the accumulated fund to take a reduced pension which increases at a fixed rate each year.

Early Leavers

Treatment of early leavers varies considerably. There may be an eligibility period before an employee can join a scheme and a vesting period, of up to five years, during which there is no entitlement to benefit from the employer's contributions on leaving service.

Other Benefits

The Social Welfare system includes a range of benefits payable on death or short and long-term disability. In Second Pillar pension arrangements, benefits on death-in-service are generally provided and many schemes also have provision for pensions to be payable in the event of serious ill-health. About 50 per cent of employees who are in pension arrangements also have separate permanent health insurance cover.

3.4 Personal Sector Savings and Wealth

Estimates made in 1996 of the extent of personal sector savings showed that while pension funds were substantial - then about £19 billion - they were much smaller than the total of personal sector wealth. The value of privately owned housing was estimated to be about £53.6 billion and the total value of residential mortgages was about £9 billion. 1995 data provide an estimate of £22.6 billion as the gross asset value of farms and stock. In addition, there are many other forms of wealth including financial assets such as shares, deposits and the value of businesses¹¹.

However, the distribution of wealth is skewed although there are insufficient data to say precisely how skewed. Accordingly, estimates of aggregate personal sector wealth cannot be used to make judgements regarding the adequacy of retirement provision. It is clear also that many self-employed people view their business or farm assets as an important part of retirement provision. It is less clear whether their view about what constitutes adequate provision is realistic.

1. The Board takes the view that a determination of adequacy of living standards in retirement should be based on a person's total resources, not just the level of formal pension provision. Having said this, the fact remains that the areas where retirement income is likely to be most inadequate are at lower income levels or for those with most fragmented employment histories and these are also likely to be the groups with the lowest level of non-pension assets.

¹¹ See National Pensions Policy Initiative Consultation Document, pp 20/21.

3.5 Replacement Rates in Practice

At retirement, several things change which alter a person's income and standard of living. In some cases, the difference between net take-home pay prior to retirement and the corresponding position afterwards is smaller than expected. This is particularly true for those in the lower income deciles, although even small drops in income at these levels can be serious.

The factors which can contribute to this are as follows:

- progressive nature of income tax rates;
- reduction in PRSI contributions:
- reduction in pension contributions;
- increase in tax free allowances; and
- value of non-cash benefits.

The combined effect of these vary with circumstances. For example, the replacement rates for single people will be less than those for married couples. However, it needs to be borne in mind that this Appendix is based on a person with 30 years service at retirement as a member of an integrated defined benefit scheme with a 1/60th accrual rate. In practice, some will have a higher pension though many will have less as a result of changing jobs.

Research into actual replacement rates experienced at retirement is not available. It would be valuable if it could be combined with an assessment of retirees' other available assets.

2. The Board recommends that consideration be given to an ongoing research programme to ascertain the actual impact of retirement on personal disposable income.

3.6 Market Development of Supplementary Pension Provision

Pension schemes have existed in Ireland for many years but the growth in occupational pension schemes accelerated in earnest after the Finance Act 1972 which set up a clear legal and fiscal framework for them. Coupled with rapid industrialisation, pension provision grew rapidly through the establishment of occupational pension schemes set up under trust. Such schemes ranged from one-member schemes to schemes with up to several thousand members.

By the 1980s, the majority of large indigenous companies had set up occupational pension schemes. These were invariably set up on a defined benefit basis. The vast majority of incoming multinationals established schemes shortly after setting up their operation in Ireland. Up to the mid-1980s, almost without exception, such companies took the lead from their domestic counterparts and set up defined benefit schemes. Increasingly, these employers, many from the United States, brought some new approaches with them and the latter part of the 1980s saw the development of defined contribution schemes for such companies. More recently, the schemes established by incoming multinationals have been established on a defined contribution basis, almost without exception. *Table 3.3*, based on the Board's statistics, illustrates this trend over the last 5 years.

Table 3.3 Number of Occupational Pension Schemes

		e sector schemes* s at 31.12.1992		te sector schemes* as at 31.12.1997
Number of Members	Defined Benefit	Defined Contribution	Defined Benefit	Defined Contribution
1	297	23,962	198	46,763
2 - 50	1,698	4,092	1,467	6,225
51 - 100	234	46	221	90
101 - 500	272	25	294	57
501+	59	0	62	0
Total Schemes	2,560	28,125	2,242	53,135
Total Members	207,545	52,786	212,057	100,551
Average Number of				
Members per Scheme	81	2	95	2

Source: The Pensions Board Annual Reports/data.

Employers saw defined contribution coverage as having some clear advantages - the most obvious being that the liability is limited to the agreed contribution rate. In a defined benefit scheme, the contributions paid are those recommended by the scheme actuary who employs a variety of techniques involving the use of actuarial and other assumptions, relating in particular to the rate of future salary growth and investment return. The extent to which the recommended contribution will prove adequate to meet the liability will depend on the extent to which the assumptions used match up to actual experience. Employers sometimes have had to increase contributions where experience was unfavourable - for example where pensionable salaries (and therefore pension rights) increased faster than anticipated and/or where the investment return was less than was needed to sustain the scheme. On the other hand, a significant number of employers have been able to reduce contributions due to favourable experience. This has been particularly so over recent years where investment returns have been particularly good.

^{*} includes commercial State bodies; excludes additional voluntary contributions and death benefit schemes.

Effectively, under a defined benefit scheme the liability, and hence the cost, is unknown and many employers now setting up occupational pension schemes are reluctant to accept the uncertainty. This uncertainty is particularly relevant to occupational pension schemes with smaller numbers of members because there is naturally a greater risk of the assumptions not materialising. The smaller the membership, the greater the risk. In the extreme, the contributions payable in respect of defined benefits under a one-member scheme will be particularly volatile. Hence, smaller employers have shown an increasing tendency to avoid the defined benefit approach and many moderate-size defined contribution schemes have been set up.

Nevertheless, a significant number of smaller employers had defined benefit schemes prior to the Pensions Act, 1990 (the Pensions Act). The long-term promises implied by defined benefit schemes raised issues for regulators and financial reporting and, in particular, the National Pensions Board noted that many of the small defined benefit schemes operated without adequate actuarial supervision. Furthermore, it was noted that defined benefit schemes were not required to fund to any particular standard - it was thus possible to adopt methods of contribution which in effect minimised costs in the early years but required substantial contributions as the member approached retirement age. If a company is making long-term promises, regulators and shareholders need to be sure that sufficient resources are either explicitly put aside or earmarked to meet the future liabilities. This led to funding standards being introduced following the Pensions Act, and to various new accounting standards. The minimum funding standard, in particular, required the production of a regular actuarial funding certificate to confirm that adequate resources were set aside to ensure that, at a minimum, a specified level of funding of pension promises was in place.

As expected, after introduction of funding standards, many smaller employers who had not adequately recognised the cost of the defined benefit promises to their employees were forced to reassess the extent of this commitment. In reality, many found that the commitment to their employees had all along been to make a certain level of contribution. In other cases the terms of the schemes had to be renegotiated. As will be clear from *Table 3.3*, a number of smaller defined benefit schemes converted to a defined contribution basis although the likelihood is that, even if funding standards had not been introduced, the employers involved would have been forced to reassess their commitment at a subsequent date. There is no evidence that the new regulations had the effect of promoting a switch to a defined contribution basis by properly managed defined benefit schemes.

It is a matter of fact that, at this stage, there are few new defined benefit schemes being set up (except as a result of restructuring schemes which already exist) and this trend has been evident for several years. Almost all new schemes are being set up as defined contribution schemes for the reasons of predictability of cost, fewer regulatory requirements, transparency, and also influenced by the new United States companies locating in Ireland.

There is continuing growth in defined benefit coverage as a result of new employees joining existing schemes. Although there is clearly a continuing risk that some employers might be prompted to change from defined benefit to defined contribution, in practice, apart from the smaller cases already mentioned, such conversion has happened relatively rarely. One reason is that many of the properly managed defined benefit schemes set up in the 70s and 80s have benefited from strong investment markets and are in a position not only to bear the financial demands but also to reduce the employer's contribution. Indeed some have noted that if they had switched to defined contribution, the benefits of the strong investment markets would have accrued to the members. Furthermore, an employer wishing to change to defined contribution has to undertake several steps to make such a switch. Also, the trustees are crucially involved in such switches with responsibility to ensure equity, and there are specific Pensions Act requirements on winding-up which would act as a deterrent to unnecessary scheme closures.

That said, many employees, particularly young employees, see merit in the defined contribution principle. In particular, the value of the benefit they earn is visible in monetary terms and easily understood and is also seen to be more flexible in the context of today's employment patterns. Also, in a period of high investment growth they see that investment gains would be credited to them rather than, as noted above, used to reduce employer costs (under a defined benefit scheme). Furthermore, in the majority of cases the full value of the accumulated fund vests on withdrawal. Even though this may or may not be as good as the benefit which would have vested under a defined benefit scheme, the concept of a readily identified fund being available for transfer is more easily understood than the vesting benefit formulae which must be a feature of defined benefit schemes.

These patterns of changing pension provision have happened in exactly the same way in other countries such as the United States, United Kingdom, Australia and Canada. Even though lower regulatory costs under defined contribution schemes may be offset by higher administrative costs, employers usually prefer the predictability of costs. Younger mobile employees find the defined contribution approach more easily understood and transparent but older employees will express a preference for the defined benefit approach because they will value the certainty of the pension outcome. However, it seems that there has been a lower incidence of actual switches from defined benefit to defined contribution in Ireland than elsewhere. One of the reasons for this lower incidence of switches in Ireland is the regulatory framework which ensures that switches happen only in a controlled way.

The current breakdown of membership of different types of occupational schemes in Ireland can be seen from the Board's data for 1997, which are summarised in *Table 3.4*.

Table 3.4 Number of Members of Occupational Pension Schemes

	Unfunded (Public Sector)	Funded (Privant Commercial Commer		AII Schemes
Scheme Type	Defined Benefit	Defined Benefit	Defined Contribution	
Scheme size	(000s)	(000s)	(000s)	(000s)
More than 50 members	207	188	17	412
50 members or less	0*	24	84	108
Total	207	212	101	520

Source: Pensions Board data for schemes registered as at end 1997.

This gives a clear indication of where defined benefit schemes hold sway and where defined contribution schemes have proved more attractive. The table also shows that 32 per cent of employees in private sector and commercial semi-State occupational pension schemes are in defined contribution arrangements already. In addition, the ESRI Survey 1995 showed approximately 65,000 self-employed people had personal pension plans (i.e. defined contribution coverage) and these are not included in the figures above.

There is other formal pension provision by individuals, either through additional voluntary contributions to their occupational pension schemes or by way of personal pension plans (for the self-employed or those in non-pensionable employment). These have largely been run on defined contribution bases.

With the extension of Social Insurance to virtually all full-time private sector employees in 1974 and the gradual increase in the level of Social Welfare pensions, most employers establishing schemes for the first time decided to take account of the Social Welfare pension payable to a single person from Social Insurance in structuring the scheme pension formula. This practice, referred to as integration, was well established in other countries where higher levels of State pension were payable. Some schemes which had already been established on a non-integrated basis took the opportunity to introduce a Social Welfare offset for new employees joining the scheme. The ESRI Survey 1995 showed that in the private sector approximately 67 per cent of members were in schemes which integrated their pension benefit with the Social Welfare scheme. Since this percentage is based on all schemes, including defined contribution schemes, it can be seen that the vast majority of members of defined benefit schemes in the private sector have their benefits integrated with the Social Welfare scheme. Although defined contribution schemes are generally not directly integrated with Social Welfare pensions, in practice the rate of contribution being paid under defined contribution schemes will usually have regard to the fact that members will have an entitlement to Social Welfare pensions.

^{*} There were less than 1,000 members in such schemes.

3. The Board recognises the different merits of various types of provision and the right of employers and employees to choose and negotiate the best approach to meet their own circumstances.

3.7 **Consumer Protection**

The extent and nature of consumer protection in respect of pension provision varies considerably with the form of provision.

Individuals who have personal pension plans are direct parties to a contract with the life assurer. Their assets are protected by the solvency supervision carried out by the Regulators of Life Assurers under the umbrella of the Regulations¹² implementing the EU Third Life Directive¹³. The conduct of the business, and the sales process in particular, is subject to the regulation of intermediaries, the requirements of the Regulations implementing the EU Third Life Directive, the codes of conduct operated by the life companies, the requirements of the Unfair Contract Terms Regulations¹⁴, the Insurance Ombudsman (whose remit includes personal pension plans), the regulations on cost disclosure currently being prepared and the general body of consumer protection legislation. In short, there is a wide range of measures and clear methods for those wishing to seek redress.

Occupational pension schemes have quite different protection. The trustees are responsible for protecting the rights of members and are expected to take a "prudent man" approach in arranging and operating the various parts of the scheme. On top of that, the Pensions Act imposes several responsibilities on trustees, in particular, disclosure of information, ensuring compliance with funding standards and "whistleblowing" by trustees or their professional advisers in the event of suspicion of irregularities. Members may also have the benefit of the supervision of solvency of life assurers and regulation of intermediaries if this is appropriate to the way the trustees have arranged the running of the scheme.

Apart from the protections which are embodied in the Pensions Act and monitored by the Board, the individual member of an occupational pension scheme does not have any direct access to consumer protection and many measures applicable to personal pension plans are not available to trustees. The only recourse the individual has is to sue the trustees. Clearly this is extremely unlikely to arise where the trustees carry out their duties with due care, as would be the norm with trustees who are individuals or corporate bodies with appropriate experience.

There could be a gap in small schemes where the employer acts as sole trustee and has neither the resources nor experience to assess the quality of advice it gets. It would be possible for a defined contribution scheme to be set up which bears very high charges or has an unsuitable investment approach, the effects of which are borne entirely by the member. The Board does not view this as a situation which is likely to give rise to problems in many cases, but it recognises that it must ensure there are meaningful ways of dealing with problems in the occasional bad case. It should also be said that the number of problem cases which have come to the attention of the Board to date is small.

European Communities (Life Assurance) Framework Regulations, 1994, S.I. No. 360 of 1994.

Council Directive 92/96/EEC of 10 November 1992 on the Co-ordination of Laws, Regulations and Administrative Provisions relating to Direct Life Assurance and amending

Directives 79/267/EEC and 90/619/EEC. EU (Unfair Terms in Consumer Contracts) Regulations, 1995, S.I. No. 27 of 1995.

3.8 Financial, Operational and Market Issues Highlighted in the Consultative Phase

The Consultation Document¹⁵ outlined some practical issues and difficulties associated with pension provision. A number of key issues and questions were posed.

In the submissions received in response, many commented on the importance of achieving adequacy of First Pillar benefits and the need to ensure that they retained their real value measured against prices or, frequently, general earnings levels. Furthermore, addressing First Pillar benefit levels is seen to be the simplest way of ensuring improvements of living standards in retirement across the whole of society.

In terms of Second Pillar provision, the submissions received highlighted several issues as being of particular significance, including:

- inflexibility of the tax and legal system to recognise such matters as frequent job changing;
- the difficulty of transferring benefit entitlements between employment, self-employment and unemployment;
- the risk that, for a given capital amount saved, the value of an annuity purchased on retirement may be subject to significant variations including unexpected falls in annuity rates;
- jargon and difficulty in understanding the operation of pension products;
- the need for a wider choice of suppliers;
- flexibility in when and how to take benefits;
- exclusion of groups such as the voluntary sector, long-term unemployed, those doing unpaid work;
- some distrust of financial institutions and intermediaries:
- high cost levels; and
- the requirement that employers meet at least one-sixth of the cost of benefits for scheme members.

These issues were raised in submissions from both individuals and organisations. While their substantive basis may vary from case to case, the fact that these issues are seen as problematic is itself important. They were validated by the findings of market research commissioned by the IAPF which found that the most common reasons for not having supplementary provision are as shown in *Table 3.5*.

¹⁵ National Pensions Policy Initiative Consultation Document, February 1997.

Table 3.5 Summary of Market Research Findings into the Reasons for Non-coverage (Percentages of sample)

I can't afford a pension scheme at the moment The charges involved in organising a pension are too high I don't really understand pensions I will have saved enough over the years for my retirement I am too young to worry about a pension The company I work for does not have a scheme I have only been working for a few years	0.4
The charges involved in organising a pension are too high I don't really understand pensions I will have saved enough over the years for my retirement I am too young to worry about a pension The company I work for does not have a scheme I have only been working for a few years	%
I don't really understand pensions I will have saved enough over the years for my retirement I am too young to worry about a pension The company I work for does not have a scheme I have only been working for a few years 64 64 64 64 64 64 64 64 64 6	75
I will have saved enough over the years for my retirement I am too young to worry about a pension The company I work for does not have a scheme I have only been working for a few years 549	64
I am too young to worry about a pension 53 The company I work for does not have a scheme 52 I have only been working for a few years 49	64
The company I work for does not have a scheme 52 I have only been working for a few years 49	54
I have only been working for a few years 49	53
	52
The Chate manager will be adequate amount for man	49
The State pension will be adequate enough for me 48	48
I won't be able to get at the money in a pension scheme if I need it	47
Source: Submission of the IAPF to the Pensions Board; findings relate to 1997.	

The results varied by sector - in particular, 65 per cent of employees without cover quoted the fact that their employer simply did not have a scheme. By contrast, the ESRI Survey 1995 found that 61 per cent of firms not providing a scheme indicated that there was no demand from employees for a scheme.

A number of aspects were raised specifically relating to the difficulties women have in pension provision. These referred particularly to the varied and broken work patterns women often have, caused by rearing children, caring for relatives and other unpaid or voluntary work. As a result, paid employment is often relatively atypical or short-term in nature and frequently in sectors where lower pay or a low incidence of pension coverage is the norm. The need for individual benefits rather than benefits arising from a dependency position was also highlighted as was the fact that many women outlive their partners but find that occupational pensions may be reduced substantially or even cease when they are widowed.

Most submissions felt that the appropriate way forward was to improve both the First and Second Pillars of the current pension system and there was a lot of attention given to simplification and the benefits that could flow from it. There was no appetite for radical overhaul of the whole system as in some other countries but considerable improvements were believed to be achievable by building on what already exists. The vast majority of respondents favoured a voluntary approach to pension coverage although many felt that if improvements did not deliver the higher coverage sought, a mandatory approach would be appropriate.

Several submissions focused on specific problems of individual circumstances or specific pension schemes including:

- qualification rules for PRSI benefits, especially for older self-employed people. This is a wide-ranging
 issue covering far more than just pension entitlements and is kept under review by the Department of
 Social, Community and Family Affairs;
- taxation and levies applicable to pensioners. The situation of older people was specifically mentioned in the 1998 Budget and is likely to continue to be considered in the Budget process;

- levels of benefit in some public sector schemes, particularly for lower-paid workers and those with broken service histories. The whole area of public service pensions is currently being reviewed by the Commission on Public Service Pensions, due to report later in 1998;
- problems arising from integration, mainly at the point of retirement when people find that the benefits from their occupational pension scheme are a good deal lower than they expected. This has been given specific attention in this Report;
- difficulty in a few specific schemes, especially older schemes in companies which went through significant restructuring. In the specific cases raised, while there may have been no breaches of law, there are clear differences of opinion about the relative priorities to be given to different groups, what level of benefits might be payable over and above strict legal entitlement, degree of financial disclosure and procedures for changes in scheme rules. Recommendations in this Report will help with some of the problems but most fall outside the remit of the current Initiative and will be borne in mind by the Board in planning its future work;
- the apparent shortfall, despite the Pensions Act, of consumer protection as instanced in cases such
 as in the preceding point, or the lack of a Pensions Ombudsman. The Board plans to report to the
 Minister for Social, Community and Family Affairs on the question of a Pensions Ombudsman later
 in 1998;
- ownership of scheme surplus. The Board is currently considering issues about surplus and will be making a report on this to the Minister for Social, Community and Family Affairs later in 1998; and
- the competitiveness of the pensions industry. The recommendations in this Report should help in many ways to provide better choice and value for money.

Many of these issues are clearly outside the scope of the Initiative but they are being, or have been, considered by the Board.

A summary of the submissions and of the responses to the key issues raised in the Consultation Document are given in Appendix A.

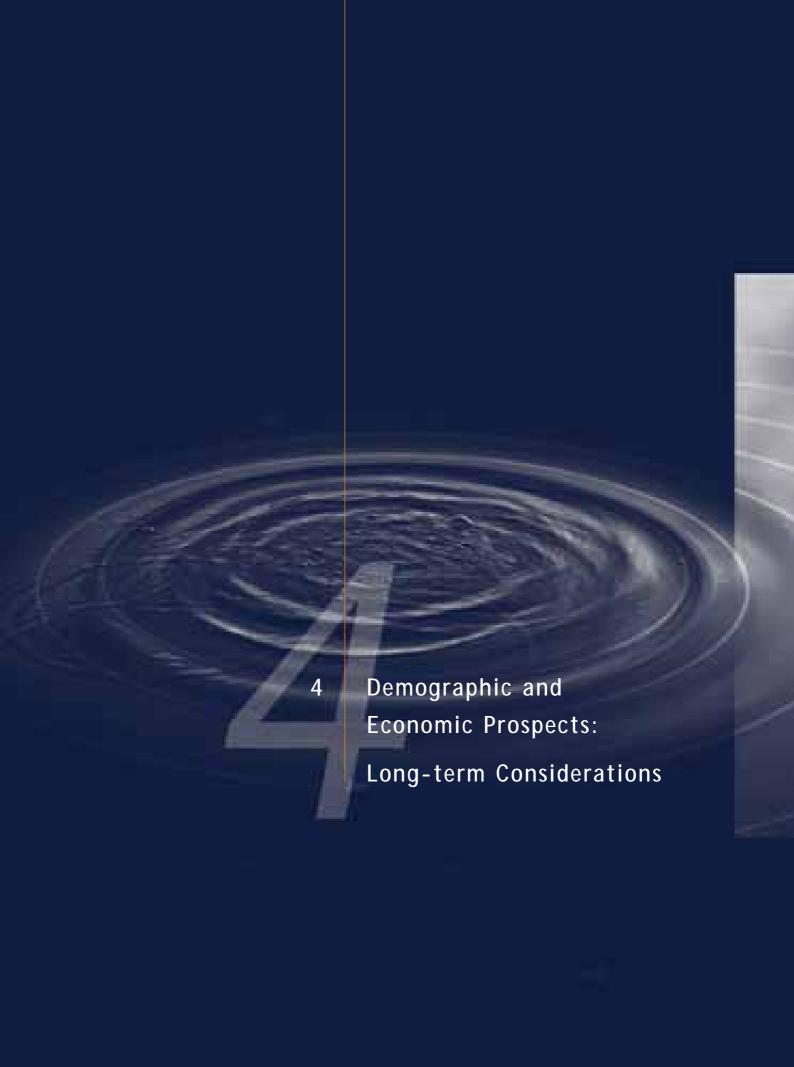
3.9 Summary of Issues

The issues of coverage revolve around questions as to whether the level of the existing Social Welfare pension is adequate. It is clear that, while many people can look forward to substantial occupational or personal pensions over the Social Welfare levels, there is a significant proportion of the workforce and their dependants who cannot. As noted previously, the ESRI Survey 1995 shows that over half the workforce have no occupational or personal pension cover. There are substantial obstacles in extending coverage to the lowest covered sectors - the small employers, atypical workers and certain industries characterised by lower pay levels or mobile workers.

The major issues to be dealt with can be summarised as being to:

- establish the appropriate level for Social Welfare pensions, balancing the need for adequate incomes for all with the associated effect on employment costs and/or taxation;
- raise people's awareness of their need for adequate retirement incomes and the necessity to plan for it;
- enable people to understand the options open to them so that decision-making can be simpler and made with confidence;
- modernise supplementary provision to be better suited to present and anticipated employment patterns;
- fill any gaps which may exist in the statutory protection of members of various types of pension arrangements either within or outside the existing remit of the Pensions Act and the Board;
- simplify the operation of supplementary provision for both employers and workers;
- widen access to supplementary provision;
- underpin trust and confidence in the whole pension system;
- facilitate greater choice and competition; and
- identify and remedy any shortfall in consumer protection which arises, notwithstanding the protections in existing legislation including the Pensions Act.

These different goals need to be addressed in ways which are practical and sustainable and ensure that the considerable amount of existing good coverage is not undermined in any way.



4 Demographic and Economic Prospects: Long-term Considerations

4.1 Introduction

The evolution of the population and its age structure are key issues in the planning of pension provision. Economic trends such as the growth of output and of employment also have a very important bearing on this issue. Before considering the Irish situation in detail, a summary of some international trends is presented.

4.2 Population and Labour Force Trends: International Context

The population of the world's advanced economies is already relatively elderly but is still ageing rapidly. This may be illustrated by a variety of statistics relating to the period to 2025¹:

- the *median age* of the European Union's population increased by only four years (from 32 to 36) between 1960 and 1995. It will increase by 9 years, from 36 to 45, between now and the year 2025;
- the number of *young people* (aged under 20) in the Union will fall by almost 10 million equivalent to a drop of 11 per cent;
- the number of adults of working age will also decline by over 13 million people or 6.4 per cent;
- the number of retired people will rise by over 37 million or almost 50 per cent;
- with life expectancy at birth for women already over 80 years in several countries, the prospect is that
 the number over this age will grow very rapidly in absolute numbers and as a proportion of its total
 population;
- the elderly dependency ratio (that is the ratio of those aged 65 and over to the population aged between 20 and 64) will continue to rise. In France, Germany, the United Kingdom and Italy, this ratio is already over 20 per cent. By the year 2020 it is projected to be over 30 per cent in most European countries and by 2030 it will average 40 per cent in the European countries of the OECD. Elderly dependency ratios of this magnitude have never previously been attained in human history. In Ireland, on the other hand, the OECD projects a ratio of 25.3 per cent by 2030. (It might be noted that the conventional ratios of 65 and over to 15 or 20 to 64 do not reflect the incidence in many countries of deferred entry to the labour force due to further education or its earlier leaving due to early retirement);
- the population of working age will not only contract relative to the elderly population but it will itself
 also become more elderly, due to a significant rise in the proportion of the labour force that is aged
 over 40; and
- on the assumptions of unchanged employment/population ratios in each age group, the employment dependency ratio (the ratio of the non-employed to employed population) will rise in line with the rising elderly dependency ratio.

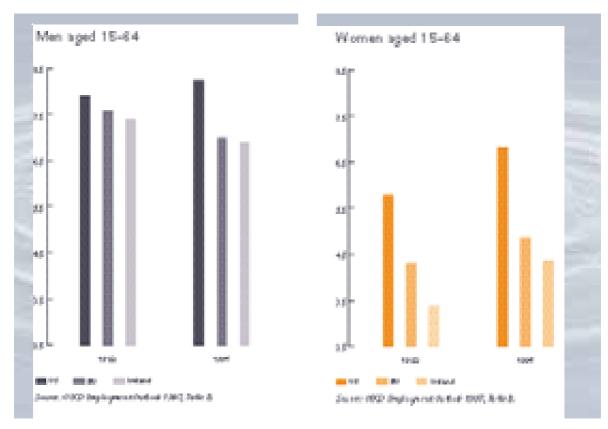
These statistics are taken from European Commission, The Demographic Situation in the European Union, Brussels, 1996; Rosevare, Leibfritz, Fore and Wurzel, "Ageing populations, pension systems and government budgets: How do they affect saving?" and "Ageing populations, pension systems and government budgets: Simulations for 20 OECD countries," Paris: OECD, Economics Department Working Papers No. 156 (1995) and 168 (1996). The Irish projections used in these reports have since been updated by the Central Statistics Office's projections quoted later in this Chapter.

The broad picture of the future depicted by these projections is generally accepted. It is not sensitive to variations in the underlying demographic assumptions such as future mortality or fertility rates, provided these are kept within realistic ranges. Although the timing, the exact magnitudes, and the regional patterns are uncertain, it can be accepted with a high degree of confidence that the general demographic patterns summarised above will materialise.

However, projecting the structure of the population and labour force is not a mechanical exercise. It is important to recognise the scope for feedback from changing patterns to the underlying determinants. In the context of the scenario outlined above, the most important potential feedbacks to consider are:

- falling unemployment. The unemployment rate in the EU at present stands close to 12 per cent. Youth unemployment rates well above 20 per cent have been recorded in several countries. The demographic scenario outlined above implies a growing scarcity of young people young adults in particular and growing requirements for workers in labour intensive service sectors (such as the health care sector, care of the elderly, etc.). A favourable implication of the ageing of the population is the opportunity it offers to reduce unemployment and youth unemployment in particular. However, this opportunity will not materialise automatically. To translate a scarcity of young people into lower youth unemployment will require increased labour market flexibility. Moreover, since health care and care of the elderly are largely financed by the public sector in the countries of Europe, the creation of employment in these areas also has implications for public sector spending;
- rising labour force participation. The adverse implications of shifts in the balance of the population towards the older age groups could also be offset partially by increases in labour force participation rates. Male labour force participation rates, in particular, have declined markedly throughout Europe as earlier retirement has become more common and young adults stay on longer in the educational system. The growing scarcity of younger workers will alter the labour market incentives to take up employment. For example, low youth unemployment rates and higher entry-level wage rates would be expected to lead to a drop in educational participation rates. Similarly, retirement rates could also fall as job opportunities for older people become relatively more abundant and better paid, but the response of the older age groups will depend very much on the nature of pension provision. While women's labour force participation rates have been rising, especially among those aged 25-44, there is scope for further increases in participation rates among younger and older women; and
- the employment/population ratio (the ratio of the number at work to the total population in the
 relevant age group) takes account of both unemployment and non-participation in the labour force.
 Chart 4.1 shows how these ratios have developed among two key population groups in Europe,
 Ireland and the United States, over the past 15 years. The scope for increases in Europe and Ireland
 is evident;





increased immigration. The EU adjoins countries to the south and east with large populations who could
avail of the economic opportunities offered by the economies of the member states. As the population
of Europe continues to age, and the imbalances between active and retired population become more
accentuated, the attraction of immigration to young non-Europeans will increase. As immigrants tend
to be concentrated in the young adult age groups, a significant inflow would alleviate the projected
imbalances in Europe's population over the medium-term.

How likely is it that these adjustments will have a significant effect on the conventional scenario of a rapidly ageing population outlined above? It is impossible to give a precise answer to this question. The importance of the possible adjustments will vary greatly between member states, depending on the starting point (in terms of labour force participation rates, age at retirement, stock and age of immigrants, etc.). However, it should not be ignored that in some countries their combined impact could alter the scenario substantially from that sketched out on the basis of projections that make no allowance for this type of factor.

4.3 Projections of the Irish Population and Labour Force

An Expert Group convened by the Central Statistics Office prepared a set of population and labour force projections covering the period 1996-2026². The availability of these recently published projections is of great value in the context of examining the prospects for pension provision in Ireland.

2 Central Statistics Office, Population and Labour Force Projections 1996-2026, The Stationery Office, Dublin, April 1995.

The central projection shows that elderly dependency will decline slightly between 1991 and 2006, and then rise rapidly. The projected elderly dependency ratio (defined in these projections as the ratio of the population aged 65 and over to the population aged 15-64) in 2026 ranges from 26.3 to 29.0 per cent, compared with the actual ratios of 18.5 per cent in 1991 and 17.6 per cent in 1996. The key feature of this projection is that Ireland is starting from a relatively low elderly dependency ratio and, unlike almost all other OECD countries, does not face the immediate prospect that this ratio will rise. All available projections indicate that Ireland's elderly dependency ratio will fall slightly over the next ten years, and rise rapidly in subsequent years. Not until the second decade of the next century will the level of dependency in this country reach the level currently obtaining in several European countries, including the United Kingdom, Norway, Sweden, Italy, Germany and France³.

By the middle of the next century, the elderly dependency ratios in Ireland will have risen quite sharply and are quite likely to have largely caught up with those in other developed economies, although there will still be differences arising from different mortality rates and labour force participation rates. The overall dependency ratio (the ratio of those aged over 65 and those aged below 20 to the population between ages 20 and 64) will also rise but much less dramatically. These are seen from the following data derived from the Actuarial Review. In this Review, the elderly dependency ratio is defined as the ratio of those aged 65 and over to those between ages 20 and 64.

Table 4.1 Ratio of those in Dependency Ages to Working Age (20 to 64)

	1996	2006	2016	2026	2036	2046	2056	
Elderly dependency ratio (%) Overall dependency ratio (%)	20.6 80.1	19.7 67.0	24.8 70.7	32.6 75.4	40.1 79.9	49.2 90.5	53.3 95.2	
Source: data from Actuarial Review, Table 4 (i).								

4. The Board notes the important conclusion that Ireland alone has the opportunity of preparing for a high level of elderly dependency over a period of relatively low dependency. The opportunity presented by this relatively favourable demographic backdrop will be enlarged if the recent buoyant economic performance is sustained.

Projections of Ireland's elderly dependency ratio are sensitive to variations in the assumptions concerning fertility and mortality. The assumptions regarding net migration have a greater impact – emigration raises the elderly dependency ratio. All of the Central Statistics Office's projections incorporated significant net emigration over the years 1991-2006. These assumptions have already proved too pessimistic for the period since 1991.

³ A qualification to this projection needs to be made for the fact that it assumes unchanged labour force participation rates. In the future, changes in this or in the age of retirement would have to have an influence on the projected pattern of elderly dependency.

Projections of the labour force involve additional assumptions relating to labour force participation rates. This magnifies the uncertainty attached to the results. Participation in the labour force is determined by economic and other social circumstances. It is difficult to decide on appropriate assumptions for this variable over a period when the age structure of the population is changing radically. It is not known how Irish people will respond to the dearth of young workers and rising proportion of elderly people which is in prospect by the middle of the next century. It is certainly plausible to anticipate some increases in participation rates as a response to the changing labour market situation. This view is supported by the data displayed in *Chart 4.1*, on employment/population ratios.

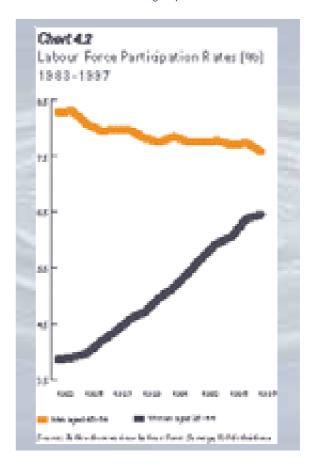
The most striking change in labour force participation is the rapid growth in the numbers of women at work. The Labour Force Surveys show that between 1983 and 1997 female participation rates have increased from 41 per cent to 69 per cent for ages 25-34 and from 26 per cent to 52 per cent for ages 35-44 with lower increases at older ages⁴. However, these are still low by international standards and the increases are likely to continue, working their way through in time to increased participation rates at older ages.

Whilst the number of women at work has increased rapidly, the number of employed men has grown only slowly. There has been a fall in male labour force participation rates particularly amongst older men in the last 15 years. These contrasting trends are illustrated in *Chart 4.2* for the two groups most affected.

The difficulties inherent in projecting the labour force are illustrated by considering the projections of the Irish labour force prepared by the Expert Group on the basis of the information available in 1995. The labour force was projected to grow by 1.3 per cent a year between 1991 and 1996, but the actual growth rate was 1.9 per cent a year. Moreover, employment has increased more rapidly than the labour force – by 2.5 per cent a year over the period 1991-1996. The rate of growth of employment has been even faster since 1996.

4.4 Implications for the Funding of Pensions: The International Context

The demographic developments outlined above, combined with the fact that most western countries have relied on "pay-as-you-go" funding of State provided pensions, has led to widespread fears of a looming crisis in public pension systems. Moreover, the adverse implications for the public finances are



heightened by the consideration that most European countries rely primarily on publicly provided pensions to provide for their populations in their retirement and old age.

⁴ See National Pensions Policy Initiative Consultation Document Table 11, Page 69 and Labour Force Survey 1997, Table 11B.

The deteriorating demographic situation outlined above has focused widespread attention and concern on its implications for pension systems. Much of this attention has been confined to implications for publicly financed systems and Government budgets⁵.

The OECD studies provide a comprehensive set of simulations showing the impact on pension contributions and payments of five different scenarios, namely:

- the baseline scenario: data from national sources were used to model the implications of maintaining existing contribution and entitlement structures;
- a later retirement scenario: under this scenario the age of entitlement to benefit rises gradually to 70 years, and additional paid contributions occur up to this age;
- a cost-containment scenario: under this scenario total pension expenditure was limited to the rate
 of growth of GDP after 2015. This implies across-the-board cuts in benefit levels and modified
 indexation:
- a targeting scenario: this scenario assumes that from 2010 onwards, replacement ratios are
 held constant but the proportion of the elderly population that obtains a pension gradually falls
 to 30 per cent. In other words, public pensions become limited to those on lower incomes, with
 others having to rely on private provision (Second Pillar); and
- a wage indexation scenario: this contrasts with the previous scenario by assuming that all pensions are wage-indexed. Under existing public pension rules in most OECD countries, benefits are adjusted only for price increases during retirement.

It should be noted that the OECD analysis, in relation to public pension provision, included First Pillar pensions and public sector Second Pillar pensions, both being on a pay-as-you-go basis.

The study evaluated these alternatives in several different ways. The simplest consisted in a projection of contributions and payments as a percentage of GDP. It is worth quoting the authors' conclusions at some length:

"Three key features emerge.

- First, there is a marked difference in the magnitude of public pension payments. In the United
 States, the United Kingdom, Canada, Australia, Iceland and Ireland, pension expenditure peaks at
 less than 10 per cent of GDP, whereas pension expenditure is much higher in most other countries,
 with Germany, Italy, Austria, Belgium, Finland, Portugal, Spain and Sweden all peaking at more than
 15 per cent of GDP. These differences reflect both the relative generosity of pensions and differences
 in elderly dependency ratios;
- Second, in most countries, pension payments continue to rise until the baby-boom generation
 has passed (around 2030-2050) and then stay high in the second half of the period covered by
 the scenario. In contrast, in Japan, Germany, Italy, Canada, the Netherlands and Spain, expenditures
 peak and then fall after the baby-boom generation passes; and

In addition to the OECD studies cited in footnote 1, the following reviews may be mentioned: World Bank, Averting the Old Age Crises: Policies to Protect the Old and Promote Growth, Oxford University Press, New York, 1994: D. France and T. Munzi, "Public pension expenditure prospects in the European Union: A survey of national projections," European Economy, No. 3 1996.

 Third, for those countries with contributory pension schemes, the gap between contributions and pension payments is much larger in Japan, Germany, Austria, Belgium, Norway and Sweden than in the other countries.
 [OECD, 1996, op. cit]"

Table 4.2 summarises the findings for Germany, Ireland and the United Kingdom. (Data for 20 OECD countries are contained in the original study).

The study brings out the problem facing public pension systems in countries such as Japan, France, Italy, Austria, Belgium, Denmark, Finland, the Netherlands, Portugal, Spain and Sweden - in all of which the baseline scenario reveals expenditure on pensions rising to over 10 per cent of GDP by the middle of the next century. These simulations also reveal how large an impact alternative policies would have on public pension expenditure. Wage indexation would add about 3 per cent of GDP to the pensions bill, while on the other hand postponing entitlement to pension would reduce expenditure by about one percent of GDP relative to the baseline projection.

Table 4.2 Expenditure on First Pillar and Public Sector (Second Pillar) Pensions under Various Scenarios (as per cent of GDP in 1994 prices)

Country	Scenario	1995	2000	2010	2020	2030	2040	2050	2060
Germany	Baseline	11.1	11.5	11.8	12.3	16.5	18.4	17.5	16.5
	Cost containment	11.1	11.5	11.8	12.0	12.0	12.0	12.0	12.0
	Wage indexation	11.1	11.5	11.8	12.3	16.5	18.4	17.5	16.5
	Later retirement	11.1	11.5	10.7	9.0	10.6	12.6	12.8	12.3
	Targeting	11.1	11.5	11.8	8.8	7.8	8.8	8.3	7.8
Ireland	Baseline	3.6	2.9	2.6	2.7	2.8	2.9	3.0	2.6
	Cost containment	3.6	2.9	2.6	2.7	2.7	2.7	2.7	2.7
	Wage indexation	3.6	2.9	3.0	3.7	4.2	5.2	6.2	6.2
	Later retirement	3.6	2.9	2.1	1.8	1.8	1.9	2.0	1.8
	Targeting	3.6	2.9	2.6	2.0	1.1	1.4	1.7	1.7
United	Baseline	4.5	4.5	5.2	5.1	5.5	5.0	4.1	3.6
Kingdom	Cost containment	4.5	4.5	5.2	5.3	5.3	5.3	5.3	5.3
	Wage indexation	4.5	4.5	5.9	6.2	7.8	8.5	8.3	8.4
	Later retirement	4.5	4.5	4.3	3.7	3.4	3.3	2.9	2.5
	Targeting	4.5	4.5	5.2	3.2	1.9	2.0	2.0	2.0

A more complete picture is obtained by looking at the net present value of the projected pensions contributions, payments and net balance (as a percentage of 1994 GDP) under the five alternative scenarios. These data are shown in *Table 4.3*.

This exercise brings out the stark fact that, for all 20 countries studied, the baseline scenario throws up future financing problems: on present (real) contribution and payment rates, the public pension systems have an excess of the value of future benefits over the value of future contributions (at their present level). The size of the excess varies from 17.8 per cent of 1994 GDP in the case of Ireland to figures of over 150 per cent in Belgium. Apart from the United Kingdom and United States both with 23 per cent, most other countries have excesses of between 50 per cent and 120 per cent of GDP. A policy of indexing pensions to wages would raise this excess to 55.8 per cent of GDP for Ireland.

While the Irish system does have a deficit on this presentation, it is the most favourably placed of the 20 systems for which these calculations were performed. Furthermore, the fact that both benefits and contributions are lower than in most other countries examined means that the Irish Government should have fewer economic or political constraints than other governments in deciding how to manage pension costs in future.

Table 4.3 Net Present Value of First Pillar and Public Sector (Second Pillar) Pension Contributions, Payments and Balance (as per cent of 1994 GDP)

ountry	Scenario	Contributions	Payments	Balance
Germany	Baseline	286.3	347.9	-61.6
	Cost containment	286.3	313.2	-26.9
	Wage indexation	286.3	347.9	-61.6
	Later retirement	301.1	308.7	-7.6
	Targeting	286.3	274.6	11.7
reland	Baseline	89.2	107.0	-17.8
	Cost containment	89.2	105.7	-16.5
	Wage indexation	89.2	145.0	-55.8
	Later retirement	93.4	89.5	4.0
	Targeting	89.2	85.5	3.7
nited Kingdom	Baseline	118.2	142.0	-23.8
	Cost containment	118.2	147.1	-28.9
	Wage indexation	118.2	180.8	-62.6
	Later retirement	124.1	121.5	2.6
	Targeting	118.2	109.5	8.7
se: OECD, loc. cit.				

The inclusion of Ireland in the OECD study summarised above provides a benchmark for international comparison of the prospects facing the public pension system in this country. The relatively favourable position of Ireland emerges very clearly. This reflects three principal facts:

- the Irish public (First Pillar) pension system is at present relatively limited, in terms of replacement ratios;
- the demographic situation in Ireland is expected to evolve more favourably than that in other countries during the early decades of the coming century; and
- there is in Ireland a well-developed funded occupational pension scheme sector.

It might, at the same time, be noted that many European countries have been experiencing difficulties in sustaining their public pension systems and have been implementing cost containment measures including, in some cases, moves to curtail traditionally high benefit levels. Other countries (e.g. United States) have had the advantage of buoyant economic growth.

4.5 Actuarial Review of Irish Social Welfare Pension System (First Pillar)

4.5.1 Conclusions

The Actuarial Review was published in September 1997. The most important conclusions contained in this Review are:

- the proportion of those over 65 relative to those of working age⁶ will initially reduce slightly and then increase steadily to the end of the projection period (1996 2056);
- if pensions are indexed to prices, spending on the Social Welfare pension system will fall relative to GNP, from 4.8 per cent in 1996 to 2.6 per cent in 2056;
- if pensions are indexed to wages, spending on the Social Welfare pension system will rise relative to GNP, from 4.8 per cent in 1996 to 8.0 per cent in 2056; and
- if the Exchequer subvention to the Social Welfare pension system is frozen at its present level of 5 per cent of total contributions, contribution rates would have to increase by 19 per cent if pensions were indexed to prices, or by 227 per cent if pensions were indexed to wages.

⁶ The Actuarial Review takes "working age" as 20 to 64 rather than the 15 to 64 generally used in international comparisons.

4.5.2 Assumptions

These conclusions derive from the assumptions used in the Actuarial Review. The core assumptions are:

- real GNP will grow at an annual average rate of 5 per cent between 1996 and 2006, falling to 3 per cent over the following ten years and finally to 2 per cent between 2016 and 2056;
- unemployment will fall to 6 per cent (on International Labour Organisation definitions) by 2007
 and stabilise at that rate:
- net migration will be zero after 1996; and
- the labour force will grow in line with the Central Statistics Office's projections. In particular, this assumes continuing large increases over the period to 2006 in participation rates for married females especially those aged up to 40.

4.5.3 Updating of Projections

Since publication of the Actuarial Review, the Department of Finance has produced a revised estimate for GNP for 1998 of £44.3 billion. The Board has adopted this revised estimate together with the original GNP growth rates from the Actuarial Review, as the basis for tables and charts in the remainder of this Report.

Table 4.4 summarises:

- (i) the position outlined in the Actuarial Review (£78 per week from 1997);
- (ii) the post-Budget 1998 position (£83 per week from 1998); and
- (iii) the Government's commitment in the "Action Programme for the Millennium" to the achievement of an Old Age pension rate of £100 per week by 2002. This is then used as the benchmark projection in future analyses in this Report.

Table 4.4 Updating of Costs in 1998 Constant Price Terms

Year		ıl Social We Payments* f		Tot	al Outgoin As % GNP		
	Actuarial [†] Review	Post 1998 Budget	£100 p.w. in 2002	Actuarial*** Review	Post 1998 Budget	£100 p.w. in 2002	
Payment Rates incr		prices					
1996	1,707	-	-	4.8 (4.8)	-	-	
1998	-	1,902	1,902	-	4.5	4.5	
2001	1,872	1,977	2,140	3.8 (4.2)	4.0	4.4	
2002	-	2,006	2,231	-	3.9	4.3	
2006	2,003	2,115	2,350	3.2 (3.5)	3.4	3.8	
2011	2,224	2,351	2,611	3.1 (3.4)	3.3	3.6	
2016	2,545	2,692	2,989	3.1 (3.3)	3.2	3.6	
2026	3,152	3,339	3,705	3.1 (3.4)	3.3	3.6	
2036	3,738	3,963	4,395	3.0 (3.3)	3.2	3.5	
2046	4,283	4,548	5,040	2.9 (3.1)	3.0	3.3	
2056	4,328	4,601	5,095	2.4 (2.6)	2.6	2.8	
Payment Rates incr		n average ea	rnings				
1996	1,707	-	-	4.8 (4.8)	_	-	
1998	-	1,902	1,902	-	4.5	4.5	
2001	2,026	2,097	2,146	4.1 (4.5)	4.3	4.4	
2002	-	2,170	2,237	-	4.2	4.3	
2006	2,394	2,476	2,552	3.8 (4.2)	3.9	4.1	
2011	2,934	3,038	3,129	4.0 (4.4)	4.2	4.3	
2016	3,708	3,840	3,954	4.4 (4.8)	4.5	4.7	
2026	5,597	5,802	5,973	5.4 (5.9)	5.6	5.7	
2036	8,091	8,392	8,637	6.4 (6.9)	6.6	6.8	
2046	11,302	11,732	12,073	7.3 (7.9)	7.5	7.8	
2056	13,920	14,457	14,872	7.4 (8.0)	7.6	7.9	

^{*} In line with the Actuarial Review (Page 1), this covers Old Age Contributory and Non-Contributory, Retirement, Invalidity, Widow's/Widower's Contributory and Non-Contributory Pensions and the cost of the Free Schemes.

^{**} Total Payments and Administrative Expenses.

^{***}Figures in brackets show the corresponding figures published in the Actuarial Review i.e. based on the GNP estimates in the Review.

[†] Figures are in 1997 constant price terms.

4.5.4 Sensitivities

Sensitivity analysis, undertaken in the Actuarial Review and subsequent to its publication, provides estimates of the impact of variations in the assumptions contained in respect of:

- migration; and
- economic growth.

Table 4.5 Illustration of the Sensitivity of Migration Assumption

4.5.5 Migration

The core projection in the Actuarial Review is based on the assumption of zero net emigration. However, it must be borne in mind that, at present, there is net immigration and this trend could become more significant as the effects of declining numbers of Irish school leavers are felt on the labour market. Table 4.5 shows the effect of assuming net inward migration of 10,000 per year up to 2056. For illustrative purposes, this is based on a payment rate of £100 per week in 2002 and prices/earnings indexation thereafter. Overall, it can be seen that this change has little, if any, overall effect until after 2016, when the situation deteriorates compared with the core projection of zero migration.

Total Outgoings* as	Percentage of GNP	
Year	Zero Net Migration per year	10,000 Net Inward Migration per year
Payment Rate of £1	00 p.w. in 2002 and	Price Indexation Thereafter
1998	4.5	4.5
2002	4.3	4.3
2006	3.8	3.8
2011	3.6	3.6
2016	3.6	3.6
2026	3.6	3.7
2036	3.5	3.7
2046	3.3	3.5
2056	2.8	3.0
Payment Rate of £10	00 p.w. in 2002 and E	Earnings Indexation Thereafter
1998	4.5	4.5
2002	4.3	4.3
2006	4.1	4.1
2011	4.3	4.3
2016	4.7	4.7
2026	5.7	5.9
2036	6.8	7.0
2046	7.8	8.2
2056	7.9	8.4
* Total Payments and Adi	ministrative Expenses.	

4.5.6 Economic Growth

The Actuarial Review's core assumption regarding the growth of GNP implies an annual average growth rate of 3.4 per cent over the thirty five year period 1996-2031. This is somewhat lower than the average rate of growth recorded over the period 1961-1996 (4 per cent) and only two thirds the growth rate recorded over the period 1991-1996. While the current growth rate may not be sustained, there are no immediate signs of a slowdown. Even the difference between the 4 per cent annual growth rate of GNP over the last thirty five years and the 3.4 per cent growth rate assumed in the Actuarial Review for the coming thirty five year period cumulates to a 23 per cent difference in the ultimate level of GNP. Accordingly, small changes in the growth rate can result in significant differences in pensions expenditure, when expressed as a percentage of GNP.

The growth in the proportion of expenditure on pension payments and issues relating to the affordability of this expenditure are very sensitive to the projected level of growth in the economy, as indicated in *Table 4.6.*

Total pension outgoings are expressed as a percentage of GNP based on:

- (i) the core assumption;
- (ii) core + 1 per cent per annum;
- (iii) core -1 per cent per annum.

For illustrative purposes, the pension outgoings are based on achieving the Government commitment of £100 per week by 2002 and price or earnings indexation thereafter.

Table 4.6 Illustration of the Sensitivity of Growth (GNP) Assumptions

Payment Rate of s	£100 p.w. in 2002 - 1998	Constant Price Terms			
	Total Pension Payments	Additional Contribution Required	Total O	utgoings as Perce	ntage of GNP
Year	£ million	£ million	Core	Core +1%	Core -1%
Payment Rates inc	crease in line with prices				
1998	1,902	759	4.5	4.5	4.5
2002	2,231	911	4.3	4.2	4.5
2006	2,350	794	3.8	3.5	4.1
2011	2,611	855	3.6	3.2	4.1
2016	2,989	1,061	3.6	3.0	4.2
2026	3,705	1,384	3.6	2.8	4.8
2036	4,395	1,615	3.5	2.4	5.1
2046	5,040	1,916	3.3	2.1	5.4
2056	5,095	1,625	2.8	1.6	5.0
Payment Rates inc	crease in line with average	e earnings			
1998	1,902	759	4.5	4.5	4.5
2002	2,237	917	4.3	4.2	4.5
2006	2,552	996	4.1	3.8	4.4
2011	3,129	1,373	4.3	3.8	4.9
2016	3,954	2,026	4.7	3.9	5.5
2026	5,973	3,652	5.7	4.4	7.5
2036	8,637	5,857	6.8	4.7	9.8
2046	12,073	8,949	7.8	4.9	12.4
2056	14,872	11,402	7.9	4.5	13.9

The projected rise in the cost of public pension provision should also be viewed against the backdrop of other trends in the Irish economy. As the elderly dependency ratio rises, the proportion of the population aged under 15 or 20 years will fall. The projections contained in the Actuarial Review show that between 1996 and the year 2036 the proportion of the population aged under 20 years will fall by one third - from 33 to 22 per cent. The absolute numbers of young people will fall by 25 per cent between 1996 and 2036 (and by a further 11 per cent over the following 20 years). Thus the rising cost of providing for the elderly will occur against a background of falling requirements for childcare and educational provision. While there is no guarantee that this will automatically result in reduced public spending, the possibility should not be ignored when assessing the scope for manoeuvre in responding to the increased demands on the public purse to provide for the elderly⁷.

An estimate of the "needs-weighted support ratio", taking account of the changing age structure of the population and the different demands of each age group on public sector expenditure, shows the Irish ratio rising slightly between 1990 and 2010 and then falling back to the 1990 level (OECD, 1995, op. cit.).

There are, moreover, other important developments that will affect the public finances over the period considered in the Actuarial Review. By far the most important of these is the projected reduction in the burden of public sector debt. As a consequence of recent low levels of borrowing (and the prospect of budget surpluses in the immediate future), low interest rates, and the prospect of even lower rates following Ireland's entry to EMU, the burden of debt service charged to taxes has declined from 11.1 per cent of GNP in 1985 to 5.7 per cent in 1997, and is projected to decline to 2.7 per cent by the year 2003⁸. Once again it would be wrong to assume that this money would automatically become available for spending on the elderly, but it would be equally misleading to view the projections of the cost of public expenditure on pensions in isolation from this important simultaneous development.

4.5.7 Summary

In summary then, the Actuarial Review contains a valuable summary of the likely evolution of public spending on pension provision. A feature is the sensitivity of the estimates to changes in key variables. In particular, either of the following possible favourable developments relative to the core projections contained in the Actuarial Review would significantly reduce the cost of public pension provision; both combined would have an even more dramatic effect:

- that the rate of growth of Irish GNP will be maintained at or above its long run average; and
- that the increasing scarcity of workers in the younger age groups could significantly raise our employment/population ratios, which are low by international standards.
- 5. The Board endorses the Government's intention of conducting actuarial reviews at five yearly intervals to allow the updating of projections, in the light of demographic, economic and financial developments, which will enable the pursuit of appropriate economic policies.

4.6 International Competitiveness

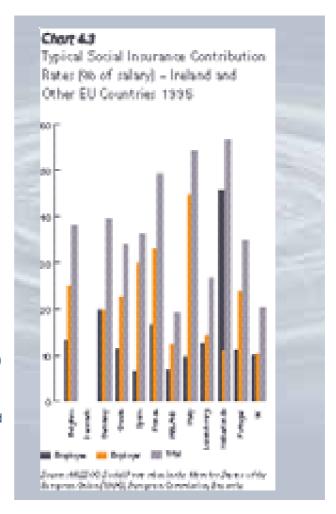
PRSI contributions finance most of Ireland's social insurance benefits, including First Pillar pensions. The contributory principle is considered to be an important element of social solidarity. However, the financing of public pensions through payroll levies or taxes on both employees and employers has implications for the costs of hiring labour, although it removes the burden that would otherwise have to be imposed elsewhere by the Exchequer. Concern is often expressed that higher contributions to fund the pension system would have an adverse effect on employment. It is claimed that any increases in rates of contribution would increase labour costs and impair the country's ability to compete on world markets and, in particular, in the United Kingdom market. However, there is no systematic evidence that this has been an important factor in Ireland, to date.

⁸ Duff, FitzGerald, Kearney and Shortall, Medium-Term Review: 1997-2003, Dublin: The Economic and Social Research Institute, 1997, Table A.7.

The issue of competitiveness is a complex one and there are interactions between competitiveness, growth and social development which need to be considered if simplistic conclusions are to be avoided. It is true that higher pension contributions increase the cost to employers of hiring labour unless they are shifted back to employees (resulting in lower take-home pay). On the other hand, it should also be acknowledged that there are social costs associated with poverty in old age.

In competitive international markets, these higher labour costs cannot readily be shifted forward to customers through price increases. These are important issues in a country like Ireland which has traditionally accorded employment creation and unemployment reduction a very high priority. However, at the same time it must be recognised that increased labour productivity and efficiency and associated economic growth can offset the cost disadvantages of meeting commitments to higher social expenditure.

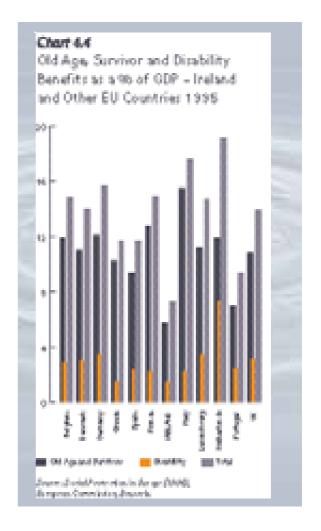
It is acknowledged that the making of precise comparisons between different countries is complicated by the differences between national systems. However, in a comparison with other countries (*Chart 4.3*) it emerges that social security contribution rates (expressed as a percentage of salary for a worker on average earnings) in Ireland are very low.



Correspondingly, public spending in Ireland on old age, survivors and disability ranks amongst the lowest in a comparison with other European countries (*Chart 4.4*). However, to some extent, variations in standards across countries (and the associated costs) of First Pillar pensions reflect the state of development of the Second Pillar. For example, spending on Second Pillar pensions in Ireland is greater than in some continental European countries. Accordingly, it would be incorrect to infer that differences in the cost of First Pillar pensions between Ireland and other countries are reflected fully in better cost competitiveness here, when Second Pillar costs are higher.

Any future movement of standards of retirement income in Ireland towards European levels is likely to be achieved by a combination of improvements in First Pillar and development of Second Pillar provision.

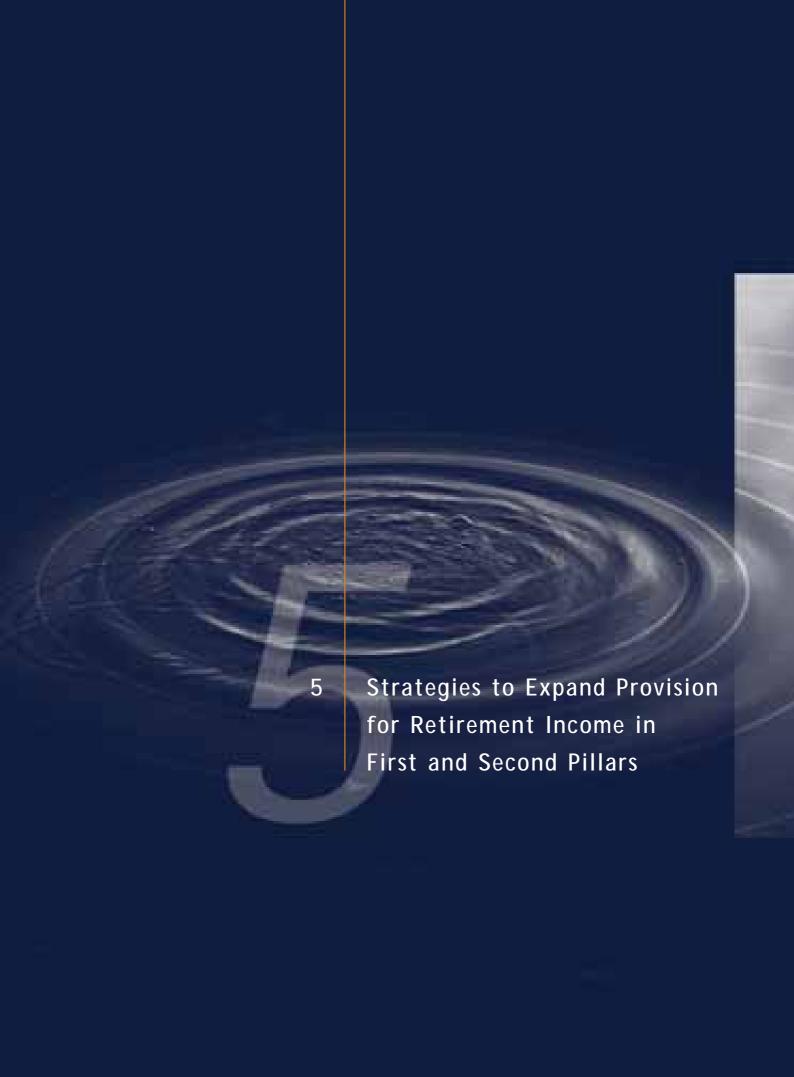
In a comparison of total annual costs of all public and private pensions it is estimated that, in Ireland, these currently amount to a little over 9 per cent of GNP. With the proposals contained in the strategy set out in this Report, this cost can be contained to 11.8 per cent of GNP at most in the period up to 2046 (See *Table 5.8*). By comparison, the same



costs in many other European countries are presently greater than this. For example, in Germany the figure for old age pensions alone is already in excess of 11 per cent of GDP, while in Italy it is over 12.5 per cent. It should be noted that the figures for Germany and Italy both exclude the costs of private sector Second Pillar coverage. Furthermore, in nearly all cases, a strong increase will occur over the next 25 to 40 years especially in countries in continental Europe.

4.7 EMU

It is assumed that Ireland will be amongst the EU member states, to be decided in May 1998, which will participate in EMU. Given the stated aim of EMU to observe, from 1 January 1999 forward, the irrevocably fixed exchange rates, and with the EU Regulations to govern the legal framework of the euro, it is not anticipated that EMU will have an adverse effect on the value of pension entitlements generally. This view would apply both to the transition period (from 1 January 1999 to 1 January 2002) and to the period after 1 January 2002 when euro notes and coins are in circulation. The advent of EMU may mean that long-term interest rates will continue to fall and this will have implications for annuity purchases. These need to be seen against an environment where there is likely to be low inflation and a compensating rise in asset prices. This issue is considered further in Section 6.6.1. The wider implications of EMU, including, for example, the possible long-term effect of the new economic and monetary environment on the investment of pension fund assets, are felt to be outside the scope of this Report.



5 Strategies to Expand Provision for Retirement Income in First and Second Pillars

Adequate provision for retirement income in the future will require both improvements to the basic Social Welfare old age pension (which itself should provide an adequate minimum income guarantee for the avoidance of poverty) and development of the supplementary pension provision system to provide much more simplified access than exists at present. This latter development will need to be backed up by robust institutional arrangements to build confidence in supplementary schemes and an educational and information drive to convince people of the need to make sufficient retirement savings. If these do not prove sufficient, further steps, including mandatory contributions, should be considered in the context of the progress review to be undertaken as proposed in Section 5.7.

In this chapter, the objectives, broad recommendations, costs and constraints of the Board's reform strategy are set out, (Section 5.1). The role of the Social Welfare old age pension is discussed, (Section 5.2) and the effect of First Pillar proposals on Second Pillar (Section 5.3). Next the Tax Environment for the Second Pillar (Section 5.4) and the Board's views and recommended broad approaches for improving voluntary provision are described, (Section 5.5). The Board then considers the role and scope for developing and applying mandatory elements, (Section 5.6). Finally, a graduated plan is proposed for implementing the proposed strategy, (Section 5.7).

5.1 The Reform Strategy

5.1.1 Overview

The major underlying goal of the Initiative is, in brief, to ensure adequate provision for retirement income for all. The goal needs to be qualified first of all by acknowledging that its full achievement may always remain beyond reach, bearing in mind the costs involved and the constraints that may be encountered. In addition, of course, the concept of adequacy has to be defined more precisely, and the underlying rationale clearly understood. Quantitative goals need to be set that make the objective an operational one. Nevertheless, the Initiative's goal is a straightforward one, and one which will encounter few opponents of principle.

Though the main objectives of this Initiative can thus be stated simply, ensuring that they are achieved will involve changes on several different fronts, corresponding to the various avenues by which provision is made for retirement income. Four distinct avenues are identified:

- Social Welfare mandatory pension provision, including the contributory and non-contributory old age pensions;
- occupational pension provision in voluntary employer-sponsored schemes (employee membership often obligatory);
- *individual* provision for retirement income on a voluntary basis through formal retirement contracts; and
- other mandatory provision.

The proposed reforms are interrelated in various ways. What needs to be done in terms of voluntary provision depends on what is achieved in other ways and vice versa. Furthermore, in respect of several of the most important regulatory and institutional reforms, each will convey benefits along more than one avenue of provision.

Finally, while the direction of change is clear enough, it is hard to be sure what degree of intervention is needed to achieve the goals set. Intrusive regulation, that goes beyond what is necessary to achieve the agreed objectives, including the time horizon over which they are to be achieved, implies financial and other costs that should be avoided. Therefore, it is desirable to proceed with a multi-phase plan, starting with the most urgent and least intrusive changes, with a clear intention of stepping up the pressure later if the desired results are not being achieved. Phasing also takes account of the constraints inevitably imposed by, for example, the limited administrative capacity of the system to absorb and deal with complex change. Furthermore, adopting a clearly phased approach makes it possible to postpone measures whose cost or intrusiveness prove to be either unnecessary or out of proportion to their potential contribution to achieving the goals set.

The phased and graduated approach which is recommended will allow achievements to be balanced against costs and constraints as the system evolves.

5.1.2 Broad Objectives and Principles

As already indicated, the major goal underlying the Initiative is to ensure adequate provision for retirement income for all. A comprehensive understanding of this goal needs to be underpinned by a deeper statement of what it is intended to achieve. The underlying public policy issues which are addressed are of three distinct types.

- Firstly, there is a poverty issue. It is a commonly shared aspiration appropriate to the scope of this objective that sufficient resources should be available to elderly and retired people to allow them to live in dignity. This means transferring resources to those who cannot afford to provide for themselves, and to those who reach old age without making adequate provision from their lifetime earnings. However, if the concept of poverty is clear-cut its measurement is not. It is complicated by the fact that poverty is relative, both in time and across places. Standards of living that would be unacceptably low today were more commonplace in the past and may have seemed acceptable at that time. Similarly, standards which may seem acceptable today may not be so in the future. Poverty in Ireland also means something different from poverty in many third world countries;
- Secondly, there is the problem that, without active policies encouraging them to save for retirement, many people are imprudent, shortsighted or reluctant to do so. Thus they reach old age with fewer resources than they need and should have, given their lifetime incomes, and, as a consequence, they can suffer a sharp drop in their living standards. They need to be encouraged to save more, and facilitated in doing so, notably by making better informed decisions. At the same time, just as there are people whose means make it impossible for them to save for retirement, it is important to recognise that there are also people who have adequate resources to live out their lives in the style in which they wish, without having recourse to formal pension provision. In those circumstances where retirement income is adequate in the absence of formal pension provision, there is little point devoting resources to encouraging or requiring that such provision be made. Therefore, it is most

important that initiatives and their associated targets should be established clearly and focused closely on those segments of the population where pension provision can play a beneficial role, i.e. where prospective retirement income will not be sufficient to sustain people with an adequate standard of living; and

Thirdly, there are macro-economic, public finance and national savings objectives to be borne in mind. Growth and future national prosperity, including social development and cohesion, depend on sufficient amounts being saved and invested in fixed and financial capital to take advantage of productive opportunities and to generate the national resources that will be needed for future social spending especially bearing in mind the prospective long-term trends in elderly dependency ratios. This means that the public finances need to continue to be managed in a way which facilitates saving, investment and sustainable economic growth.

The quantified expression of the Initiative's strategic goals bears these three policy dimensions in mind. Thus it makes provision both for a minimum income guarantee and for better smoothing of lifetime income into retirement (through pension-type saving). These in turn are designed to reach specified objectives in terms of adequacy (of facilitating individuals in achieving a desired level of retirement income) and coverage (of achieving targeted levels of coverage of the relevant populations for retirement income provision). These objectives are contained in the remainder of this section.

5.1.3 Avoidance of Poverty in Retirement: A Key Role of the Social Welfare Old Age Pension

A National Anti-Poverty Strategy¹ was published in April 1997 by the Government. This is aimed at addressing the most serious issues of poverty facing society in a manner which will not encourage dependency. It is appropriate that, in framing objectives for pension policy, there is recognition of the aims of this broad strategy and consistency with proposals contained in the Initiative. The National Anti-Poverty Strategy contains (on Page 13) the following statement regarding adequacy:

"Policies in relation to income support, whether these policies relate to employment, tax, social welfare, occupational pensions or otherwise should aim to provide sufficient income for all those concerned to move out of poverty and to live in a manner compatible with human dignity."

The Commission on Social Welfare, in its 1986 Report², used seven different approaches to inform and estimate in monetary terms the level of income which would represent a minimally adequate level at that time. They recommended £50 - £60 per week in 1985 terms. More recently, the ESRI has conducted a Review of The Commission on Social Welfare's Minimum Adequate Income³. It concluded that the minimum adequate income for a single adult in 1996 terms lay in a range of £68 - £96 per week4. It should be noted that these rates refer to Social Welfare payments generally and not to a particular customer group.

Sharing in Progress, Stationery Office, Dublin: April 1997.
Commission on Social Welfare (1986). Report of the Commission on Social Welfare: Stationery Office, Dublin 2.

Research Policy Series, Paper No. 29, December 1996.
Simple indexation of the original range of £50-£60 per week prescribed by the CSW in 1986 to the CPI gives a range of £69 - £83 per week in 1997 terms

5.1.4 What Income is Required to Avoid Poverty?

The ESRI point out that neither the methods employed by the Commission on Social Welfare or those used by the ESRI itself in its updating exercise "allow one to derive in an unproblematic, objective and scientific way estimates of income adequacy which would be universally acceptable and convincing". They go on to say that "statements about adequacy reflect judgements, values and attitudes: research cannot substitute for, but can inform, such judgements" (page xi). Therefore, the search for an objectively agreed income to avoid poverty in the case of older people is an unattainable goal. This does not, however, prevent a political/societal judgement being made about what is a reasonable level of income for older people, which would meet social justice criteria and reflect society's concern to protect this group who, in the main, are no longer in a position to compete for income or take advantage of potential opportunities in the labour market.

In this situation, the Board has taken account of the available research, the submissions received on the area of retirement income, and the level and structure of current Social Welfare provisions.

The Board notes that the updated range⁵ of adequate rates at £68 - £96 (1996 terms) per week is wider than the original range of £50 - £60 (1985 terms) per week. The minimum of the updated range reflects 50 per cent of average weekly net income for an adult (based on the 1994 ESRI Survey⁶) while the maximum reflects 50 per cent of weekly net earnings for a single person (based on Central Statistics Office returns⁷). In between, for example, lies a figure of £83 per week which was stated by a sample of 200 one-person older households to be their required minimum weekly income (based on the 1994 ESRI Survey⁶).

The Board is conscious that the structure of Social Welfare support for older people also provides additional cash and non-cash payments. While it is difficult to put a value on some of these payments (especially those which relate to usage) the ESRI has estimated the value to be over £12 per week in the case of an older person who is single and some £15.60 in the case of an elderly couple in cases where the benefits are actually in payment/available⁸ i.e. where the conditions for entitlement are met. It should be stressed, however, that these benefits (with the exception of Free Travel) are not universally available to older people. In addition, some of these payments are specifically targeted at the elderly precisely because of the presumption that they have special needs. Therefore, while the benefits should be acknowledged, it could be misleading to take full account of these in arriving at a target weekly rate of payment.

In addition to the above payments, a Living Alone Allowance (£6 per week) and an Over 80 Allowance (£5 per week) are payable to older people, again as a contribution towards the additional costs of specific contingencies.

The Board understands that the issues arising from the ESRI report on a minimum adequate income (see Section 5.1.3) and the issues surrounding adequacy generally will be considered further in the context of the National Anti-Poverty Strategy. It is considered that such an approach to addressing what is an "adequate" level of income, facilitates informed public debate and political decisions concerning Social Welfare rates, adequacy, economic efficiency and the hard choices involved. It so happens that the Board appears to be first to formally enter this debate following the publication of the National Anti-Poverty Strategy.

⁵ Further details of ESRI analysis at Appendix C.

⁶ ESRI Living in Ireland Survey 1994.

⁷ The income figure is lower than the earnings figure as the former refers to a representative sample of all households and would therefore include all forms of income (including Social Welfare payments) whereas the latter refers to the average earnings (only) of a specific sample of industrial workers.

These figures assume the following weekly values: Individual: Medical Card £2; Free Travel £1.27; Butter Vouchers £0.12. Household: Electricity Allowance £2.50; TV Licence £1; Telephone Rental £2.83; Fuel Allowance £2.50.

5.1.5 Adequacy and Coverage

As previously stated, the goal of the Initiative is the provision of an adequate retirement income for all. In deciding on the appropriate roles for the First and Second Pillars the issue of efficiency of delivery also needs to be considered. Regardless of the method chosen to deliver the pension, the cost of providing each £1 of pension will be £1 plus the administrative and other costs associated with the payment of the pension. The Actuarial Review estimated that the expenses of administering Social Welfare pension payments represented approximately 5 per cent of such payments. Within this, the cost of administering the contributory pension payments would be around 2 per cent. It is an indisputable fact that the administrative cost of funding and paying a small pension through a funded private scheme would be considerably greater. Since those on lower pay are, at best, only likely to be in a position to fund a small pension this additional expense is likely to fall most heavily on those on lower incomes and those working in small employments. Based on the results of the ESRI Survey 1995, this sector experiences very low coverage at present and, in addition, it must be accepted that it is least likely to be in a position to contribute towards a supplementary pension.

Therefore, a further role for the First Pillar, in addition to the avoidance of poverty, must be the provision of an adequate total retirement income for those in the lowest income deciles i.e. those for whom the provision of a pension through a private scheme is likely to be inefficient and for many unaffordable.

Having considered the issues raised in relation to both adequacy and coverage, recognising that both the level of pension and the approach to indexation need to be borne in mind, and conscious of the fact that there is no "right answer" about a rate which could be objectively agreed, the Board considers that the best strategy in order to, firstly, minimise the risk of poverty and, secondly, provide coverage to lower income people in the most efficient way, is to set the target pension rate at the upper end of the range estimated by the ESRI. As already discussed, this is £96 per week (in 1996 terms).

For reasons of practicality, the Board considers that this target should be expressed as a percentage of average industrial earnings which would equate to around 34 per cent, which seems a "reasonable" percentage in terms of what a minimum income should be⁹. It should be noted that it is at the lower end of what is the norm in EU countries generally 10. While the Board is aware that these earnings cover only industrial employment, where a minority of employees work, they are also conscious that these are the only official data on earnings available with sufficient frequency to be of use¹¹.

In deciding on the timescale appropriate for the achievement of this target, the Board has taken explicit account of the Government's commitment in "An Action Programme for the Millennium" to "achieving an old age pension rate of £100 over the next 5 years" (that is by 2002) which it sees as building on the original commitment to achieving the Commission on Social Welfare rates which have been already met. The Board welcomes the explicit acknowledgement and prioritising of the contribution of older people to society and the specific commitment to allocating additional resources to this group.

While the 34 per cent target is set by reference to 1996, the Board acknowledges that, in practice, the target Social Welfare rate for a particular year would have to be set by reference to the earnings in the previous year as, firstly, these Social Welfare rates are set some 6 months in advance and, secondly, up-to-date earnings data would not be available (in fact the previous year earnings data may still be on an estimated basis). See Appendix H, Table H.1.

CSO Survey covers about 68 per cent of total industrial employment.

Having reviewed the issues raised in relation to both adequacy and coverage and bearing in mind 6 the difficulties, discussed above, of determining a target based on objective criteria, the Board nonetheless considers that a target rate of 34 per cent of average industrial earnings¹², vis-à-vis the post Budget 1998 rate of 28.5 per cent, should form a backdrop to the achievement of the Government's £100 per week target and that this achievement should be accelerated, insofar as possible. In any event, the Board considers that the target which it proposes should be achieved within a 5 to 10 year period, effectively seeing achievement of this target rate as moving along an income continuum of what the Board regards as desirable. Related to average industrial earnings of £291 per week (based on estimated earnings data for 1997¹³), meeting the Board's proposed target rate of 34 per cent would result in a current weekly pension of around £99. Moreover, the Board considers that this figure should be updated to reflect earnings increases over the 5 to 10 year period envisaged by the Board for the full implementation of its proposed target rate.

The employers' representatives on the Board, while recognising the aspiration of the Board contained in the above recommendation, point out that defining a precise target level for First Pillar pensions for the purposes of achieving such objectives as the avoidance of poverty in old age and assisting with ensuring adequacy of pension provision, is a complex and difficult issue. Accordingly, they do not give unconditional support to the Board's recommendation in this regard.

The Board considers that the 1992 "Minimum Income" Recommendation 14 by the EU Commission with which all member states agreed, is a useful input to the uprating process as it states that social protection systems should be adapted as necessary according to a set of principles and guidelines and, that in this regard, member states should be encouraged to establish arrangements for periodic reviews of what constitutes adequacy for all groups - which is in keeping with what is envisaged in the National Anti-Poverty Strategy. The Board welcomes such an approach.

The Board is conscious that, while it is dealing with the issue of retirement income and associated survivors' payments, there could be knock-on effects for other Social Welfare customer groups. Some people are more disadvantaged taking account of other parameters e.g. lack of access to education, poor housing etc. However, as already stated, the elderly are in a particularly vulnerable position and do not have access generally to the labour market to supplement their income. Societies have conferred on the elderly a special status, and accepted in relation to them a duty of care in terms of income support measures which - rightly or wrongly - does not apply to other groups and such a position is arguably easier to take during a period of sustained economic progress. In the final analysis, the allocation of resources among and between different groups will be determined by what is socially and economically desirable and financially feasible at any particular time.

5.1.6 Risk of Poverty and Deprivation in Old Age

Recent work by the ESRI shows that relatively small changes in the level of income or the level at which poverty is measured can make a significant difference to the proportion of people falling inside poverty thresholds. In practice, this has also been evidenced in the poverty levels of pensioners over the years. Following periods when pension levels received a higher than average rate of increase, the number of elderly at risk of deprivation fell dramatically.

This target rate refers to the amount of the old age pension benefit to which the non-cash benefits referred to in Section 5.1.4. would be additional.

Industrial earnings are assumed to have increased by 4.5 per cent in 1997 giving an average £291 per week of which £99 is 34 per cent and the post-Budget 1998 payment rates

of £83 equals 28.5 per cent.
Commission of the European Communities, 1992. Council recommendation on Common Criteria Concerning Sufficient Resources and Social Assistance in Social Protection Systems, 92/441/EEC, Luxembourg

7. Therefore, the Board is confident that adoption of its recommended strategy to increase pension levels in a sustainable way will have a considerable effect in alleviating the extent of poverty among the elderly.

5.1.7 Adequacy of Income in Retirement: A Key Role of Supplementary Provision

While the avoidance of poverty in retirement is considered by the Board to be a necessary objective for an initiative of the kind embarked upon, it is by no means sufficient. If that was all that is achieved it would represent a minimalist outcome. However, it is acknowledged from the outset that framing quantitative objectives for adequate levels of income in retirement is fraught with difficulty. Yet it cannot be avoided. There are two fundamental problems. Firstly, in determining an adequate level of income in retirement it is considered appropriate that all income is taken into consideration, not only income arising from supplementary pension provision. Secondly, comparisons with pre-retirement income are inevitable. However, the relationship to adequacy in these two situations is not clear or straightforward. The ramifications of these two points are expanded upon below.

The first problem is that, while it is considered appropriate to consider all income in judging adequacy of retirement income, there are not sufficient data available regarding the distribution of wealth (from which income is derived) to enable precise judgements to be drawn about the importance of non-pension incomes in contributing to adequate levels of total retirement income. Another side to this problem (addressed later in this section) is the difficulty when it comes to establishing an appropriate target for pensions coverage.

Notwithstanding the shortcomings of available information, there is evidence¹⁵ to show that the aggregate value of net financial assets of households held outside pension funds amounts to two thirds of the value of those held within them. In addition, households own other commercial assets in the shape of businesses and farms. When the value of these assets is included, non-pension fund assets of households are probably as great as those held in pension funds. Beyond this there is the value of the residential housing stock. Leaving aside the value of housing, it seems reasonable to conclude that the income stream associated with non-pension assets must be about as great in aggregate terms as the income stream derived from pension assets. Unfortunately, it is not possible to determine with any precision the distribution of these assets across households. However, there is no doubt that it is uneven. As a result, the proportion of households which might prudently rely on non-pension income for retirement is probably quite small. Results from market surveys undertaken on behalf of the IAPF¹⁶ suggest that farmers, in particular, and some sections of the self-employed intend to rely on business assets to support them in retirement and for this reason they do not intend making provision through a supplementary pension scheme¹⁷. Of course, the question remains, will there be sufficient resources to provide an adequate level of income in retirement?

The estimates alluded to are derived from The Financial Assets of Households in Ireland, Patrick Honohan. General Research Series paper No. 162. ESRI. December 1993: The Wealth of Irish Households. Brian Nolan. Combat Poverty Agency, Dublin 1991: Collecting and Using Survey Information on Household Assets: Some Lessons from Irish Evidence Police Notes Open Legislating Series (No. 1994).

Experience, Brian Nolan, Conference Paper, University of Essex, June 1997.

16 Irish Pensions at the Cross Roads: A submission by The Irish Association of Pension Funds to The Pensions Board.

⁷ The IAPF study implies that two-thirds of those self-employed persons without formal pension provisions (almost 11 per cent of the total workforce) felt that they had enough savings or business assets to fund retirement.

As regards household wealth contained in the housing stock, the principal difficulty is that there are not any well-developed mechanisms available at present to allow people planning for, or in, retirement, to access the equity which they own, short of actually selling their property. In some countries, including the United Kingdom, attempts are being made to develop financial instruments which would permit households to realise, at least in part, the value of equity contained in residential property, in particular with a view to meeting long-term care needs.

8. Given the high rate of owner occupancy of housing in Ireland, the Board considers that the scope which these developments might offer in an Irish context should be examined from the point of view of supplementing retirement income or long-term care needs.

It is clearly necessary to have an explicit definition which can be used to assess the adequacy of income in retirement and therefore to underpin targets for the numbers of people who should have supplementary provision. In order to be practical and facilitate the measuring of progress, this has been set by reference to gross income before and after retirement. However, it is important to recognise that measures expressed in terms of gross income are only useful as a rule of thumb for assessing adequacy - what really matters is the disposable income or other means available after taking account of tax and other deductions.

The Board has considered the implications of a target level of gross income after retirement, including both First Pillar and Second Pillar pensions, of 50 per cent of gross pre-retirement income (subject to a minimum of 34 per cent of average industrial earnings). Based on the income data in Appendix B, the Board's recommendation for a Social Welfare pension of 34 per cent of average industrial earnings (currently approximately £99 per week) would meet this target for the 30 per cent lowest paid employees in the private sector between the ages of 30 and 65. More importantly, when taken in conjunction with the change in tax allowances, treatment of levies, and the value of "free schemes", this level of Social Welfare pension (which would act as a minimum level for all) would avoid any substantial drop in disposable income for many married couples and limit the fall for single people (some of whom may also qualify for a living alone allowance).

Calculations of the net replacement rates of income taking these factors into account show that for married couples with one income, the 40 per cent lowest earners would have a replacement rate of at least 90 per cent, while the 20 per cent lowest single earners would have replacement rates of at least 80 per cent. However, these are people with modest absolute incomes and any drop in income is significant - they are also those least likely to have other means available to them. There is, therefore, still some need to encourage Second Pillar provision among the lowest income deciles.

For those in the middle to upper income deciles, the adoption of a 50 per cent replacement rate for gross income means net replacement rates of the order of 65 per cent to 75 per cent for married couples and 60 per cent to 70 per cent for single people.

The percentage replacement rates for married couples with both earning prior to retirement is broadly similar to those applying to two individuals with their respective incomes, although average incomes for such households tend to be higher than the overall average.

9. The Board has come to a judgement that it would be reasonable to measure adequacy of gross retirement income from all sources (including lump sums and gratuities and other accumulated assets) against a benchmark of 50 per cent of gross pre-retirement income subject to a minimum of 34 per cent of average industrial earnings together with any associated Adult Dependant's Allowance.

An example showing the effect of the various different factors which make up the replacement rate is given in Appendix D together with replacement rates provided by the adequacy test set out above.

10. With a view to achieving a greater and more explicit underpinning of this objective, the Board recommends that further research should be procured from competent authorities into the sources and distribution of wealth in Ireland.

5.1.8 Supplementary Pension Coverage

As discussed above, adequacy of retirement income and the extent of pension coverage are closely interrelated for most of the community, because the ownership of non-pension assets is uneven. However, as shown in Chapter 3, coverage of 46 per cent of those at work (and 52 per cent of employees) by formal supplementary pension provision, is less than the desirable level. Furthermore, as indicated, coverage varies enormously by sector and between full-time and part-time workers. Prospective long-term economic trends seem to favour types of employment where coverage ratios are currently relatively low, so these effects will tend to reduce aggregate coverage.

The appropriate targets depend, to some extent, on the level of First Pillar benefits. On the basis that the Board's recommendations on these are accepted, the Board considers that up to 70 per cent of the workforce could need some supplementary provision to ensure an adequate replacement income in retirement. Those with the lowest earnings are least likely to have other means to boost their retirement income and even for the few examples for whom the Board's proposals on the First Pillar would provide replacement rates over 100 per cent, the absolute levels of income are very modest. It is clear from Appendix D that even moderate levels of supplementary provision can make an important impact on replacement rates for those in the lower income bands. For these reasons, the Board would aim to see coverage levels in the lowest income deciles noticeably higher than at present¹⁸. This is particularly important for single people. This means that the 70 per cent of those whom the Board feels should have cover are not just the top 70 per cent earners but will be spread across the income spectrum.

The Board believes it is best to set targets for a small number of broad categories rather than for a large number of smaller groups. In particular, it is aware that the high coverage already shown for the better paid implies that success in the Initiative will depend critically on finding ways of bringing meaningful cover to those less well off and it will pay specific attention to this area when assessing progress.

Supplementary pension provision is bound to remain a secondary priority for people in their 20s, while they are focused on establishing careers and families and when their incomes are still growing. As a result, the Board has set lower targets for those aged below 30 but the targets for those over age 30 represent desired ultimate targets. The Board considers that it is appropriate to set lower targets for formal pension coverage for the self-employed, as some of these, at least, can build up a substantial asset through their businesses or farms. Coverage in the public sector is already in excess of 90 per cent for men aged over 30. It also considers that the ultimate targets should be the same for men and women with the same employment status and notes that coverage levels for both sexes are reasonably similar for full-time employees and the self-employed in their 30s.

These ultimate targets for those aged over 30 are 45 per cent for the self-employed, 70 per cent for employees in the private sector and 95 per cent for employees in the public sector. These target levels equate to coverage rates of approximately 75 per cent for all employees (public and private sector) and 70 per cent of the total at work (combining employees and self-employed) in the over 30 age category.

The interim targets have been determined by considering the current coverage position and the gap between it and the desired final coverage profile. The scope for making relatively rapid progress among atypical workers has also been considered. However, currently there are many more women in atypical jobs which depresses the overall coverage rate for women and it is likely to take several years for the overall rates for men and women to converge. The ultimate coverage targets for women are greater than those for men because a higher proportion of men are self-employed.

11. In summary, the Board considers that comprehensive achievement of an adequate level of income over a lifetime would involve an ultimate goal of some 70 per cent of the total workforce over age 30 making, or having, supplementary pension provision. However, it will clearly take many years to reach that goal. Therefore, it is essential to set interim target percentages for five and ten year horizons, and to differentiate the targets by sector. The proposed interim targets by status of employment and gender are set out in Table 5.1.

Table 5.1 Supplementary Pension Coverage: Ultimate and Interim Targets by Employment Status and Gender for 5 and 10 years after Implementation of Proposals (Percentages of totals in categories)

		Age	1995	5 Years	10 Years	Ultimate
Overall Tar	gets:		%	%	%	%
All at Worl	<		46	53	57	60
Of which:	All workers aged	Up to 29	28	34	35	35
		30-65	54	62	66	70
	Self-employed		27	36	43	44
	Employees		51	58	61	64
	-Public Sector		83	90	90	90
	-Private Sector		38	48	53	58
Acilieved a	o a rosair or sabstatal y of					
Males	s a result of subsidiary ol	.,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,	49	54	58	59
Males	Self-employed	Up to 29	49 24	54 28	58 32	59 32
Males		Up to 29	24	28	32	32
Males	Self-employed	Up to 29 30-65	24 29	28 38	32 45	32 45
Males	Self-employed	Up to 29 30-65 Up to 29	24 29 29	28 38 35	32 45 35	32 45 35
Males Of which:	Self-employed	Up to 29 30-65 Up to 29	24 29 29 73	28 38 35 75	32 45 35 75	32 45 35 75
Males Of which: Females	Self-employed Employees	Up to 29 30-65 Up to 29 30-65	24 29 29 73 40	28 38 35 75	32 45 35 75 56	32 45 35 75
Males Of which: Females	Self-employed Employees	Up to 29 30-65 Up to 29 30-65 Up to 29	24 29 29 73 40 1	28 38 35 75 51 16	32 45 35 75 56 32	32 45 35 75 61 32

5.1.9 Costs and Constraints

Financial Costs

The arrangements for pension provision have wide ramifications throughout the economy. Some of the possible changes in these arrangements will impose costs of various types and could have other undesired effects. Among the costs that need to be taken into account are:

the impact on the Exchequer; the greater the share of the costs of retirement income that is borne
by the Exchequer, whether through the Social Welfare old age pension, tax relief (net of deferred
taxation) or other channels, the greater the amount of tax which the Exchequer will have to raise.
This may involve more than a simple transfer, because taxes can have costly distorting effects;

- cost competitiveness; in an increasingly global economy, the risks to cost competitiveness from tax distortions or from increases directly in business costs relative to those in other countries could ultimately limit the volume of employment they can offer and the wages they can afford to pay; and
- administrative costs; these need to be minimised as far as possible.

While not always readily quantifiable, such costs need to be borne in mind in considering potential reforms. At the same time, it has to be recognised that there is no avoiding extra cost if pensions coverage and the adequacy of retirement income are to be improved. Thus, a key issue is the distribution of extra costs in a manner which is acceptable as much as the extent of them.

Financing Pension Costs

Pensions are financed currently in a number of different ways:

- First Pillar pensions are financed mainly through PRSI contributions from those of working age and employers. There is no direct relationship between the contributions paid and the level of pension ultimately received by the contributor and, in effect, each generation of workers and employers pays the pensions of the previous generation;
- the balance of the cost of First Pillar pensions, and the cost of those public service occupational schemes which operate on a "pay-as-you-go" basis, are met from current revenue i.e. by the general taxpayer. Currently practically 50 per cent of tax revenues are generated from income and corporation taxes, with the balance largely from indirect taxes;
- funded occupational pension schemes in the private and commercial State sectors are financed by contributions from employers and, in the majority of schemes, employees. These contributions are set aside to finance the payment of future pensions and other benefits as they fall due. There is a linkage (in defined benefit schemes indirect, in defined contribution schemes direct) between contributions paid and benefit payments. Tax relief is a vital element in that the employer and employee contributions are allowed as an offset against income with a consequent cost to be borne by the general taxpayer. In addition, pension funds are not taxed on their investment returns but the ultimate pension bears normal income tax; and
- personal pension plans are financed by the individual contributor and their tax treatment is broadly similar to funded occupational pension schemes.

In deciding on an appropriate balance between the provisions of total retirement income through First Pillar and Second Pillar systems it is important to understand that regardless of what mix is chosen, the costs will fall on employers, employees and on the taxpayer. The exact distribution of these costs between individual employers, employees and taxpayers is affected by a number of factors, including the direct and indirect tax and PRSI systems as they relate to these categories, and by variations in the relationship between contributions paid and benefits received, according to the financing mechanisms used. In addition to these influences, a decision on the most appropriate mix also requires consideration of issues such as affordability, intergenerational solidarity, redistributive effects, fairness and efficiency of delivery etc. Furthermore, the balance between private and publicly funded pensions and its evolution over time is of crucial importance both from the viewpoint of the Exchequer, including the crucial general Government deficit constraint and in terms of the economy as a whole. At the same time, it must be

acknowledged that, notwithstanding all the preceding considerations, the incidence of the overall cost burden between First and Second Pillar provision is broadly similar. This acknowledgement of the present incidence of the overall cost burden is without prejudice to policy decisions on the future sharing of that cost between employers, employees and the taxpayer.

Saving Needs

A beneficial side-effect of efforts to increase pension saving will be an increase in national saving. In recent years, a steady flow of Structural Fund assistance from the EU, and a policy of very limited Exchequer borrowing, have combined with the healthy profit performance of private industry and only moderate levels of private investment demand to result in a situation where national savings have exceeded national investment, and the nation has (in net terms) been accumulating foreign assets. Thus, national savings have been more than adequate to meet the short-term needs of investment. However, this situation will not last. Already there has been a steady tendency for lower savings from the personal sector, investment demand has been picking up, and there will be downward pressure on the flow of Structural Funds. Combined with the long-term demographic prospects, a boost to personal saving from the Initiative will thus be welcome.

The impact of the Initiative would be somewhat limited by a tendency for savers to substitute pension savings for an existing stock of short-term saving. Moreover, experience in the United States shows how new tax-advantaged pension plans may induce more switching from other forms of saving medium than new saving. The overall impact should, however, result in some increase in savings.

Retirement Behaviour and Other Labour Market Aspects

Another effect is on retirement behaviour. While it is not proposed that Social Welfare pensions should be paid from earlier than ages 65/66, increased overall provision for retirement earnings could induce people to retire early, thereby reducing their lifetime contribution to national production and increasing their cost on the rest of society. This would be an unintended side-effect to be avoided if possible. In addition, occupational pension schemes have often been used to provide incentive effects that improve the efficient functioning of the labour market. Policy should not impede this unnecessarily.

Retirement Age

One of the key factors affecting pension costs is retirement age which is normally taken as 65. There are several aspects to it.

Starting from a purely demographic perspective, as mortality improves at older ages, the balance between those over age 65 (and over age 80 when an extra Social Welfare allowance is made) and those at younger ages changes quite substantially. Irish mortality rates at older ages were static for a long period and only started to improve around 1980. As a result, Ireland is already significantly behind other major economies in terms of life expectancy and the general international experience is that life expectancy at older ages can increase quite rapidly with increasing living standards.

As an example, the life expectancy at age 65 is projected to increase as set out in Table 5.2:

Table 5.2 Projected Changes in Life Expectancy of Men and Women at Age 65

The increased life expectancy is based on the Central Statistics Office's projections and assumes only improvements in mortality up to the year 2026. Given the experience that, for many years, actual improvements in life expectancy have generally proved to be a lot greater than anticipated, it seems likely that these projected increases in life expectancy may prove conservative.

Year	Men	Women
	(years)	(years)
1996	13.5	17.3
2006	14.2	18.3
2016	14.9	19.4
2026	15.6	20.2

Therefore, it may be worthwhile to consider an approach to retirement age which mirrors this expected increase in life expectancy. For example, in the United States there is a planned steady but slow increase in the age at which Social Welfare pensions will commence, in order to maintain a constant proportion of one's lifetime spent in retirement. This helps stabilise the cost of Social Welfare pensions over time expressed as a proportion of earnings insofar as these costs are affected by increasing longevity - it does not deal with the effect of a bulge in the numbers reaching retirement age.

In Ireland's case, the figures in *Table 5.2* indicate that the implementation of such an approach might mean increasing the pension age by something like six months every five or six years.

Additional projections have been carried out in order to give some idea of the consequence of increasing pension age for First Pillar pensions. These projections show that by increasing the pension age by 2 years, contribution income increases by about 2-3 per cent and the pension bill decreases by 7-10 per cent from 2016 onwards; this would mean a reduction in the pension bill of the order of 0.5 per cent of GNP. *Table 5.3* illustrates the effect, on total outgoings as a percentage of GNP, of increasing the pension age by 2 years from 2008. There would of course be other consequences to be taken into account such as the effect on employment.

The issues in practice are more complicated. Clearly, there would be a number of direct knock-on effects from an increase in First Pillar pension age. For example, supplementary provision through defined benefit schemes which have a set normal retirement age would need to consider whether they need to adapt to meet such a change and how best to do so. Defined contribution arrangements should not be directly affected. The real issue here is that terms of employment normally set out a retirement age and the prospect of retirement is less attractive if the Social Welfare pension does not start straight away.

The position prior to retirement also needs to be considered. If raising the pension age merely meant that people receiving other Social Welfare benefits continued to receive them for a longer period, there would be no savings. For savings to ensue, it would be necessary to ensure that those below pension age continue to be gainfully employed.

Table 5.3 Effect of Change in Retirement Age on First Pillar Pension Costs

This is a major challenge, especially since the overwhelming trend in recent years has been towards earlier retirement from formal employment. Some of this has been driven by companies restructuring in circumstances where strong investment returns provided the means to pay higher benefits than would be payable on purely voluntary early retirement. Some recent market research¹⁹ into people's aspirations shows that, on average, people want to be able to retire at 57 (but have very little concept of the financial implications of this). Raising retirement ages, therefore, needs a major communication exercise if it is to be publicly acceptable.

What has not been given great attention up to now is how to develop the so-called Fourth Pillar. In other words, consideration has not been given to how people could be encouraged to continue to earn at older ages or after they take formal retirement. For example, this may be part-time work in their traditional area of experience (increasingly common among self-employed professional people) or it may result from retraining or commencement of a new career, perhaps working shorter hours and/or at lower rates of pay.

	Total Outgoings* as % GNP						
Year	Maintaining Current Retirement Age	Increased by 2 Years from 2008					
£100 p.w. in 2002 and Price Indexation Thereafter							
1998	4.5	4.5					
2002	4.3	4.3					
2002	3.8	3.8					
2011	3.6	3.3					
2016	3.6	3.2					
2026	3.6	3.3					
2036	3.5	3.2					
2046	3.3	3.1					
2056	2.8	2.6					
£100 p.w. in 2002 and							
Earning	s Indexation Thereafter						
1998	4.5	4.5					
2002	4.3	4.3					
2006	4.1	4.1					
2011	4.3	3.9					
2016	4.7	4.2					
2026	5.7	5.3					
2036	6.8	6.2					
2046	7.8	7.1					
2056	7.9	7.3					

Another concept requiring further analysis is

that of changing from a fixed point of retirement. The recommendations in this Report on Second Pillar provision make explicit allowance for greater flexibility to be given to people to manage the transition from full-time work to retirement. Similar flexibility can be considered for First Pillar benefits - for example, by allowing someone to defer taking his/her Social Welfare pension in exchange for an increased pension from an older age. This raises many implications for other aspects of Social Welfare benefits and so is not considered further in this Report.

¹⁹ Research commissioned privately by Irish Life; The Research Centre 1996

The strategies adopted in other countries towards retirement age have varied. In the past, several European countries have had retirement ages below 65 and had tended to reduce retirement ages rather than increase them, while some had different retirement ages for men and women. Most of these countries have levels of benefit (often earnings-related) considerably higher than those in Ireland (as seen in Appendix H, *Table H.1*) However, the realisation in recent years of the impact of the ageing of their populations on their pension systems has led most countries to review these pension arrangements. Despite the irrefutable evidence of the emerging problems for their pension systems, it is noticeable how the question of public acceptance can make reducing the future benefit bill very difficult - Italy is a case in point.

In practice, there are a range of factors which can be combined to alleviate problems. Apart from increasing contributions, the qualification period for benefits can be increased and, of course, retirement age raised. Different countries have chosen combinations specific to their own problems and circumstances and there is no uniform pattern. For example the United Kingdom is raising the retirement age for women to deal with equality issues (and it was already low at 60). France has lengthened qualification periods and reduced maximum benefits and Italy is reducing benefits and raising retirement ages from a former level of 62 for men and 57 for women. In both the latter cases, there have been problems of public acceptability in implementing the proposals.

Other countries have been more proactive or had a better starting point. Retirement ages have been 67 in some Scandinavian countries for some time, whereas the United States will increase retirement age by 2 years over the next 25 years while at the same time it is partly funding its Social Welfare pension system to provide a cushion against fluctuations. Others, such as Germany, are starting to put priority on consideration of Fourth Pillar initiatives (and reviewing the incentive effect of other benefits available to people prior to formal retirement age) recognising that merely increasing retirement ages without a corresponding increase in economic activity at older ages dilutes the gain.

In summary, retirement age in Ireland is not currently out of line with most other countries but the public expectations tend to run in the opposite direction to the demographic and economic pressures. The Final Report of the National Pensions Board recommended that the Social Welfare pension age should not be raised but that the position be kept under review. The complexities of the practical issues involved in considering changes to retirement age (even over a long period) have meant that the Board is not making any recommendation in this Report. However, it will be an issue which should be considered regularly in the future and the regular Actuarial Reviews of Social Welfare pensions provide a good platform for doing so.

Prudential and Other Restrictions

The purpose of the Initiative is not simply to remove obstacles in the way of people acting in their own interest. That is part of the story, but only part. In other countries, the well-documented reluctance of many to make adequate financial provision for old age, and the cost structure of the pensions industry, have provided arguments for various restrictions on behaviour. These arguments have some validity in Ireland too.

For example, while prudential supervision does impose costs and limits the degree of competition in the financial sector generally, it is well-recognised - especially from the experience of other countries, but also from a number of cases in Ireland - that such safeguards are needed if the risk of abuse is to be kept to an acceptably low level. Non-professionals do not have the ability or the resources to assess the probity and capacity of fund managers and other intermediaries. Accordingly, it remains essential to have an adequate prudential structure for the pensions industry as well as some new system of assuring certain standards of quality (as provided for in the kitemarking proposals in Section 5.5.4).

Management of Change

A major initiative in such a complex field presents practical difficulties of change management. This needs to be borne in mind in designing the phasing of needed reforms. It also argues for avoiding undermining all that is good in the present system.

5.2 The Social Welfare Old Age Pension: The Avenue for Providing the Minimum Retirement Income Guarantee

5.2.1 The Minimum Retirement Income Guarantee of First Pillar

As noted, in Section 5.1.2, the Board considers that, consistent with the broad approach in the National Anti-Poverty Strategy, adequate rates of payment under Social Welfare old age pensions should be a central instrument for the avoidance of poverty in retirement. If they are to be effective in achieving this aim, payments will need to be raised from the level of £83 per week, which will apply from June 1998 and corresponding to approximately 28.5 per cent of estimated average industrial earnings in 1997, to a rate corresponding to 34 per cent of average industrial earnings. The Board envisages this increase being implemented over a 5 to 10 year period.

The costs involved in making this proposed transition to 34 per cent of average industrial earnings (including the costs of changes in associated rates of Social Welfare pensions) have been considered by the Board. Financing options and overall macro-economic implications within a 5 year time frame have been used, for illustrative purposes.

The first issue which has to be decided upon in undertaking such an exercise is what benchmark to use for making comparison, e.g. the position prevailing in the base year of 1998, or some alternative evolutionary path along which it might be reasonably expected that pensions would evolve otherwise, up to 2003.

As there is an explicit statement of policy by Government²⁰ to raise the level of old age pensions to £100 per week over five years (to 2002), it is considered that the Board's proposals would be most appropriately compared to this benchmark of stated Government policy.

Table 5.4 contains a summary comparison of the incremental costs of the Board's proposals, compared with this alternative benchmark. As may be seen, the projected incremental cost by 2003 is £440 million, in current prices, or 0.7 per cent of GNP if the Board's proposals are implemented over the minimum (5 year) period.

In overall macro-economic terms, the estimated impact of meeting the incremental costs of the Board's proposals, as illustrated, would not be significant, in terms of adverse aggregate output or employment consequences. However, it has to be acknowledged that there are cost implications associated with the already announced Government policy of raising old age pensions to £100 per week, by 2002.

In the context of the Government's stated expenditure policies it is useful to express these additional annual costs as a percentage of total current Government expenditure and to illustrate their impact on the Government's target limit of 4 per cent per annum in the rate of growth of aggregate net spending on non-capital services. On the basis of official post-Budget estimates of expenditure to 2000 and on the basis of growth of 4 per cent per annum thereafter to 2003, it is estimated that the incremental cost of the Board's proposals would contribute approximately 0.7 per cent per annum on average to the 4 per cent per annum target.

Table 5.4 Summary Comparison of Costs Associated with the Board's Proposal to Raise Old Age Pensions to 34 per cent of Average Industrial Earnings in 2003 with stated Government Policy of Raising Pensions to £100 per week in 2002 (£ million in current prices)

	1999	2000	2001	2002	2003+
1. Increment in annual Exchequer Contribution, in addition to projected PRSI receipts, required to meet the cost of raising pensions to £100 p.w. in 2002, with price indexation thereafter.	33	75	140	227	236
2. Increment in annual Exchequer Contribution, in addition to projected PRSI receipts, required to adjust current pensions to 34 per cent of					
average industrial earnings in 2003*	98	211	341	495	676
3. Additional Cost of Board's Proposal (2-1)	65	136	201	268	440
(As % of GNP)	(0.1)	(0.3)	(0.4)	(0.5)	(0.7)

^{+ 2003} represents the full costs of proposals.

^{*} on the basis of a straight line progression year by year to 34 per cent in 2003 and assuming PRSI ceilings are increased in proportion to increases in pension levels.

Table 5.5 contains an illustration of a possible financing scenario with respect to the incremental costs that would be involved in implementing the Board's proposals. It incorporates the principle of partnership, in that it involves contributions being made to the additional cost by Government, employers, employees and self-employed, although not in the proportions which apply at present. In the example presented, a quarter of the extra cost is met from a combination of re-allocations of Government spending from elsewhere and a diversion of tax revenue from other potential uses, such as reductions in income tax rates or increases in allowances. As an illustration, the impact of financing the balance from higher rates of PRSI on employers, employees and the self-employed is shown. However, the trend in recent years has been for these rates to be reduced. The employers' representatives on the Board believe that this policy is necessary to the support of cost control (including public expenditure), competitiveness and employment growth. Of course, if there was reluctance from any one major grouping to participate in a sharing of any additional costs associated with the Board's recommendations, this would be likely to result in resistance from other parties.

Accordingly, while the Board considers that the matter of how the additional costs should be shared ought to be considered by the social partners and other relevant groups, it is, of course, ultimately a decision for Government.

Table 5.5 Illustrative Financing Scenarios of the Board's Proposal Relative to the Benchmark of Current Government Policy of Raising Old Age Pensions to £100 per week by 2002 (£ million, current prices)

		1999	2000	2001	2002	2003+	
lr	cremental Cost of the Board's Proposal	65	136	201	268	440	
F	nanced by:						
	eduction in Exchequer expenditure elsewhere	8	17	25	34	55	
D	iversion of tax revenue from other uses	8	17	25	34	55	
lr	crease in yield from PRSI	50	102	150	200	330	

Table 5.6 contains a number of illustrations of alternative ways in which the PRSI income increases contained in *Table 5.5* above could be financed. These relate to adjustments in rates of PRSI and to the PRSI ceiling. For illustrative purposes the effect of increasing the PRSI rates over the 1998/99 position is set out in *Table 5.6* as a first alternative. A second partial alternative relating to the PRSI over the 1998/99 position ceilings is also indicated. It is clear that different combinations of alternatives could also be used.

Table 5.6 Illustrative Examples of Alternative Approaches to Realising Additional PRSI Income Receipts Required to Part-finance the Board's Proposal to Adjust Pensions to 34 per cent of Average Industrial Earnings.

	1999	2000	2001	2002	2003*
Required Increase in PRSI Income (£m)	50	102	150	200	330
First Alternative - Across the Board Increase in PRSI rates					
Required Increase to current PRSI rates (%):					
Employers (12% rate)	0.2	0.4	0.5	0.7	1.0
Employers (8.5% rate)	0.2	0.4	0.5	0.7	1.0
Employees (4.5% rate)	0.2	0.4	0.5	0.7	1.0
Self-Employed (5% rate)	0.2	0.4	0.5	0.7	1.0
Second Alternative - Adjustment of ceilings for PRSI contributions					
Required Total Increase to Income Ceilings (£):					
Employer (£29,000)†	3,000	8,000	14,000	abolition	A
(Employee/Self-Employed (£24,200)†	3,000	8,000	14,000	abolition	A
* 2003 represents the full position.					
† In estimating the incremental cost of the Board's proposal, it has been assulevels. The increases indicated are above these levels.	umed that PRSI cei	lings would in	ncrease in line	with increases in	pension
▲ Cannot be fully financed under Second Alternative.					

In this context, the Board considers that the principle of equalised rates of contribution²¹, as outlined in the Final Report of the National Pensions Board (Chapter 14) and more recently in the Actuarial Review (Chapter 6), should be explored further. Such an examination should also review the role of the Exchequer contribution especially given the role of credited contributions in the PRSI system.

The proposed increase in Social Welfare old age pension will, of course, result in a reduced occupational scheme pension for those employees who are members of integrated defined benefit schemes as the sharing of the post-retirement income promise will change. This will have a beneficial impact on the cost of funding such schemes and could result in significant cost savings to employers and, if the scheme is contributory, to employees. Hence an increase in employer/employee PRSI rates may not result in any additional cost for many employers and employees. There would, however, be no counteracting reduction for employers/employees who contribute to non-integrated schemes as well as for those employers/employees who make no contributions to a supplementary scheme.

²¹ The principle is that the contribution payable in each "equalisation period" should be adequate to meet the full cost of contributory pensions during that period.

The National Pensions Board recommended an equalisation period of 10 years with the calculation being carried out every 5 years in the context of actuarial reviews.

The final costs of the proposal would differ a little from the direct estimates shown in Table 5.4. On balance, it is estimated that they would be higher. Two opposite effects would be at work. A part of the additional expenditure on pensions would be clawed back by the Exchequer in terms of higher direct and indirect tax revenue. This would tend to bring the net cost below the estimates in Table 5.4. Against this, it is estimated that the additional taxes required to finance the expenditure would worsen the competitiveness of certain sectors of Irish industry, particularly, labour intensive ones. As a result, there would be some employment losses with attendant increases in public expenditure and reductions in tax revenue. On the basis of model simulations, it is estimated that these negative effects on the public finances would outweigh the positive ones.²² However, in the context of most projections available for the Irish economy for the next five years, the overall macro-economic effects of achieving the Board's proposals, including the costs of outstanding policy commitments, are unlikely to be significant.

The latest ESRI Medium-Term Review²³ projects growth of over 4.75 per cent per annum on average, for the period 1998-2002. Since its publication in April 1997, short-term prospects for growth have become even stronger. More recently, in November 1997 the ESRI has published Occupational and Employment Forecasts 2003²⁴. This projects cumulative employment growth of 184,000 in the six years from 1997 to 2003.

There would be some negative impact in overall macro-economic terms, on the medium-term projections above as a result of achieving the proposed improvements in First Pillar pensions. An estimate has been made of the magnitude of these responses using the econometric model maintained by the Department of Finance and ESRI²⁵. Thus, it has been estimated that implementation of the Board's proposals would result in GNP growth being perhaps 0.4 per cent, in total, lower in the next five years. One effect of this might be that employment growth would be 165,000 over this period, compared to 184,000 as referred to above, and it is recognised that labour intensive industries would be likely to suffer more than other areas from any employment growth impact. The impact on GNP growth and its other effects would have to be weighted against the resulting social progress and considered in the context that estimated total costs of all pensions in Ireland are, and are likely to remain, less than other European countries (see Section 4.6).

The reasons for the negative economic impact are that increased tax and PRSI rates, which cause an increase in wage costs, can result in loss of cost competitiveness vis-à-vis Ireland's trading partners. This triggers negative employment effects and a consequent reduction in overall economic activity. Overall, these negative effects can outweigh the positive impetus given to domestic demand from the associated higher consumer spending. This is because consumer spending in Ireland, generally, has a very high import content. As a result, some small net deterioration occurs in the Exchequer Borrowing Requirement, despite the fact that the initial increase in spending is balanced by higher taxes, PRSI contributions and reduced government expenditure in other areas.

12. The Board believes that achievement of its proposed target for First Pillar pensions of 34 per cent of average industrial earnings would not entail significant downside risks to the current macroeconomic projections for the next five years or so of continued rapid economic growth with strong overall increases in employment.

The model simulations were conducted using the econometric model of the ESRI/Department of Finance.

ESRI Medium-Term Review No. 6.

Occupational and Employment Forecasts 2003: FAS/ESRI Manpower Forecasting Studies No. 6.
For a description of the key features of this model of the Irish economy see for example, Bradley J.B. and John Fitzgerald, The ESRI Medium-Term Economic Model of the Irish Economy, in Medium-Term Review, 1991-1996, ESRI, Dublin.

The minimum income guarantee for retirement income will entail increasing the Social Welfare old age pension. This is against the trend in other countries where there are attempts being made to reduce the fiscal burden of the ageing of populations. The fact that the Initiative goes against that trend reflects both the relatively low level of the Social Welfare old age pension in Ireland and the relatively more favourable demographic prospects that Ireland is expected to experience in the short to medium-term.

Nevertheless, it is acknowledged that the gross fiscal cost of the Social Welfare old age pension will grow as a share of GNP in the decades ahead, and that an increase in the real value of the pension will add further to this cost.

The Social Welfare old age pension has two components, the first being that provided under Social Assistance to those satisfying a means test, the other provided as an entitlement (regardless of means) to those qualifying under Social Insurance.

13. So far as the means-tested component is concerned, the Board is satisfied that no alternative approach to providing such a minimum income guarantee will significantly reduce the fiscal cost of doing so.

For the entitlement component, the situation is more complex. Those who receive the entitlement do so on the basis of Social Insurance contributions made by them and on their behalf, but these contributions are not calculated on the basis of a self-financing saving and annuity arrangement. They also create an entitlement to a package of other benefits. Furthermore, the scheme is not funded, it operates on a pay-as-you-go basis with a small Exchequer subsidy. The shifting demography implies that an increased total tax-and-contribution burden will fall on future generations of taxpayers unless action is taken to smooth this burden by accumulating a fund. This suggests a need to generate modest fiscal surpluses in the years ahead in order to prevent the necessity for sharply increased tax burdens later. As indicated in Chapter 4, macro-economic prospects are for such surpluses to be attainable on current policies in the early years of the new century.

The Board has considered a number of alternatives, up to and including the phasing out of the contributory old age pension for new Social Insurance contributors, with the intention that these would rely more on private provision for retirement income. While such schemes would have the effect of reducing fiscal costs, they would at best be only partially successful. The fiscal savings would be limited by the increased numbers likely to draw on the Social Assistance pension. Above all, such alternatives would work against the central objectives of the Initiative by reducing the adequacy of provision.

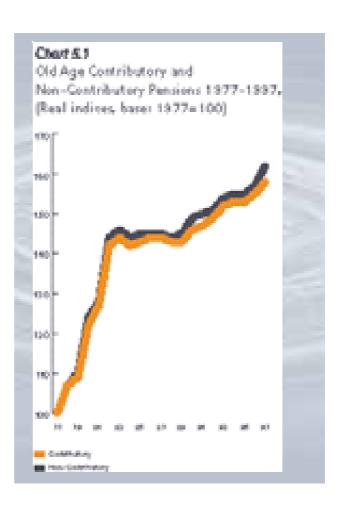
The Board supports the inherent features of Social Insurance and its extension to date especially in a pensions context. Social Insurance payments mean that enterprise and thrift are not penalised, which can be one of the main outcomes of a fully means-tested system.

14. Therefore, the Board has rejected these alternatives and recommends instead, that the entitlement component of Social Insurance should be retained. To underpin the capacity of this system to withstand additional budgetary pressures associated with its proposals in this regard, the Board considers that explicit consideration should be included in budgetary planning to smoothing mechanisms - including an explicit fund - that would minimise the additional burden on future generations of taxpayers from these proposals. The Board's views on the scope for funding are contained in Section 5.2.3.

5.2.2 Indexation

Chart 5.1 contains an index showing the level of old age contributory and non-contributory pensions in real terms, annually from 1977 to date²⁶. As may be seen from the chart, sharp increases took place in real terms, on average, from 1977-1982. Since then, real increases have been much more modest, i.e. in a range of 1-2 per cent per annum. In two years, (1984 and 1988) there were real declines and in a further three years (1986, 1987 and 1995) no change occurred in the real level compared with a year earlier.

Therefore, in practice, there has been effective indexation of Social Welfare pensions to consumer price increases, with a tendency for modest real increases to be granted over and above this in most years.



²⁶ The real index is calculated by deflating the nominal rates of increase by the rate of increase in the CPI.

Table 5.7 and Chart 5.2 show the increases in the contributory old age pension, Consumer Price Index, and average industrial earnings for successive five year periods to 1997. The substantial upgradings of the level of pension in the early 1980s were followed by five years with essentially price indexation. The last ten years have shown overall indexation of pensions much closer to earnings.

Full details of Social Welfare old age pension increases vis-à-vis prices and earnings indices 1977 to 1997 are contained in Appendix P.

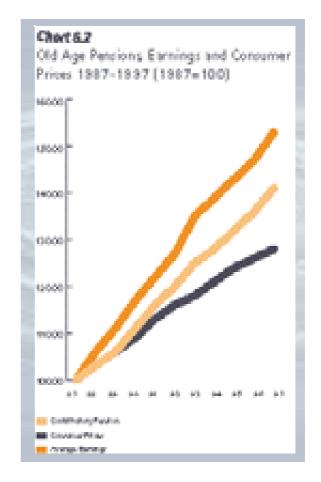


Table 5.7 Comparative Increases in Pension Levels, Prices and Earnings, 1977-1997

riod	Contributory Old Age Pension	Consumer Price Index	Average Industrial Earnings
977-1982	+190%	+103%	+103%
982-1987	+37%	+35%	+53%
987-1992	+21%	+17%	+27%
992-1997	+17%	+10%	+20%
987-1997	+42%	+28%	+53%
977-1997	+461%	+253%	+376%

15. The Board considers that, with the attainment of the prescribed minimal acceptable level of Social Welfare pensions necessary for the avoidance of poverty in old age (as set out in Section 5.1.5), substantial efforts should be made to preserve their real level, unless the economy was to enter a period of very high inflation, or a recession or both.

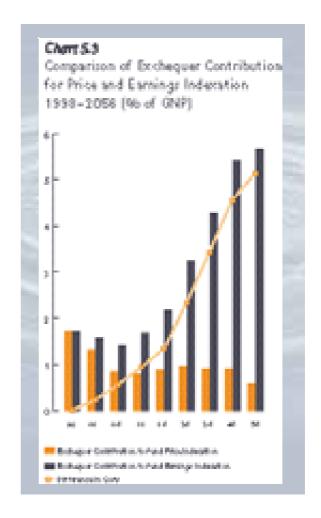
A basic goal such as this would simply ensure that minimally acceptable income levels, judged by contemporary standards, would be preserved in the future. Therefore, the Board views price indexation as a minimum, for a society where there is a broadly based commitment to the attainment of social inclusion. It considers that higher goals should be aimed for. In this context, the Board considers that it would be desirable to aim, over the medium-term, to increase Social Welfare pensions, in real terms, in line with growth of earnings in the economy, as has effectively happened over the past 20 year period.

As noted at the outset of this section, the general pattern in the past has been for some real growth to occur over time. Therefore, the key question is whether there are appropriate mechanisms that could be used to enable greater certainty to be achieved about future trends in the real value of Social Welfare pensions.

Indexation to growth in real earnings in the economy is a mechanism that is sometimes proposed as a means of ensuring that old age pensioners participate fully in economic development. The implications of this approach have been considered in the Actuarial Review. *Table 4.4* shows that full indexation to real earnings growth of 2 per cent would involve a projected increase in Social Welfare pensions outlay, based on 1998 levels, from about 4.5 per cent of GNP in 1998 to 7.6 per cent in 2056. By comparison, indexation to consumer prices, which would simply preserve the real value of pensions at their 1998 level, would result in a decline in Social Welfare pensions outlay to 2.6 per cent of GNP by 2056. The difference between the two approaches is considerable, amounting to 5 per cent of GNP at the middle of the next century.

The effect of this has been indicated in Chart 5.3.

Chart 5.3 provides specific estimates for the case where the pension (based on 1998 levels) is fully indexed to average earnings. This reveals that unless there is a sharp increase in PRSI rates and ceilings there will be a growing requirement for additional Exchequer contributions. These additional Exchequer contributions will grow from a current rate of 1.7 per cent of GNP in 1998 to 5.7 per cent of GNP by 2056, with the sharpest increases coming after 2011, tapering off after 2046.



16. The Board considers that it is impossible to draw judgements now about the likely capacity of the public finances to meet the additional transfer of resources implied by this kind of indexation.

However, the Board can draw a number of other conclusions from the findings.

A guarantee of contemporaneous indexation to real earnings growth into the long-term future would mean assigning a priority to the living standards of one group above others in society. Accordingly, the discretion of elected Government over a significant proportion of national resources that could be applied to meeting other priorities which it might decide upon - e.g. improvements in the living standards of lower-paid employees; measures to improve greater equality; tax reforms aimed at improving the environment for enterprise development - would be constrained.

17. Therefore, the Board does not recommend that a guarantee can be given to full automatic indexation to real earnings growth.

The analysis contained in the Actuarial Review reinforces the Board's view that the proposed commitment to price indexation should be regarded as a minimal one. There can be little doubt that a mechanism which resulted in Social Welfare pensions outlay falling to 2.6 per cent of GNP by 2056 from 4.5 per cent at present, or the value of these pensions falling to approximately 9 per cent of average earnings from 28.5 per cent, while the numbers in receipt of old age/retirement pensions rise from 239,000 in 1996 to a projected 759,000 in 2056, would not only fail in avoidance of poverty amongst those in retirement and dependent on Social Welfare pensions but would actually result in an increase in poverty by the middle of the 21st century.

18. As compared with the past, the Board foresees two channels that are capable of being used to achieve a more certain evolution in the real value of Social Welfare pensions in the future that reflects ongoing and prospective development in the economy. It recommends that the full scope for using these should be developed.

Firstly, with effect from 1998, budgetary policy is being formulated and implemented on a three year rolling basis. Accordingly, there is the scope for Government to articulate, in the context of its priorities and the prospective constraints on financial resources, real growth over a three year budget cycle, rather than for a twelve month period, as in the past. Secondly, there is a sophisticated process of social partnership agreements covering a wide range of economic and social issues, as well as pay. It would be worth including discussion of the scope for real growth in First Pillar pensions on the agenda of such agreements in the future. This would promote wider understanding and acceptance by all the parties involved of the implications of including or excluding Social Welfare pensioners from participating in the prospective real growth of the economy, to a particular extent, over the period covered by such agreements.

5.2.3 Funding Mechanism

If this increase in Exchequer contributions and/or in PRSI contributions is provided for on a pay-as-you-go basis, it will be the working generations from the middle years of the century who will be paying for much of the pensions of those now working, but who will then be retired. To be clear about it, the current working generation will have got off lightly relative to future generations if things work out like this. This prospect presents both an issue of intergenerational fairness and a risk that the future workers will not be prepared to assume this burden.

An appropriate policy change now can help alleviate both the fairness issue and the risk. Thus, the accumulation from now of a fund that would smooth the burden over generations can be envisaged. Contributions to this fund will be invested in a broad portfolio of financial assets selected from global financial markets that can be expected to yield a good return contributing to the growth of the fund. The purpose of the fund would be to place a ceiling on the additional Exchequer contribution required for the foreseeable future. It would mean greater sums allocated to First Pillar pensions (current and future) now, in order to limit the sums that are required in the future.

The advantages of establishing an explicit²⁷ fund along these lines are that it would:

- spread the cost more evenly over time and improve the long-term competitiveness of the Irish economy;
- make additional resources available. These would arise from investing, for maximum long-term
 returns, in whichever capital market these could be achieved. The time horizon during which these
 investments could be made would be quite long. This is because of the prospective favourable
 demographic position of Ireland, for the next 25 years or so;
- give greater scope to manage intergenerational transfers of pension costs;
- facilitate wider understanding and discussion about managing the country's real long-term financial commitments; and
- underpin a greater degree of trust among individuals and social partners.

By having a genuinely invested fund, the actual costs would be reduced. For example, if the fund were to earn an extra 2.5 per cent per annum over the gilt rate as a result of investment in real assets, the additional actual income over the period to 2036 would be sufficient to meet the cost of nearly 5 per cent of all Social Welfare pension expenditure over that period.

19. The Board recommends that steps should be taken now to establish an explicit mechanism to fund, at least partially, the prospective substantial growth that is projected to occur in Social Welfare old age pensions, if they grow in line with real earnings.

An alternative to the explicit fund which is proposed by the Board would be an implicit fund. In essence, the proceeds of such a fund would be applied to reducing the national debt and the implicit return to the fund would be the saving in interest cost as a result of the repayment of debt. The reason why the Board has not recommended this alternative is because it is considered that a larger rate of return could be achieved by maintaining an explicit portfolio with the characteristics and broad investment mandate highlighted above.

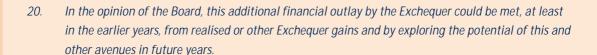
Preliminary calculations illustrated in *Chart 5.4* indicate that, while providing a level of benefit equal to 34 per cent of average industrial earnings with some increase in the PRSI ceilings, it might be possible to cap additional Exchequer contributions at 3.8 per cent of GNP from about 2011 until 2046 from a base level of 1.7 per cent in 1998. By contrast, the additional Exchequer contributions would have risen to 6.8 per cent of GNP by 2046 if the benefit level were increased to 34 per cent of average industrial earnings and a pay-as-you-go basis were retained.

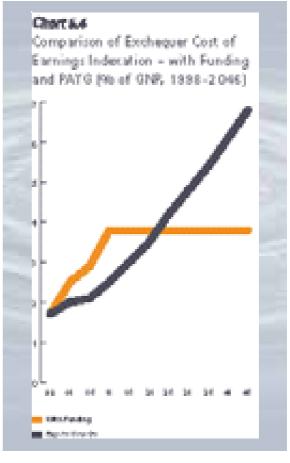
These estimates are based on the following assumptions in relation to the development and growth of the fund:

- an annual contribution of £250 million for the first five years, i.e. 1999-2003;
- an annual contribution of £500 million in the next five years, 2004-2008;
- followed by an annual contribution equal to
 50 per cent of projected PRSI contribution
 income allowing this to grow with income until
 withdrawals were needed to maintain "additional Exchequer contributions" at 3.8 per cent; and
- the fund's assets earn a rate of return of 5 per cent per annum in real terms on average.

Taking the base scenario of the Actuarial Review, this would yield a fund in 2031, of £30 billion or about 26 per cent of GNP. Further details in relation to the Fund and projected financial flows to and from it are contained in Appendix G.

The major requirement here would be for a substantial increase in the Exchequer contribution to pensions, from 1.7 per cent of GNP in 1998 to 3.8 per cent by 2011 which would be maintained until 2046.





The effect of the proposed funding mechanism would, of course, be largely nullified if it led to additional borrowing by the Government. In that case, the mechanism would in effect not lead to any additional national saving by the current working generation, and would not resolve the issues of fairness and risk mentioned above. In order to ensure that the additional funding was not cancelled out by additional borrowing it is proposed that the funds should be invested under specific rules limiting the assets to be held so that no Irish Government securities are allowed.

Introduction of the concept of funding part of future liabilities arising under the PRSI system raises certain practical issues. The task would be undertaken by an agency established under statute. The statutory agency, which should operate independently of Government, but under supervision that would include representatives of the social partners, could be empowered to sub-contract the management of the funds. The statute would provide for clarity of accounting and accountability, and lay down guidelines for the investment mandates to be employed. The statutory agency would need to be given the responsibility to operate and manage the funds in accordance with agreed parameters and to ensure that the fund is invested in line with an appropriate mandate. Efficient operation of the fund is also critical if it is to realise the benefits of setting aside resources in advance.

21. The Board recommends that a clearly stated mechanism for determining flows in and out of the fund is established and published to ensure that uses of the fund cannot be subject to any inappropriate pressures.

Furthermore, the fund should be set investment criteria which allow it to be managed competitively and with the clear goal of maximising long-term real rates of return.

These imply that there should not be any constraints on commercial investment and in particular, that there should be no mixing of financial and social objectives. The entity charged with overseeing the operation of the fund should be sufficiently independent of other State agencies or functions to ensure that there is no risk of such confusion.

The absolute size of the proposed fund would not present threats of distortions of Irish capital markets, if the proposed investment parameters apply. For example, the fund is expected to grow to 26 per cent of GNP by 2026 if the maximum Exchequer contribution is 3.8 per cent of GNP in any year²⁸.

At end 1997, the combined capital value of the Irish equity and gilt markets was equal to 135 per cent of GNP and the then current value of Irish pension funds was equal to almost 66 per cent of GNP. However, the potential for distortions to be created would arise if the proposed fund was restricted or constrained to invest a predetermined share of the value of the fund in Irish securities.

The establishment of the fund, as recommended, would be consistent with the criteria, set out in Chapter 2, to govern any strategy for the future of the national pensions system. In particular, those criteria acknowledged that any proposals needed to be assessed against the sustainability of the system. The proposal to establish a fund to assist in the long-term financing of the First Pillar is designed to secure that sustainability; the fund would achieve this by levelling the financing burden over time thereby avoiding the otherwise significant strains which would be likely to occur during a number of decades in the first half of the next century.

The Board considers that the establishment of an explicit mechanism for funding the First Pillar would make a significant contribution to the management and planning of the overall public finances. Continuation of the present pay-as-you-go system will entail a growing burden on Exchequer resources, especially after the second decade of the next century. By comparison with other European economies, where the demographic profile is much less favourable than in Ireland, the cost of Irish First Pillar pensions is relatively light at present. Therefore, the funding proposal would be an effective means of capturing some of the dividend from the current favourable demographic situation and using it to meet future costs, which are projected to be much heavier than at present, and more in line with the recent experience of other European countries. The effect should be to avoid the Irish financing situation escalating towards the levels currently being experienced in other European countries.

It is vital that Government continues to monitor the growth in these liabilities over the long-term. The recent Actuarial Review, for the first time, highlights the need to plan well in advance for the expected rise in First Pillar costs that will emerge. The Board, in recommendation 5 (Section 4.5.7), has endorsed the Government's intention of conducting such actuarial reviews at five yearly intervals.

In summary, the recommendations to raise the level of First Pillar pension benefits to 34 per cent of average industrial earnings over a 5 to 10 period, to establish a funding mechanism to underpin the indexation of that benefit to earnings increases and to raise the level of coverage of supplementary pensions, will require substantial resources to continue to be allocated towards retirement savings. However, the funding mechanism means that the total proportion of GNP so used will change only gradually and in a way which enables any necessary adjustment to be made in good time and with minimal disruption, as shown in the following table.

Table 5.8 Total Pension Costs as Percentage of GNP Showing Effect of Funding First Pillar Benefits

Cost as % of GNP	1996	2006	2016	2026	2036	2046	
First Pillar without fund	4.84	4.84	5.55	6.84	8.08	9.25	
First Pillar using fund	4.84	5.61	6.39	6.39	6.40	6.24	
Second Pillar*	4.18	4.56	5.02	5.43	5.18	4.76	
Total							
Without fund	9.02	9.40	10.57	12.27	13.26	14.01	
Using fund	9.02	10.16	11.41	11.82	11.58	11.00	

^{*} Public and private sector combined including funded and unfunded schemes.

5.2.4 Other Social Welfare Payments and Allowances

As set out in Section 5.1.2, the Board's recommendation on the future target level of pensions is based on the related issues of both adequacy of pension payment and level of pension coverage. A potentially important knock-on effect that needs to be borne in mind is the possible impact on other Social Welfare benefit rates. To the extent that adoption of higher rates for old age pensions could create a political climate in which equivalent increases in other Social Welfare rates become inevitable, there could be several undesired side-effects, including additional fiscal cost and possible disincentive effects for employment and economic expansion. It needs to be made clear that there is a definite distinction between the old age, widow's/widower's pensions and long-term illness payments on the one hand and other benefits, such as unemployment or sickness payments on the other. The Board considers that in addition to the underlying rationale for the target rate, there are three important reasons why it would be inappropriate to link increases in retirement and related pensions directly with other Social Welfare payments.

Firstly, the former are quite predictable and inevitable being the result of ageing, permanent illness and mortality. They represent clear entitlements, in respect of which contributions have been made and which everyone can expect if they meet the conditions. While the other benefits are also an entitlement they apply only in certain circumstances which may or may not arise and which are not intended to endure for long periods, as is the case with retirement pensions. In addition, the rate of unemployment payment, for example, must take account of incentive issues, which are not relevant to retirement pensions.

Secondly, claimants of old age or related pensions normally have quite limited options to augment their income or generate new sources of earning unlike many other Social Welfare customer groups. Therefore, Social Welfare benefit is likely to be a more vital and core part of long-term income for old age and related pensioners than for others.

Thirdly, there is a considerable allocation of public resources directed at training, education, retraining and job search assistance for those who become unemployed. The benefits from these programmes of public expenditure are not relevant to those on retirement pensions and, therefore, due allowance should be made in the levels of direct payment to recognise the benefits of these various programmes.

Finally, it is noted that Budget 1998 gave explicit special treatment, under both Social Welfare and income tax headings, to provision for the elderly.

22. On this basis, the Board considers that it is reasonable to draw a distinction between the short-term and long-term groups of beneficiaries and that there would be justification in continuing to differentiate between these different types of benefit.

The widow's/widower's pension is a primary benefit in its own right and it is recommended that it should be treated in the same way as the basic old age pension.

Regarding the widow's/widower's pension, the recommendation that this benefit should be treated in the same way as the basic old age pension is made in the knowledge that this category of benefit includes widowed persons under age 66. The Final Report of the National Pensions Board recommended different treatment, for the purposes of eligibility for pensions, of widowed persons aged 66 and over and those aged under 66. It is accepted, for example, in terms of likely labour force participation and income-generating capacity, that the position of widowed persons under 66 and especially those without dependent children will differ from those of 66 and over. However, consistent with present policy²⁹, as well as with the basis of costings in the Actuarial Review, the costings in this Report have included widowed pensions aged both over and under 66. The Board considers that this is an issue requiring wider consideration than the remit of the present Report. It should be noted that if widowed persons aged under 66 were excluded, the costings of the Board's First Pillar proposals would be a little less than stated.

Regarding short and long-term benefits, the Board is of the view also that the relative predictability of old age and related pensions affords the opportunity for different financial management of these two groups of benefit. Old age and related pensions are more stable and capable of steady development whereas other benefits show greater volatility in line with economic and social conditions. At present the two are combined (and had to be separated in the recent Actuarial Review).

- 23. Therefore, the Board recommends that consideration be given to separating the part of the Social Insurance Fund corresponding to short-term and long-term benefits, together with the associated contribution income, from the rest of the Fund.
- 24. The Board further recommends that separate actuarial reviews of long and short-term benefits should be undertaken even if overall costs of both kinds of benefit continue to be borne by single PRSI rates.

At present the non-contributory Social Assistance old age pension is lower than the contributory Social Insurance old age pension rate and the percentage gap is about 12.6 per cent. It might be argued that as a non-means-tested entitlement, the Social Insurance is already a valuable supplement to the basic Social Assistance pension and that it is not necessary to pay more than the minimum guarantee to justify the contributions that have been made to the Social Insurance Fund. However, it is accepted by the Board that there is a wide spectrum of opinion on this point and that, while the Final Report of the National Pensions Board recommended that no such differential should exist, the Commission on Social Welfare recommended a differential of 10 per cent.

25. The Board concurs with the Commission on Social Welfare proposal.

²⁹ A Widower's Contributory Pension was introduced in 1994 and a Widower's Non-Contributory Pension in 1997.

The main benefits of such an approach, in the view of the Board, reside in the psychological importance and reinforcement of the contributory principle, together with the sense of reward which it engenders, for contributors.

5.2.5 Qualification by the Representative of the Minister for Finance

"This note qualifies my approval of the strategy outlined in this Section of the Report.

Governing Criteria

In the course of a discussion of the criteria that should inform the future development of the pensions system (Chapter 2), it is stated that:

'the most important issues are considered to be the capacity of any new policy departure to:

- extend coverage;
- improve adequacy;

balanced against the likely impact on:

- cost competitiveness and employment needs;
- the sustainability of the new system; and
- Exchequer costs.

Any tendency for taxes, or employers' payroll costs, to rise must be taken into account under this heading, as must any impact on the Exchequer as regards tax revenue or public expenditure.

The Report's assessment of the various governing criteria is, in my view, quite correct. However, it is equally my view that the target rate for Social Welfare old age pensions put forward fails to strike an appropriate balance between the relevant factors. Subject to the uncertainties that attach to long-term forecasts in particular, the target rate indicated may prove to be incompatible with the prudent evolution of both the public finances and of the wider economic and employment needs of the country in the longer term. Consequently, I am unable to support this rate (or any rate which is explicitly linked to earnings). In arriving at this position, I have had regard to the considerations outlined below.

Possible Mismatch of Costs and Resources

The results of the Actuarial Review demonstrate the inevitability of the structural changes in the population in favour of older people during the early decades of the next century and the substantial pension cost and financing pressures which will accompany this trend. Healthcare costs are likely to be similarly affected. In contrast, considerably less certainty exists as to whether the economic growth necessary to provide the resource required to meet this demand can be secured or whether any significant public expenditure dividend can be realised from elsewhere within the demographic profile. Ireland must avoid the crucial mistake made by those countries now experiencing pension cost difficulties i.e. against the immediate background of buoyant economic conditions, making too generous pension commitments which prove to be unsustainable in the longer term. It is instructive to note from the OECD analysis outlined in Chapter 4, that Ireland is no exception among the countries studied on the baseline scenario in facing future pension financing problems. The analysis shows that, despite its favourable starting point, Ireland has a not inconsiderable excess in the value of future commitments over future contributions. It is also noteworthy that the share of Ireland's national output required to meet total pension commitments is already at a level close to that in some of the countries which the OECD figures indicate are facing the need for more serious remedial action.

Public Finance Implications

Implementation of the proposed target rate would have serious consequences for the public finances. Latest projections for the period to 2003 show net current expenditure already growing close to the 4 per cent average annual limit set by the Government. Adopting the proposed target rate over the same timeframe would push spending above this limit. Securing offsetting savings on the scale required to remain within the limit would prove very difficult, given the committed nature of much of public expenditure. Subjecting the public finances to the additional pressure involved must also be considered against the background of the following factors:

- given our prospective membership of EMU, the need to respect the requirements of the Stability and Growth Pact. In particular, attention must be paid to the necessity to be in a position to avoid breaching our budgetary parameter obligations in the event of an economic downturn;
- the Government's commitment to a reduction in personal taxation levels and to the substantial reduction in Corporation Tax rates already announced; and
- the constraints in regard to indirect taxation rates associated with trade in the EU Single Market.

Apart from the aforementioned revenue constraints, it should also be borne in mind that the flow of EU funds is likely to decline over the period ahead which will add further to budgetary pressures, as could developments associated with enlargement of the European Union.

The above concerns can be made more concrete by relating the additional cost of achieving the target rate of pension to current national output. This additional cost would be equivalent to about 4.5 per cent of GNP at the end of the projection period. In 1998 terms this represents about £2 billion, which is equivalent to 13 per cent of total current tax take, including income tax, value-added tax and excise duties. Any substantial increase in the tax burden would obviously have an adverse impact on competitiveness which could jeopardise the longer term potential for employment maintenance and creation.

It is clear therefore that the scale of the proposed transfer of resources to pensioners is very large indeed. It is a matter of debate whether if such sums were to be spent in the wider social area that Social Welfare spending has such priority as to warrant its being the sole beneficiary. Even if the answer to this were "yes", the question has to be asked if, within the Social Welfare area, pensions warrant such a priority over all other programmes. No compelling evidence has been advanced to justify giving this priority.

The public finance concerns outlined above would be further compounded if the proposed funding arrangements for Social Welfare pensions were to proceed. Since, in my view, it is unrealistic to expect that the envisaged scale of resources for such funding would be forthcoming in the manner foreseen (that is, through "realised or other Exchequer gains": £250 million per annum over 1999-2003; £500 million per annum over 2004-2008) the Exchequer and the taxpayer would be called upon to meet the bulk of the ongoing funding requirement. In any event, asset disposal would not reduce the impact of the additional spending on the budgetary positions. This is because Social Welfare pensions expenditure counts towards the calculation of the General Government Deficit - the key EU criterion of the annual budgetary balance - when it is paid, regardless of how the expenditure is funded. In such circumstances, the adoption of the funded approach would have to be compatible with overall public finance requirements at the time.

Continued Reliance on the Exchequer

Despite the fact that a central element of the Initiative was to secure substantially greater supplementary pension coverage, the scenario emerging for the next 50 years or so shows an increased rather than any diminishing reliance on the Exchequer to meet pension requirements. This would be particularly the case if the present pay-as-you-go system continues to apply.

Poverty Considerations

Moving pension payment rates to the level set out in the Government's "Action Programme for the Millennium" would result in a significant improvement in the position of pensions. No compelling evidence has been advanced to show that securing the avoidance of poverty among pensioners requires that these rates should be further increased as far as the proposed target rate. There is also the related concern that the incentive to take up supplementary pension cover, especially among the priority groups identified, could be undermined by setting the Social Welfare pension rate at an inappropriate level.

Potential Implications for Non-Pension Payments

The potential knock-on impact of significant pensions improvements on other Social Welfare payment rates and on labour market incentives must also be considered carefully. The arguments presented on this point have merit, but may not be generally regarded as convincing. This is particularly the case when considered in the context of those other persons who are dependent on Social Welfare payments, who may have greater family commitments than pensioners and who also lack opportunities for increasing their incomes. Extending the proposed pension increases to other Social Welfare programmes would also have a serious impact on labour market incentives which would result in both increased public expenditure and a serious restriction on potential economic growth."

5.3 Effect of First Pillar Proposals on Second Pillar

As noted in Chapter 3 (Section 3.6), many occupational pension schemes are integrated with the Social Welfare pension. In particular, the vast majority of defined benefit schemes have their benefits integrated with Social Welfare pension entitlements. This, in effect, means that these schemes define their benefits as an overall level of income replacement taking account of Social Welfare pension entitlements.

A result of the Board's recommendation that the Social Welfare pension be increased to 34 per cent of average industrial earnings will be that the scheme benefits under integrated occupational pension schemes will be reduced consistent with retaining the overall pension at its promised level. This will occur in circumstances in which the interaction of integration and other factors (such as lower pay, integration treatment of part-time/atypical workers) are already a cause of dissatisfaction.

It is clearly important that these issues be dealt with in any proposed reforms of the overall national pensions system. They are accordingly considered in detail and recommendations made in their regard, in Chapter 6 of this Report.

5.4 Tax Environment for Second Pillar

5.4.1 General

Special tax treatment of the different elements of cash flows in pension funds is long established and the tax reliefs available have been one of the powerful incentives to effect pension provision.

The principal features of the tax arrangements for funded occupational pension schemes are as follows:

- within limits, contributions made by employees are deductible for income tax and PRSI purposes;
- employers' pension contributions are also tax deductible in computing employers' profits for taxation purposes and are not taxed as employees' remuneration;
- the investment income and capital gains of the scheme are exempt from income tax and capital gains tax. Funds may claim tax credits attaching to the dividends of companies up to 6 April 1999, after which such credits are due to cease. Funds pay stamp duties levied on equity share transactions and on property deals;
- on retirement, most members may take up to one and a half year's annual remuneration in the form
 of a tax free lump sum;
- where permitted, refunds of personal contributions to members who leave service are liable to tax at the rate of 25 per cent regardless of the individual's tax status;
- pension benefits aside from the lump sums are subject to income tax in the normal way; and
- social insurance pensions are included with occupational pensions (and any other income) in assessing tax liability.

Broadly similar tax treatment applies to members of unfunded public sector schemes and to personal pension arrangements. There are, however, differences in detail as between occupational schemes and personal pensions such as the limits and conditions applying to contributions or benefits, in particular, the limit of 15 per cent or 20 per cent of earnings in contributions to personal pensions for tax relief purposes.

The overall impact on the economy is clearly very important on account of the large amounts involved and the term "tax expenditure" is occasionally used to represent the current "loss" to the Exchequer.

This is too simple as there are several different cash flows, each of which could be quite different if the tax treatment were different. However, they are currently redistributing money, first to those with pension plans from those without them and secondly, foregoing tax today in order to recoup it later when pensions are paid, at which stage redistribution will favour those without pensions.

Although quantifying the cash flows is not easy, the yearly Revenue Commissioners' Statistical Report 1996 estimates the value of tax reliefs on contributions. The latest estimates refer to contributions for 1994/95.

Table 5.9 Estimated Value of Tax Reliefs 1994/95

No estimates are given in the Revenue Report of the cost of the reduced PRSI contribution income. The Consultation
Document included estimates for 1993/94 of the value of exemption of investment income at £125 million, the exemption of tax on lump sum retirement benefits at £20 million and the tax receipts from pensions in payment at £95 million.

Type of Contribution	£m	% of Total Tax Revenue				
Occupational schemes						
- employees' contributions	87	0.8				
- employers' contributions	160	1.5				
Retirement annuities	52	0.5				
Source: Revenue Commissioners' Statistical Report 1996.						

5.4.2 Recommendations of the National Pensions Board

The National Pensions Board reported on the Tax Treatment of Occupational Pension Schemes in January 1988. In particular this report concluded and recommended:

"Tax Relief on Contributions

The only effective method of raising additional revenue through withdrawal of contribution relief would be to eliminate tax relief on employee contributions and either eliminate employer contribution relief, or tax employer contributions in the hands of the employees. This would have serious consequences for both the occupational pension system and the tax system. It would create incentives for employers to underfund schemes, or not fund them at all. Employers and their employees would see little justification in setting up formal pension arrangements. Finally, any such change would require an alteration in the tax treatment of pension payments if double taxation is to be avoided. We would recommend that the present reliefs on employer and employee contributions be maintained.

Taxation of Pension Funds

We believe that the present tax treatment of pension funds is simple to understand and operate, is broadly equitable and clearly acts as a major encouragement to the establishment of funded occupational pension schemes.

We see no justification for changing the present tax status unless it is decided fundamentally to alter the present system by discouraging occupational pension schemes and providing incomerelated pensions through an extended State system. This issue has yet to be addressed by the Board and until the Board has completed its consideration of this matter we recommend no change in the present system.

If the measure were to be introduced simply as a means of raising substantial additional tax revenue the gain to the Exchequer will have been achieved at the expense of a major impact on occupational pension provision.

Taxation of Pensions

We see no justification for treating the pensions which emerge from pension schemes any differently from other income for income tax purposes.

Taxation of Lump Sums

The Board was unanimous in its view that any change in the present tax-free status of lump sums should not extend to such sums earned or accrued prior to the date of any change. The majority of members, whilst accepting that the current status is anomalous, if viewed solely on fiscal grounds, nonetheless considered that the question should not be determined solely on fiscal grounds and the social consequences of such a change should also be taken into account. Moreover, it considered that the tax gains involved in taxing rights which accrue in the future would not be significant in the short-term. In the light of the considerations set out above, a majority of members recommend that no change should be introduced to the present treatment of such payments.

A minority view was expressed that the fact that the tax exemption of lump sums is an accepted fiscal anomaly constitutes an overriding reason for the withdrawal of the exemption for lump sum rights accumulating from the date of any change.

We recommend that, for arrangements set up after a future specified date, the basis for calculating the lump sum element of the member's entitlement should in the case of a "20 Per Cent Director" be changed from the current maximum of one and a half times the member's final remuneration to one representing a fraction of the member's scheme retirement benefits i.e. one quarter.

Tax Treatment of Pensions for the Self-Employed

We recommend an increase in the present contribution limit for self-employed persons (15 per cent of net relevant earnings) in order to bring it more into line with the position for employees. A limit of 20 per cent would, in our view, be appropriate. We recognise that any such change would have cost implications for the Exchequer.

We also recommend the introduction of a system whereby a self-employed person may pay a contribution in excess of the normal limit in a particular year and have the excess contribution allowed for tax purposes in that year. The amount of excess contribution which would be allowed for tax in any year would be limited to any unused relief during the preceding six year period based on earnings and contributions actually paid in those years. We recognise that this recommendation also has cost implications for the Exchequer."

5.4.3 General Approach of the Board

Since the tax treatment of occupational pension schemes has been examined and reported on by the National Pensions Board in the relatively recent past, the Board has not re-examined in detail the issue, or the conclusions of that report within the context of the Initiative.

26. The Board notes, however, that the present regime is based on the broad principle that when a person or his/her employer postpones the use of income by putting it aside for pensions, the payment of tax on such income and any interest it earns is deferred until the income is received. Such a regime is consistent with the approach in most other OECD countries. Furthermore, it acts as a major encouragement to the provision of funded pensions by employees, employers and the self-employed.

Given the progressive nature of the income tax code, reliefs, however, may be at higher marginal rates than the tax rates on pensions in payment (although this would not be true for contributions paid by companies liable to 10 per cent corporation tax). Clearly there is considerable redistribution taking place between different parts of the economy (e.g. between those who contribute and those who do not) and over time. Some of this redistribution is likely to be regressive as coverage is concentrated more on higher tax payers.

The one anomaly in the present regime, as noted by the National Pensions Board, is that lump sums up to a specified level are accorded preferential treatment insofar as the contributions and the payment are both tax-free. This concession is very much valued by pension scheme members, including those with modest incomes, and acts as a significant incentive in the promotion of funded pension provision by employers and individuals.

In this Report the Board has set out a number of proposals which it believes will lead to a significant increase in supplementary pension coverage on a voluntary basis. Targets have been set which if achieved will lead to 70 per cent of the total workforce over age 30 making, or having, supplementary pensions coverage. By definition, pensions are long-term investments. An individual being encouraged to "lock away" significant sums of money to enjoy the fruits of the sacrifice many years later has a right to expect a framework that is durable and not one that is subject to major adverse variations in the future.

27. It is the view of the Board that any uncertainty in the overall tax regime will act as a major deterrent to private pension provision and could seriously undermine the strategies proposed in this Report for improving supplementary pension cover.

5.4.4 Earnings "Cap"

One change to the tax regime that was considered by the Board in the context of the Initiative and which it believes would not run counter to the objective of extending pension coverage was the imposition of an earnings "cap" whereby contributions and benefits, on earnings in excess of the "cap", would not qualify for the current tax reliefs. The excess contributions would not be tax deductible and if paid by an employer would be taxed as a benefit in kind; contributions could not be invested in a tax exempt fund but the benefits emerging would be tax-free thereby placing such an arrangement on a par with conventional savings. Some would justify such a system on the grounds that it would be redistributive, with the tax saving to the Exchequer enabling it, at least in part, to finance the tax loss associated with new pensions provision for lower-paid employees and/or to contribute to the cost of the recommended increase in the level of Social Welfare pensions. Others would argue that the tax and Social Welfare system is already redistributive and that even after allowing the high earner tax relief on his pension contributions, he/she has borne a disproportionate share of the overall tax liability.

Having considered the matter, the Board decided not to recommend the introduction of an earnings "cap" at this stage for a number of reasons:

- unless it was set at a relatively modest level and introduced on a retrospective basis, the likelihood is that it would not generate any worthwhile tax gain to the Exchequer;
- based on the experience in the United Kingdom, where an earnings "cap" was introduced in 1989, it
 would add a further layer of complexity to the administration of the current tax reliefs, particularly
 in the case of defined benefit schemes and would, therefore, run counter to the objective of
 simplifying the existing tax rules.
- 28. Although not recommending the introduction of an earnings "cap" at this stage, the Board believes that the issue should be kept under review.

The representatives of the Minister for Finance and Minister for Social, Community and Family Affairs on the Board consider that the introduction of an earnings "cap" should be examined in detail by a group comprising the appropriate authorities including Revenue Commissioners, Department of Finance and Department of Social, Community and Family Affairs, in consultation with the Board and with relevant interest groups.

5.5 Improving Voluntary Private Provision

5.5.1 Problems Addressed which now Inhibit Coverage and Quality

The second avenue of provision for retirement income relates to voluntary provision through formal occupational and personal pension schemes. These are already significantly encouraged by tax reliefs, and the major barriers identified to an expansion of coverage fall under the headings of:

- access to pension provision;
- information gaps;
- running cost particularly with respect to small and personal pension plans;
- avoidable investment and annuity risks; and
- problems of design to meet the needs of a more mobile workforce.

Access to formal pension provision with its associated tax incentives has historically been inextricably linked to employment and there is considerable complexity in understanding when contributions can be made to different types of provision and how much can be put aside from time to time.

In particular, this has meant that those not employed are precluded from providing for themselves. Even those at work, while in theory able to participate in pension cover, can find it difficult to understand the questions to ask, to appreciate the practical restrictions and even how to go about setting up pension provision in the first place. This is also true for those with lower incomes, those who change jobs frequently, and atypical workers (who are often not eligible to join a scheme open to other workers).

The complexity, therefore, makes it difficult for many to find relevant and cost-effective sources of pension provision and for providers to access such people economically.

Access to pension cover can, therefore, be improved dramatically by breaking the formal link between employment and pension provision and by simplifying the current regime for both the individual and the provider. Other more explicit steps are recommended to enable people to have access and to start their own provision in a simple and straightforward way.

Information gaps emerge because of the complexity of the institutional and regulatory arrangements involved. This applies both to defined benefit schemes and defined contribution schemes, bearing in mind such aspects as the Revenue limits on tax-free contributions and the difficulty faced by non-professionals in judging their future pension needs and the adequacy of current savings to meet these needs.

A basic lack of awareness of the value (and cost) of pension provision is also widespread leading to apathy or a lack of immediacy in starting pension saving.

Assessment of the quality of investment fund management and the probity of financial intermediaries is also beyond the ability of the typical non-professional. Information gaps generate uncertainty and doubt, and inhibit pension savings.

The challenge of reducing *running cost* applies to costs faced by employers in providing occupational schemes, to the industry in meeting regulatory requirements, as well as to the beneficiaries themselves. Complexity is also the key issue in contributing to the administrative cost of making pension arrangements. In particular, small employers are reluctant to embark on the overhead costs of setting up a pension plan, while individuals, who cannot participate in group schemes, find that a large fraction of their initial pension savings can be absorbed in administrative charges. While there is no evidence of overcharging and mis-selling on the scale experienced in the United Kingdom, that experience shows the potential problem and itself discourages the would-be saver.

Risk arises both in terms of the investment performance of a pension fund before retirement and of the annuity paid thereafter. The investment performance of long-term funds is much discussed, and varies widely as between different fund managers. Over the long-run, the value of a poorly-managed fund can fall very far below the mean. This is a particular problem for defined contribution arrangements where the investment risk is essentially borne entirely by the individual.

It is clear that most older savers do not have sufficient excess resources to take what is perceived as high degrees of risk with the sums set aside for retirement. On the other hand, unduly cautious investment policies, placed in fixed interest or cash-like securities, by younger savers, systematically lose out over the long-term - and by quite a substantial margin. Guidance for individuals is clearly called for.

At or about the time of retirement, the value of the fund in a defined contribution plan is converted into an annuity on the life of the pensioner. Representing, as it does, a firm guarantee by the institution that they accept the longevity risk, this annuity is inevitably priced on a conservative basis - even in a competitive market. As a result, the annual sum payable often appears low to the pensioner in relation to the capital sum. This is especially so if market interest rates are low at the time of retirement. An additional problem is that, if it is set in fixed nominal terms, the annuity will not protect the pensioner from inflation. A further difficulty relates to perceptions: many people who convert a tangible fund or lump sum into an annuity feel they are exchanging cash for future promises; moreover, if they die, the cash may not revert to their estate or dependants, unless they make specific arrangements in this regard, by accepting a lower annuity with some guaranteed reversion on death. A number of potential means to mitigate these problems of annuity risk are available. (These are dealt with in Chapter 6).

Increasing variety in career structures and the expansion of part-time employment generate a number of technical obstacles to the accumulation of pension rights, and increases the cost of doing so. Regulations and the *design* of pension plans need to be brought up-to-date to offer prospective contributors the assurance that they will be able to have, at reasonable cost, continuity in the build-up of a fund and that the tax treatment of their contributions will be fair. Without such assurance, prospective contributors will be reluctant to get involved. In addition, some increased flexibility and simplification in the benefit structure can make pension saving more attractive.

Each of these problems can be alleviated by measures which are proposed below. By improving arrangements for the delivery of low-cost, value for money and secure provision for pension saving in a simple, transparent and well-understood manner, the Initiative intends to create a platform for a substantial expansion in the effective demand for pension plans. In addition, the need for a programme of increased education and awareness is considered to be an essential element for ensuring the success of the Initiative.

Although occupational schemes and individual provision via retirement annuities are often seen as quite different avenues and are, to some extent, treated differently by tax and prudential regulations, a salient feature of the recommendations is that much applies in common to both avenues.

5.5.2 Defined Benefit or Defined Contribution

As explained in Chapter 3, occupational pension schemes developed initially on a defined benefit basis but in the last decade or so the majority of new schemes have been established on a defined contribution basis to the point where currently approximately 32 per cent of those employees covered in the private sector are in defined contribution schemes³⁰. One issue frequently debated is the relative merits of occupational defined benefit and defined contribution schemes. In reality the differences between them are often exaggerated. For a given level of joint employer and employee contribution as a percentage of earnings, the expected level of pension may not be very different. The level of pension will depend on such factors as investment performance and costs. Final salary defined benefit schemes are likely to favour those who stay at the expense of early leavers. In a defined benefit scheme the employer bears much of the risk, whereas in a defined contribution scheme the employee bears much of it. On the other hand, favourable investment returns in a defined contribution scheme accrue to the employee whereas under a defined benefit scheme excess returns accrue to the employer and, in many cases, are used to reduce future contributions. The principal reason why lower benefits are often provided by defined contribution schemes is simply that the contributions are at a lower rate.

The vast majority of current defined benefit schemes are well managed and adequately funded and it is important that the Board's recommendations for improving supplementary pension cover support and complement existing good defined benefit schemes and do nothing which might prevent an employer from setting up a defined benefit scheme in the future where circumstances are appropriate. Nonetheless, the reality must be faced i.e. the majority of schemes set up in the past decade have been on a defined contribution basis. Furthermore, in many of the areas where current coverage is low, establishing a defined benefit scheme would give rise to potentially very volatile funding requirements due to the small numbers involved and the likelihood of the actuarial and other assumptions materialising being small. As a consequence, there would be a distinct possibility that benefit promises may have to be reduced perhaps when a member is close to retirement with little opportunity to make good the reduction.

The major focus of the Board's recommendation for improving and extending supplementary pension coverage is, therefore, of necessity based on the defined contribution principle. Nonetheless, it is important that employees are facilitated in considering the adequacy of the pension likely to emerge from a defined contribution scheme. Hence, a major recommendation from the Board is the provision of relevant information (including a certificate of reasonable expectation) in a form which can be readily understood by all whose benefits are arranged on a defined contribution basis.

³⁰ From Table 3.3. Taking those with retirement annuities into account, 44 per cent of all those with private sector coverage have defined contribution types of cover.

5.5.3 Occupational and Personal Provision: Differences and Similarities

While it is customary to think of occupational pensions and personal pension arrangements as being quite different, the underlying logic is quite similar.

29. Recommendations of the Board contained in this Initiative aim to encourage further convergence to the point where - at least for defined contribution schemes - the structures will be not only similar but so close as to allow for continuity of retirement saving throughout a career in which the beneficiary moves in and out of employment or self-employment.

As a major vehicle for achieving this, the Board recommends the introduction of a Personal Retirement Savings Account (PRSA). It is considered that its introduction will facilitate a major simplification of the regulatory and legal structures that exist at present. It would facilitate other developments also, such as umbrella schemes, which could contribute to increased coverage. Furthermore, the introduction of the PRSA will provide a platform for a major information and education drive that will help increase awareness and promote retirement saving.

The characteristics of the PRSA, and its relationship with existing arrangements, are spelled out in Chapter 6. The PRSA will be a defined contribution (or money purchase) vehicle and will be based on the structures for the retirement annuity contracts already available to the self-employed. It will be made available to employees and others to make contributions. PRSAs will also be open to employers' contributions, additional voluntary contributions and to the deposit of transfer values. Portability will be improved at low administrative cost. In short, the PRSA will be a flexible multi-purpose tool for retirement saving and is envisaged as the major vehicle for growth of pension provision. Insofar as much of the remaining reforms apply both to occupational and personal plans alike, they will be treated together as in Section 5.5.4 below.

But there remain certain reforms and issues specific to occupational schemes. Among the main points here are:

- higher occupational coverage will be the consequence of expected EU legislation, which has been
 drafted already and which mandates the extension of existing schemes to permanent part-time
 workers. Of course, this will involve additional costs for some employers;
- a simplification of tax rules for occupational schemes, but which protects against abuses. These
 reforms would facilitate beneficiaries combining defined benefit and defined contribution schemes
 whether simultaneously or sequentially through their working life and allow free-standing additional
 voluntary contributions to be taken; and
- despite many recent reforms, there is still a need to improve vesting and preservation provisions and revaluation of deferred benefits to take account of inflation. The latter would be potentially costly, but not unduly so in the likely low-inflation environment of the EMU.

The Board's detailed recommendations and prescriptions in relation to these matters are contained in Chapter 6, Section 6.7.

5.5.4 Improvements Common to Occupational and Personal Provision

The specific improvements proposed by the Board that are common to occupational and personal pension schemes are in the following areas:

Meeting Ownership and Information Gaps

In addition to a broad educational initiative to generate widespread awareness of the need for pension savings, and of the new simplified structures which facilitate them, two specific types of information improvement are proposed.

The first will provide for more and clearer information to members of defined contribution schemes and those with PRSAs of the benefits which are accruing to them. This will include a certificate of reasonable expectation regarding the implications for future pensions of the actual and prospective investment performance of the accumulated fund and structured guidance to members as to the adequacy of the savings being made.

The second measure will be a kitemark or quality assurance of the detailed pension scheme contract. Rather than insisting on a standardised contract which must be applied to all approved pension schemes, new contracts will be scrutinised for the protection they offer to the beneficiary. While this scheme could be self-policed by the industry, recent United Kingdom experience suggests that it would be more credible if operated by a public agency. The kitemark would also extend to investment mandates and to the structure of charges. Any perceived risk that this procedure could lead to an expectation that beneficiaries would have to be compensated by the State in the event of default, or of poor investment performance, should be removed by a clear statement of the scope of the quality assurance.

When the kitemark regime is sufficiently established, a review should be made to see if it is having the desired effect. If not, then further layers of customer protection may need to be introduced.

Reducing Costs

Costs can be reduced by availing of economies of scale, by simplifying regulation and by controlling abuse of market power.

Under the heading of economies of scale, the simplification of products should facilitate the development of industry-wide or umbrella schemes but would not be limited to these.

The introduction of standardised investment mandates should give the additional confidence to individuals to take appropriate levels of risk with their savings. This is likely to lead to higher investment returns (than if the individuals made entirely their own investment choices) and should make a significant impact on the size of ultimate pension emerging.

Simplification of regulation should proceed in four broad directions:

- First, tax rules for different types of provision need to be harmonised to ensure easy transition between one and the other, for example, as a person moves between employments that have occupational schemes, employments without occupational schemes and self-employment. At present, the calculation of allowable contributions and the costs of transfer can be onerous. This simplification will facilitate coherent pension provision at reasonable cost for the atypical career. These changes have to be specified in careful detail, not least to protect the Exchequer against loss of revenue through manipulation of the new rules beyond their intended scope. (The kitemarking initiative mentioned above should also contribute to simplification);
- Second, regulations to improve the supply of relevant pension plans should be clarified and streamlined. The purpose of this recommendation is twofold: first, to ease entry for established financial institutions with wide retail networks (for example, building societies, credit unions or An Post), thereby facilitating a wider and more convenient distribution of plans from approved providers; second to make provision for employers and unions to establish industry-wide schemes or for other umbrella schemes. The main purpose of regulation is to ensure clarity over the responsibility of supervision of pension activities and to ensure that it is relevant to the particular needs of pension provision, as well as to catch the non-compliant and/or fraudulent operators and to deter such activity. These criteria should be used as guiding principles in conducting the proposed review and to establish the extent to which there are unnecessarily restrictive regulations, i.e. ones which do not meet these criteria or provide effective safeguards to customers from potential new providers;
- *Third*, the Board could become the common regulator of both occupational pension schemes (as at present) and of the new personal pension regime to be led by the PRSA; and
- *Fourth*, the use of an Appointed Actuary system of supervision will enable this to be carried out reliably and without excessive workload falling on the regulator.

In order to reduce the danger of abuse of market power by pension fund managers and distributors, two steps need to be introduced. First, charges should be required to be stated in advance and should be in the form of a stated annual percentage of contributions or of asset value. This will need to be defined closely and policed. Second, legislation authorising the Minister to impose controls on rates of charge should be contemplated. This second step carries some risk of discouraging industry participation and its implementation may be held in reserve pending an assessment of experience with the first step alone. Its constitutional legality would also need consideration.

Avoidable Risks Related to Investment Returns and Annuity Value

It is very important to encourage appropriate risk/return profiles for the investment strategies adopted by individuals and to ensure these are carried out without incurring unduly heavy transactions costs. It is believed that the introduction of standardised investment mandates would help considerably. These mandates will ensure that the fund managers operate within certain criteria which take into consideration the age of the beneficiaries and the issue of annuity risk. Kitemarking will specify whether the fund chosen is in accordance with an approved mandate, although it will be quite permissible to adopt a different investment stance provided that this is clearly identified as being non-standard. These mandates should not have a minimum domestic/overseas requirement.

Index-linked annuities should be established as the norm. This will become easier in a unified EMU financial market where the euro rate of inflation will be readily hedged assuming continuation of membership by Ireland.

5.6 Other Mandatory Provision

Improvements proposed in the Social Welfare old age pension (Section 5.2), and in the voluntary provision of occupational and personal pensions (as outlined in Section 5.5) represent a development and intensification of existing policy measures and recent trends. On their own they may not go far enough to achieve the goals set. More compulsion may also be needed.

A degree of compulsion in terms of the design of schemes and the behaviour of the pensions industry is already involved in elements of the Initiative as they relate to occupational and personal pension plans. But so far as beneficiaries and employers are concerned, at present the PRSI system is the major mandatory element. Additional elements of compulsion could be extended in any of four different ways, listed below.

Types of Compulsory Second Pillar Provision

- (a) Mandatory provision of access by all employers to coverage for all employees;
- (b) Mandatory contributions by employees (in reserve);
- (c) Mandatory contributions by self-employed (in reserve);
- (d) Mandatory contributions by employers (in reserve).
- 30. The Board recommends that the first of these (i.e. (a)) should be implemented in the short run.

 Additional increased coverage could certainly be achieved by going further down the list (at (b) to (d)), but this would entail costs that should not be incurred unless necessary.

Therefore, the Board recommends that these additional options should be held in reserve. Further consideration should be given to these only when it can be ascertained that insufficient progress has been made towards the targets set out in Table 5.1 Section 5.1.8. The first meaningful opportunity for such a review would arise five years after the implementation of the proposals. The review would take account of any new information such as that resulting from the research proposed in recommendation 10.

(a) Mandatory Provision of Access by all Employers to Coverage for All Employees

This would essentially reduce access costs for employees at a relatively modest administrative burden for the employer. The regulatory simplifications, and the prospect of one or more umbrella schemes being introduced, should considerably reduce the cost burden of complying.

31. The Board recommends the introduction of universal access via payroll deductions by the employer, with employer/employee discussion to decide which provider should be chosen. (See Chapter 6, Section 6.4.2). It also recommends (in Chapter 6) that, from their introduction, PRSAs would not be subject to a requirement for employers to meet one-sixth of the cost, and that trust schemes would be treated similarly in this respect.

(b, c) Mandatory Contributions by Employees, or by All Income Earners

This could work as a kind of forced saving scheme. Provided that the contributors are confident that their savings will be returned to them, together with accumulated investment earnings, in the form of retirement income, it will not be seen as a tax. In order to avoid the risk that it will not be credible, and effectively to distinguish it clearly from taxation, most such schemes in operation or under discussion across the world do not pay the forced savings into a Government-controlled provident fund (like that of Singapore), but, if not, then assurance would be needed that the cost and reliability of the scheme is adequate. Another clear distinction from taxation and from social insurance contributions, is that the contributions would be placed in a defined contribution-type scheme, the entitlement to the value of the invested funds clearly accruing to the contributor.

This would be guaranteed to increase coverage, though its impact on national savings would be likely reduced by substitution from other savings media.

32. While such an approach could be envisaged, the Board considers that it goes too far in present circumstances when so many other reforms and proposals coming from this Report are pending. Accordingly, the Board recommends that this option should be considered in the context of a progress review to be undertaken five years after the implementation of the proposals, if insufficient progress is being made towards the goals set.

(d) Mandatory Contributions by Employers

In the short-to-medium-term, with pre-contracted wage rates in effect, mandatory pension contributions would amount to an increase in employer costs and a benefit to employees. In the absence of offsetting cost reductions for employers, there would be short-term effects on competitiveness. Similar arguments might also apply to the mandatory establishment of a defined benefit scheme to which the employer is required to contribute. However, the likelihood of reductions in employers' costs following from increases in First Pillar provision and the possibility that these reductions may offset the increased costs of improved Second Pillar provision should be considered carefully in relation to this option. Clearly, mandatory contributions by employers would be an effective way of achieving the desired objectives, if an acceptable basis for doing so and for sharing the increased costs with other players could be found.

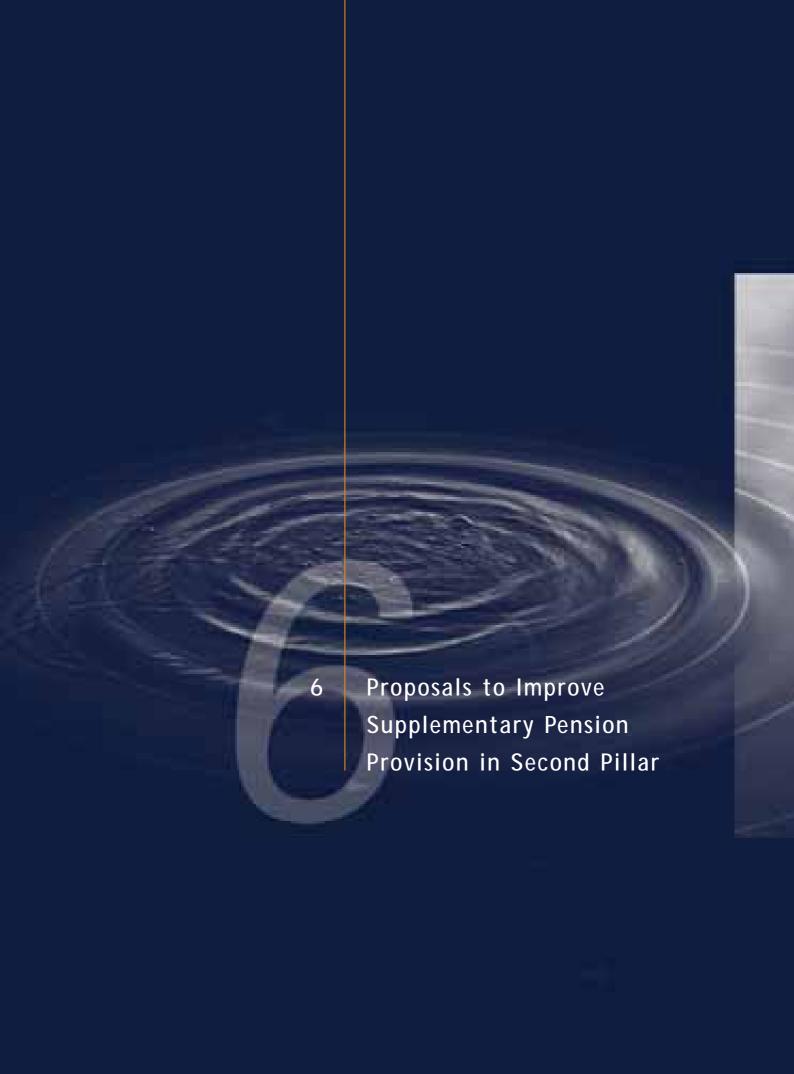
33. While such an approach could be envisaged, the Board considers that it goes too far in present circumstances when so many other reforms and proposals coming from this Report are pending. Accordingly, the Board recommends that this option should, like those at (b) and (c), be considered in the context of a progress review to be undertaken five years after the implementation of the proposals, if insufficient progress is being made towards the goals set.

5.7 A Graduated Plan

The design of this Initiative is governed by the need to balance the likely ability of the reforms to achieve what is being sought with the costs of the reforms and the practical constraints involved.

Any desired coverage rate can be achieved by sufficiently severe compulsion, but there are costs, both financial and indirect.

- 34. In the Board's view, it is essential to balance the risks and costs of compulsion with the benefits it can achieve and to go no further down the road of compulsion than is necessary to achieve agreed objectives.
- 35. The recommended Second Pillar package is at the limit of what could be introduced feasibly with confidence over a relatively short timescale. However, it cannot be guaranteed to achieve the coverage objectives. That is why the Board has also outlined further measures to be held in reserve for the present, but which could be introduced following a review of the effectiveness of the measures actually adopted. It is recommended that this review should take place five years after the implementation of the proposals.



6 Proposals to Improve Supplementary Pension Provision in Second Pillar

6.1 Overview

This chapter contains an elaboration of measures and recommendations that require to be introduced and implemented to give effect to the strategic approach, proposed in Chapter 5, as it relates to improving supplementary pensions provision. In addition, the measures address issues and concerns in relation to the current pensions environment, which have been discussed earlier in Chapter 3. The rationale for proposals contained in the strategy is set out in detail and the implications and ramifications of recommendations are elaborated upon.

Numerous recommendations are made to improve the extent and quality of coverage. For the most part, the changes proposed are interdependent. If implemented as a whole these would entail a major and fundamental, but manageable, change to the existing basis of pension provision.

As well as recommendations to support the growth of pension provision, other fundamental objectives are addressed, namely:

- ensuring that the customer has access to coverage which is understandable;
- allowing the customer to make informed decisions;
- recognising the reality of customer circumstances;
- offering good value for money;
- generating greater trust in the system;
- providing a robust and flexible platform within which the pension system, in future, can adapt with relative ease;
- recognising the current position of individuals, employers and the pensions industry; and
- building from that which already exists in a way which is realistic.

Many measures are proposed to assist in achieving these objectives.

The prime reason for the Initiative is the belief that there is much which can be done to improve the extent of pension coverage. In addition, the Board is aware that there are many other aspects of pension provision where quality or delivery could be improved and it believes that addressing these would help materially to achieve the primary coverage goals. Many of these aspects were identified in submissions and market research carried out in response to the Consultation Document and at the National Pensions Conference. These are set out in Chapter 3 and Appendix A. Among the most important problem areas arising are:

- perceived complexity of pension provision and the language used;
- consequential difficulty in reaching decisions about appropriate pension provision;

- inflexibility in current legal structures in catering for more frequently changing employment status, particularly those in atypical careers;
- exclusion from pension provision or the lack of easy access to it;
- limited range of suppliers;
- the potential for mistrust; and
- costs, seen as relatively high especially for smaller arrangements, including those costs perceived
 as arising from Pensions Act regulation and trustee responsibility on employers with small
 occupational arrangements.

However, the Board is aware and acknowledges that there are many aspects of current pension provision which are very valuable and sound and that the overall pensions environment in Ireland is well regarded generally, notwithstanding the concerns highlighted above. In particular, very many people already have high quality provision in place which should address their retirement needs satisfactorily. Therefore, in framing recommendations, the Board has been careful to ensure that measures which are proposed would not undermine these arrangements, but would rather support and complement them. Indeed, in developing its recommendations, the Board has taken into consideration possible effects on existing good quality coverage.

This recognition has led the Board to take an approach which might be summed up as evolutionary rather than revolutionary, but which still offers considerable prospect of significant development in coverage in the near term. It has framed its recommendations deliberately in a way which allows a platform to be built which would be capable of considerable further extension if the mandatory aspects of the graduated approach are called for in the future.

This means that, with respect to many of the specific recommendations which follow, the degree of change involved would be quite significant but scope remains to extend them further in a way that would be more radical. Thus, the Board has aimed to strike a balance in proposing changes so that they go sufficiently far to bring about significant improvement but not so far that existing coverage might be undermined or that conditions would arise where undue risk was created which could prevent commercial providers from adapting successfully. It has also tried to avoid recommending change which would be overly complex or where the resulting market behaviour would be quite unpredictable.

There is a need for a graduated approach to the implementation of the proposed restructuring. It is not possible to predict, in precise quantitative terms, what would be achieved by way of extra coverage, in either the extent or quality - that will depend on how the pension providers and others seize the new opportunities which would be made possible through implementation of the Initiative.

It is considered that a framework has been proposed which enables providers to choose how much use to make of the additional flexibility that would be created as a result of implementing the Board's proposals, in adapting or developing products in order to meet customers' needs better than was previously possible. New providers who may bring new approaches would be encouraged to enter the market by virtue of the opportunities created as a result of the new product and simplified access. The market for pension provision is not uniform and there is a need for a diverse range of providers.

The recommendations for improvement and extension of supplementary pension provision can be grouped under a number of different headings, namely:

- introduction of a new type of pension vehicle, the Personal Retirement Savings Account (PRSA). This is aimed at meeting the needs of the flexible labour market of today without undermining existing good provision, especially in defined benefit schemes. Because of its expected simplicity, it is likely that it would supplant some existing defined contribution and additional voluntary contribution arrangements, but would not result in an inferior quality of pensions product. By facilitating new distributors to enter the market, who could tap previously untouched customer sectors, it would become available to more people than existing arrangements. It would have a degree of simplicity and cost-effectiveness which has not been available in the past from existing arrangements. These features should add significantly to its attractiveness;
- simplifications and changes to tax structures. The purpose of the Board's recommendations is to reduce complexity which increases cost and makes it more difficult for employers and individuals to understand and commit themselves to making pension provision;
- steps which will widen access to pension provision. These relate to allowing access for all employees
 to coverage through their employer, equal treatment for part-time, seasonal and other atypical
 workers, allowing those not acutally working to make provision and facilitating the establishment
 of umbrella schemes;
- establishment of a norm for what would be regarded as a good quality product. It is recommended
 that products which meet the standards of flexibility, scope and information which make up the
 norm should be allowed show a kitemark so that customers can have confidence that they meet
 common needs. Part of the purpose of this is to help customers to make the best long-term
 decisions in relation to their future needs, especially in terms of investment. Another objective
 is to ensure that, with increased simplicity, customers can be sure that the product has the
 characteristics that are required;
- *improvements to existing pension arrangements.* These measures, such as improved vesting and preservation provisions, generally entail little additional cost to the schemes involved and are geared more at improving value and flexibility for those already covered; and
- a regulatory regime suited to the new environment. Generally the proposals make use of structures which already exist or involve additional steps which are considered to be needed in any event.

The proposal to introduce PRSAs is an innovation and is regarded by the Board as a major step towards the creation of a more flexible and portable pensions product suited to the needs of today's labour market. However, all the main avenues of development are intrinsically interlinked. For example, the introduction of PRSAs should facilitate the commercial development of new forms of access which are proposed and it should encourage new entrants to the pensions provision market. All of these developments will benefit from and contribute to creating a greater degree of confidence and trust which should flow from the proposed establishment of quality measures. The entire proposed development of Second Pillar pensions will require appropriate supervision, and sufficient safeguards are contained throughout the proposed measures to ensure that their introduction would not undermine existing good occupational coverage and benefits.

The recommendations made under each of these headings apply to the different strands of the strategy contained in Chapter 5: to personal pension plans, to occupational pension schemes, across all types of provision, or to an environment in which there was to be a mandatory approach taken. In order to avoid duplication in this chapter, recommendations are presented according to the type of development which is involved rather than by reference to the type of current provision to which they apply.

6.2 Product Innovation: The Personal Retirement Savings Account (PRSA)

The Board foresees the introduction of the PRSA as a key development which would encourage retirement savings throughout a career in which the beneficiary moves in and out of employment or self-employment. It is considered that PRSAs would have a significant impact on improving pensions coverage, since they would meet more closely the specific requirements of current and prospective employment patterns.

6.2.1 Definitions and Key Features

What is a PRSA?

It is an investment account which is owned by an individual. It holds units in investment funds which are held with and managed by an approved PRSA provider. It may be transferred from one provider to another (subject to some controls to prevent abuse - mainly additional information in relation to charges, including the costs that would arise in transferring from one arrangement to another). It would be transferred to an institution authorised to offer annuities when a life annuity is eventually purchased. It may be viewed also as a new marketing device, which would offer a distinctly more relevant and accessible pension provision to everyone. It would contain explicit built-in measures to establish quality and trust. These characteristics would be a valuable and essential plank in realising the potential offered for significant growth in coverage.

PRSAs should be introduced under new legislation, which would establish them formally as investment vehicles requiring approval from the Board and the Revenue Commissioners. They should qualify for similar tax treatment to other pensions products and contain other attractive features. Specific conditions should apply to their use and operation which would distinguish them from other savings products. In particular, there would need to be limits placed (for tax purposes) on the amount that could be invested.

They should be personal in nature, i.e. owned by an individual, although they could be grouped (as an umbrella scheme or other group arrangement) for administrative purposes, e.g. for employers to contribute to, or to route individual contributions to, investment managers.

PRSAs are contracts with individuals. Accordingly, they would be subject to the general body of consumer protection legislation and existing measures relating to personal financial contracts such as disclosure as described in Section 3.7. There would be additional protection provided by the proposals for kitemarking appropriate PRSA products and from the regulatory regime for PRSAs.

The proceeds from PRSAs should be available to provide benefits on death or retirement. Prior to that they should be invested by an approved institution. On death, the value of the fund should pass to the owner's estate less appropriate taxation; alternatively, it could be used to provide a pension for a dependant. On taking retirement benefits (part of which could be taken as a lump sum) most of the proceeds should have to be used to buy a pension from an institution authorised to offer annuities. This need not be the same organisation as the investment manager - an institution can carry out either or both of these functions.

Financial institutions wishing to offer PRSAs should have to assume various responsibilities in order to be (or remain) an approved PRSA provider. These are described in Section 6.8. Typically, life assurers, banking institutions, building societies, credit unions, An Post and fund management companies, would be suitable PRSA providers or parent companies of PRSA providers - as would non-financial enterprises which have large distribution networks (following the example of supermarket chains in the United Kingdom) - provided in all cases that they demonstrate sufficient capability, long-term commitment to the market and compliance with appropriate regulation.

It is considered that PRSAs would be attractive to a wide range of workers, from atypical workers and a wider range of other workers - such as those in smaller companies or those seeking free-standing additional voluntary contributions - to highly paid professionals or business people.

Key features of PRSAs are considered to be:

- they would be available to individuals irrespective of employment status. This is in direct contrast with the current situation where an individual can contribute to a retirement annuity only if he/she has relevant earnings from self-employment or is in non-pensionable employment. An individual in pensionable employment may be able to make additional voluntary contributions to boost benefits (a small minority of schemes do not have such provision). However, at present, if an individual's employment status changes, there is an obligation to cease contributing to the existing pension arrangement, although the person may start all over again in a new arrangement, depending on the new circumstances. As careers become more and more fragmented, the costs of all of this will become increasingly onerous and unacceptable both to individuals and providers. By contrast, the owner of a PRSA would be able to continue it whenever a change occurs in job, or if they stop or start work. This would represent a major advantage over both existing personal pension plans and occupational defined contribution schemes. Therefore, the PRSA has the capacity to fill gaps in coverage more effectively than existing arrangements;
- they would have a flexible retirement age, with benefits determined purely by reference to the fund accumulated and without any reference to a planned retirement date. Early or late retirement would be catered for simply by allowing benefits to be taken at the appropriate time;
- a deferral option would be permitted allowing an owner of a PRSA to draw a certain level of income from his fund but postpone the time when he must eventually buy an annuity for life (at age 75 at the latest);
- there would be better information to owners and greater customer protection as compared with the
 present as a result of the kitemarking arrangements that are proposed as an integral element in the
 introduction of PRSAs:

- a standard minimum set of terms and conditions would provide a framework for PRSAs. These would explain in simple language what can and cannot be done by way of investment and taking of benefits. No such standard applies to either personal pension plans or occupational pension schemes at present;
- it is envisaged that investment mandates would be developed so as to help owners to understand and accept an appropriate level of risk, in order to maximise their long-term benefits. At present, investment is probably one of the most obscure aspects of pension provision; and
- the potential would be created for a wider range of pension providers extending to banks, building societies, credit unions etc. Hence, access would be expected to be easier and competition would be likely to be keener than at present.

The current prohibition on individuals withdrawing part of their accumulated fund, or using their pension plan as collateral, has been seriously questioned. The main argument for some flexibility is that, if this restriction is a major deterrent to increasing coverage, some relaxation of the conditions under which pensions could be used to raise capital would be a significant encouragement to increased coverage. If a person has immediate financial needs, it may seem incongruous to deny them access to funds in all circumstances.

The alternative view is that pension provision should not be diluted for any reason no matter how pressing, and that the various incentives should not risk being abused for short-term financing needs.

There is experience from the United States which is relevant. There, 401(k) plans are not dissimilar in many ways to PRSAs. Some 401(k) plans have associated loan facilities attached. There is research to show that plans which have these facilities have a higher take-up rate especially among the lowerpaid and the amounts contributed are noticeably higher than for plans without them¹. Loans can be made for a range of purposes but there is evidence that most people see them as unsuitable for nonessential purposes². A small proportion of members avail of loans at any one time and they tend to be concentrated among the lower-paid contributors. This experience would tend to support the case for permitting some use of the funds built up.

Critically, the capacity for some form of access to accumulated funds would seem likely to enhance the attractiveness of PRSAs, thereby increasing the incidence of their take-up and resultant overall pension coverage. This enhancement could be especially important in encouraging younger people to commence saving for retirement.

36. Having considered the matter, the Board has come to the conclusion that PRSAs should be able to be used as collateral but only to the extent of 25 per cent of the fund built up, and subject to a cap of £25,000 and possibly other restrictions³. This would mean that a lender could have resort in due course to the tax-free cash element of the PRSA but not to the remaining pension.

See Report from the US General Accounting Office, 401(k) PENSION PLANS - Loan Provisions Enhance Participation But May Affect Income Security from Some (GAO/HEHS-98-5).

In particular, appropriate measures would be needed to prevent circumvention of normal tax rules.

A question arises as to whether in practice a conflict could arise between the objectives of, on the one hand, developing a product which offers greater flexibility, with the need, on the other, for increased simplicity and low cost. In this regard, the Board's approach is to create a framework within which commercial providers can develop pensions products. This does not imply that they have to incorporate the maximum flexibility which would be made possible by the Board's recommendations.

A short summary of the characteristic features and requirements of PRSAs which the Board considers necessary and appropriate is set out in Appendix L.

6.2.2 PRSAs: Legal Protection Compared with Existing Defined Contribution Trust Arrangements

Currently, there are two different legal frameworks which apply to pension provision, one based on contract law relating to retirement annuity contracts and the other based on trust law which governs occupational schemes. These systems are the cornerstones for the protection provided to members.

It is sometimes argued that existing trust law affords greater protection than contract law. However, in the case of small arrangements the matter is not clear cut in practice and is open to different interpretation, particularly where the employer acts as trustee. Relying on an employer as trustee to ensure that pension assets are clearly separated from company assets and to whistleblow on itself may provide limited security.

At present, the main practical responsibilities of a pension fund trustee are to:

- 1. protect the members' rights as enshrined in the trust deed;
- 2. ensure contributions are paid when due;
- 3. be responsible for investment decisions regarding underlying fund assets usually delegated to a fund manager;
- 4. ensure the security of the assets, separate from those of the employer;
- 5. make decisions about benefits where necessary;
- 6. carry out statutory responsibilities under the Pensions Act including payment of benefits and keeping of records;
- 7. deal with auditors and actuaries as appropriate; and
- 8. honour whistleblowing responsibilities.

As PRSAs would be governed by contract law, it would be necessary to have a different way of ensuring that these functions are discharged. It is considered that they could be achieved in the following ways. For example, point 2 might be handled by a requirement to provide statements of contributions and benefits from the PRSA provider at regular intervals, and available on request, backed up by clear whistleblowing responsibilities. 3 could be dealt with by kitemarking, whereas 4 is a question of supervision of the PRSA provider and 5 would be a matter for the individual. 6 and 7 would be matters for the PRSA provider. 8 is still important and would need to be expressed in PRSA legislation in a way meaningful to the situation of a small company.

Each year, Board data contain an analysis of schemes which come under its remit (excluding those which only provide additional voluntary contributions or risk benefits), classified by size. *Table 3.3* shows that of the 55,377 private sector schemes registered with the Board at end 1997, 2,242 are defined benefit schemes and 46,763 of the 53,135 defined contribution schemes have only one member. Though not identified in the data, it is likely that most of these 46,763 one-member schemes also have the employer acting as trustee.

When these two points are taken into consideration together, the Board believes that the use of trust law and Pensions Act regulation as the basis for small defined contribution arrangements may create an amount of compliance activity which is not cost effective and which, in all likelihood, is no more successful than contract law in protecting the interests of employees.

Currently pension provision falls broadly under one of the headings below. Looking at the merits of each in turn indicates that:

Defined benefit schemes are subject fully to the Pensions Act and have a real need for trustees to make decisions about benefits, financial arrangements etc. Trustees also fulfil a valuable role in ensuring the independence of the scheme's assets from employers. Generally, they work very well and provide excellent benefits and protection to members.

Large defined contribution or additional voluntary contributions trust schemes (i.e. those with individuals or corporate bodies other than the employer acting as trustees) are simpler in terms of Pensions Act requirements but trustees still contribute substantially to the professionalism of the decision-making in terms of suppliers and investment managers or about entitlements, as well as ensuring a relatively high degree of independence.

Small defined contribution or additional voluntary contributions trust schemes (i.e. those where the employer acts as sole trustee) are exposed to a relatively high degree of regulation as well as the difficulty of ensuring an effective separation of roles, even though there have been very few problems reported to the Board to date. One-member arrangements, generally for senior employees, have the same characteristics.

Other arrangements - retirement annuity contracts (for the self-employed or those in non-pensionable employment) and buy-out bonds for those who have left occupational schemes - are personal in nature and subject to contract law. However, the former do not currently come under any regulator with specific pension responsibility.

Large defined contribution or additional voluntary contributions schemes would not be substantially different to groups of PRSAs. There is no reason to believe that the commercial terms available would be significantly different. The Board believes that employers should be free to make their own decision as to which approach would be best suited to their own circumstances, provided that members are given adequate advance information about the effect of a proposed change.

The Board considers that PRSAs would be a preferable vehicle for small defined contributions arrangements where the employer acts as trustee. It does not believe that it would be appropriate to compel conversion of such schemes to PRSAs although it would be supportive of providers who proposed a simple and financially neutral way of changing to PRSAs. The Board has considered the practicality of insisting that all small or individual arrangements should be established as PRSAs rather than as trust schemes but believes that market practice will achieve this. However, the concern about employer trustees remains and the Board would consider regulation to limit the practice if it appears necessary.

The Board believes that PRSAs would represent a significant improvement to personal arrangements, particularly in their attractiveness to sectors which have low coverage at present.

Overall, the introduction of PRSAs could have a number of effects on the legal basis under which coverage is usually provided. These are summarised in *Table 6.1*.

Table 6.1 Expected Impact of PRSAs

Work status:	Employees	Employees	Employees	Single employee	Self- employed*	Leaver	Not at work
Type of Current Pension Arrangement:	Group Defined Benefit	Large Group Defined Contribution or Additional Voluntary Contribution	Small Group Defined Contribution or Additional Voluntary Contribution	Individual Defined Contribution	Retirement Annuities Contracts	Buy-out bond	None
Current legal basis							
	Trust	Trust	Trust	Trust	Life policy	Life policy	N/A
Most likely legal basis for new arrangements							
	Trust	Trust or Group of PRSAs	Group of PRSAs	PRSA	PRSA	PRSA	PRSA
* and those in non-	-pensionable emp	loyment.					

37. In summary, the Board recommends that new pension coverage should consist of either occupational schemes, set up under trust, or of PRSAs. "Small Self-Administered Schemes" which often operate on a one-member basis but are subject to close scrutiny would also be permitted as at present. The options of retirement annuity contracts and Personal Retirement Bonds should not be available any longer. The Board will keep the question of an employer acting as trustee of its own pension scheme under review.

6.2.3 The Scope for PRSAs to Generate Potential Additional Coverage

The Board is confident that the introduction of PRSAs would mean that growth in coverage would be achieved at a faster rate than at present. In addition, it is expected that it would encourage those who are making pension provision already to increase the level of contributions, especially among the self-employed sector and in regard to stand alone additional voluntary contributions.

However, it is difficult to quantify the likely impact on coverage from the introduction of PRSAs. The commercial impact on the pensions industry could be considerable. New entrants would be expected to emerge, especially from the banking/building society/credit union sector and from investment houses. Additional umbrella schemes are likely to be considered and new life would be injected into the affinity group arrangements common among professional bodies.

Improved access to pension provision, greater portability at low cost, and better quality assurance are all factors likely to help overcome resistance and reinforce trust that pensions products provide good value.

The first set of advantages come from the way that PRSAs would address many of the current known factors which inhibit coverage:

- the prime step is the unified and simplified approach to pension provision for individuals. This will
 make it much easier to understand what pension provision can provide and how it works and how
 someone can use it best to meet their own needs. There would no longer be two sets of complicated
 conditions to work through. Plain language and easier decisions will be much more common;
- the fact that pension provision can be arranged and continued without being dependent on someone's exact employment status will remove any risk that a pension plan started now will be irrelevant as a result of career changes or breaks;
- the greater flexibility in how benefits can be taken is more relevant to the increasing uncertainty about future retirement behaviour;
- decisions to make pension provision should be easier and rest much more with the individual up to now it was often necessary for someone's employer also to accept and understand the
 concept of pension provision. This could lead to considerable delay or perhaps to nothing being
 done in the end; and
- in combination, these factors should give people considerable additional confidence and trust in their ability to make pension decisions and in the products they buy.

The introduction of the PRSA is also likely to have a considerable commercial impact and increase the supply of pension provision:

- the greater simplicity should expand the number of people who can give appropriate advice on the simpler products now available;
- this in turn should encourage suppliers into the market who would previously have regarded pensions as too complex or expensive a business to enter;
- it will be easier for employers to take on a role in facilitating pension provision;

- approaches which have been seen as impractical in the past may now be viable (e.g. some umbrella schemes);
- greater simplicity will make product comparison much easier and enable appropriate quality standards to be established; and
- new players and approaches should help reduce cost levels.

Many of these points underlie some of the recommendations in the rest of this chapter which rely on the simplicity and accessibility of PRSAs to work. These changes should be of particular benefit to women as they allow much greater flexibility in saving for retirement, catering easily for frequent changes in working patterns, providing individual cover and allow a more accessible range of products and providers to develop in the future. The simplicity in the basic design of the PRSA is considerably reinforced by some of the changes to the tax regulations.

The Board is encouraged by the fact that several other countries, for example the United Kingdom, who are reviewing their pension arrangements are focusing on similar types of simple, widely available pension vehicles as the basis for extending coverage.

The many similarities with the United Kingdom pension structures has led the Board to monitor the equivalent debate currently taking place there. Many of the issues raised in submissions to the Board have also been raised in the United Kingdom. However, as there are many differences between the two structures and as the United Kingdom debate has not yet reached the point where consensus or decisions have emerged, that debate has been of limited assistance in formulating the proposals under the Initiative. Nevertheless, the Board will continue to monitor developments in the United Kingdom, the United States and elsewhere, particularly with a view to ensuring successful implementation of the detailed aspects of PRSAs.

6.2.4 Potential Impact on Lower-Paid Sectors with Weak Coverage

The Board is especially concerned to promote coverage amongst the lower-paid and other sectors in which pensions coverage is low. In order to support this without directly intervening in the operation of the market, it makes the following recommendations:

38. Prohibit PRSA charges expressed in cash terms. Such charges, even though justifiable from a provider's perspective, for transactions whose cost is independent of size (e.g. contribution collection), weigh proportionately more heavily on smaller contracts. Prohibiting their use would ensure that lower income customers are given similar value for money to higher income customers and, consequently, it is more likely to mean that terms would be seen as attractive.

Establish a minimum entitlement to tax relief of pension contributions of 15 per cent of earnings or £1,200 per annum., whichever is greater. Such a minimum entitlement would assure people that pension provision is not less attractive just because their earnings are low.

39. The Board's proposals, if implemented, would enable existing banks and building societies to enter the PRSA market. The Board would welcome such a development and can see opportunities for a number of new entrants to the market - such as credit unions, An Post and certain non-financial enterprises such as retail chains - to develop their own PRSA products. Indeed, it expects that the entry of new providers could have a significant positive effect on competition.

6.2.5 Possible Substitution Effects

The introduction of PRSAs may give rise to some substitution effects. For example, as noted in Section 6.2.2, PRSAs could replace existing coverage provided through current pension arrangements. This would not be problematic if it resulted in improved quality of coverage and steps to ensure this, are included in the information requirements recommended in Section 6.5.2.

40. The Board recommends that it should remain permissible for an employer who is contributing to a pension scheme to have or make it a condition on taking up employment, that employees join the pension scheme. (This would include arrangements where the employer agrees to contribute towards a PRSA).

This is essential to avoid the possibility of unscrupulous attempts to tempt people out of employer-sponsored schemes as happened in the United Kingdom where employers were legally prohibited from having pension scheme membership as a condition of employment.

Another possible substitution effect would arise if there was a tendency for PRSAs to replace other savings or to lead to demands for other savings products to be given similar tax treatment, for example, bank and building society savings. However, there are significant differences in the characteristics of pension provision and other forms of saving. In particular, although they would be able to be used as collateral to a limited degree, PRSA savings would not be otherwise accessible whereas most other forms of savings are available at relatively short notice even if there is some degree of penalty. Secondly, the tax treatment of pensions, other than lump sums, is essentially tax deferral. Traditionally, this has been accepted as a reasonable guid pro guo for long-term savings.

On the basis of these considerations, the Board believes there is little ground for considering that PRSAs would give rise to additional scope for tax-sheltering savings than is already available with existing products, or for significant transfers to PRSAs to take place from other savings media, such as savings schemes of An Post.

6.3 Simplifications and Changes to Tax Rules

The Board has indicated, in Chapter 5, its approach to the overall tax environment for pension schemes. The present section contains the Board's approach to the specific tax rules which should apply to PRSAs and to the other existing types of pension arrangements which are to continue under the proposed reforms.

6.3.1 Principles

The Board has borne certain principles in mind in considering the broad thrust and detailed application of tax rules in future. It recommends that these are carried forward in future work specifying the detailed provision necessary to give effect to the Board's recommendations.

However, the Board recognises that in many situations these principles may conflict but that the overall guiding principle must be that any changes to the tax relief system should be driven by the need to address genuine gaps in coverage or to recognise the changing pattern of work experience and are not to enhance pension tax reliefs per se.

The principles in support of this which the Board recommends are as follows:

- the existing tax regime should not be diluted;
- the tax regulations should be simplified to the extent possible;
- the tax system should not favour new products at the expense of existing arrangements or vice versa;
- tax treatment should be neutral in regard to one's employment status (e.g. as an employee or self-employed); and
- the benefit of tax relief should accrue as far as possible to the person making the provision.

Specific consideration should be given to the following areas:

- transitional and administrative arrangements need to be practical and cost-effective and prevent abuse or manipulation;
- self-assessment should apply to new pension arrangements in ways which minimise unnecessary administration;
- potential tax leakage from other forms of savings should be considered; and
- the continuation of immediate relief against tax and PRSI in respect of pension contributions paid by deduction from salary.

As an overall recommendation, the Board recognises that considerably greater flexibility is being proposed for pension coverage by the steps outlined in this chapter, in particular the breaking of the formal link between pension provision and employment and the universal access to provision.

41. Accordingly, the Board recommends the removal of the current Revenue regulation which requires that employers meet at least one sixth of the cost of any occupational pension provision in order for the benefits to gain Revenue approval.

This is not intended to facilitate the reduction of existing or future coverage, or contributions by employers, but rather to make possible the commencement or continuation of pension contributions during periods of homeworking, self-employment, unemployment, education and training etc.

6.3.2 Proposed Tax Rules for PRSAs

Basis for Revenue Limits

There are a number of possible options for establishing Revenue limits to apply to PRSAs. Firstly there are limits based on contributions. This is an obvious approach for defined contribution type arrangements. It is relatively easy to police as all the work is done at the input stage and it relates directly to the major potential abuse - excessive tax relieved contributions. Limits based on benefits is the other approach. This is more difficult because it can be determined only after the event. Accordingly, it is much harder to judge an appropriate level of contribution - too much may exceed the benefit limits - too little may not provide as much as was anticipated.

42. The Board recommends that contribution based tax limits should be adopted for PRSAs.

Period for Limits

There can be different periods over which a limit can be applied:

- limit for each year;
- yearly limits but with provision to carry forward or carry back unused limits; or
- career based limits.

The first approach would allow a fixed limit each tax year. If not used, it could not be carried forward.

The second approach is based on yearly limits but allows for some transfer of unrelieved contributions from one year to the next. All individuals could avail of unused PRSA relief for the most recent tax year, in the same way as is possible, currently, under retirement annuity contracts. PRSA contributions upon which relief has not been granted in the year in which they were paid and which are not eligible for back-dated relief could be carried forward indefinitely. This is the current system used for retirement annuity contracts.

The existing benefit-based limits for occupational schemes are rather like career-based limits in that they are not concerned with when contributions are paid. For many people the ability to actually fund pension contributions varies over their career, especially at young ages when the self-employed may be investing in their business and while family expenditure may be high.

By contrast, there is sometimes more cash later when careers are stabilised and families have grown up. Greater flexibility to make contributions over a longer or shorter period has obvious advantages.

Currently, limits for contributions to retirement annuity contracts rise with age but are not nearly as flexible as those allowed for occupational schemes, where it is possible to fund for very high levels of benefit over a relatively short period. Total contribution levels of 50 per cent of salary or more are possible in occupational schemes. However, there is a rationale to preventing contributions being made in a totally discretionary way in order to minimise tax liabilities and so some year-by-year limits are reasonable.

There are currently two definitions used for determining Revenue limits:

- net relevant earnings for retirement annuities which is broadly earnings less deductions allowed for tax purposes in respect of interest, covenants and capital allowances; and
- final remuneration used for occupational schemes where limits are based on benefits rather than
 contributions. The main feature of this is that it averages variable elements of earnings over a few
 years so that it is not possible to manipulate earnings prior to retirement to enable large benefits to
 be paid and consequent large contributions to be relieved. This potential abuse would not be possible
 with the contribution-based limits proposed for PRSAs.

It is recommended that the "net relevant earnings" approach be taken as the base for determining limits but that it be reviewed to see whether the definitions could be simplified further so that for the majority of employees the earnings limit is easily derived from information on their P60.

43. The Board recommends that yearly limits for contributions should be adopted, but that these should be higher than those currently available to contributors to retirement annuity contracts at older ages in order to enable better funding of pensions at these older ages.

The Board recommends limits equal to 0.5 per cent of earnings for each year of age, subject to a minimum of 15 per cent and a maximum of 30 per cent. Contributions should be capable of being made against the previous year's income and unrelieved contributions paid but, due to yearly limits, not relieved should be capable of being carried forward indefinitely to be relieved against earned income subject to the limits for future years. The definition of "earnings" should follow that currently used for retirement annuities.

In addition, each person should have a minimum entitlement to tax relief of pension contributions of £1,200 per annum, which may not be transferred to a spouse.

The Board recommends that individuals should be allowed to continue to contribute after they have started to take benefits, based on their continuing earned income (excluding pension) and within their limits. This would be in line with the concept of phased retirement.

The limits should apply to the total contributions made by self-employed persons. For employees, the PRSA limits should apply in respect of the combined employer/employee contributions.

For clarity, it is worth stating that there would not be limits on how much could be contributed to PRSAs - the limits referred to would be for tax relief purposes. However, the Revenue should retain powers to assess benefits derived from contributions in excess of these limits, in order to deter potential abuse of the tax-exempt investment returns on pension savings.

Before a decision is taken on the implementation of recommendation 43, examination of the details should be undertaken by a group comprising the appropriate authorities including Revenue Commissioners, Department of Finance and in consultation with the Board and relevant interest groups.

Death Benefits

Following the general principle applying to taxation of pension arrangements that tax relief is given on the contributions but that benefits are taxed, it is necessary to set limits to the amount of death benefits which can be provided tax-free under PRSAs - under occupational pension schemes there is a limit of four times final remuneration which can be paid as a lump sum free of income tax, and dependants' pensions (which are subject to tax) can also be paid up to certain limits.

The Board believes it is important to allow people to choose different levels of retirement contributions and additional life cover to suit their own circumstances and that they should be free to choose separate providers for each. The overall contribution-based limits for tax relief set out above would apply to the total amount they pay towards retirement provision and life cover. The Board believes that people should be told how much their additional life cover is costing them and that limits should be set in terms of death benefits that may be paid free of income tax. The basis for determining the extent of such limits could be computed based on:

- the specific amounts paid towards life cover (as happens under retirement annuity contracts at present);
- a percentage of the total death benefit (which would be simple to administer); or
- four times net relevant earnings, with a minimum amount to cover those not in employment (which would put PRSA holders in the same position as those in occupational pension schemes).

The precise arrangements to be implemented would be subject to consideration by the expert group referred to in this Section 6.3.

Taking Benefits and Tax-Free Lump Sums

It is envisaged that a person may start drawing retirement benefits from a PRSA at any time between the age of 55 and 70. Earlier retirement should be allowed in the case of permanent incapacity. The Revenue should also be empowered to agree an earlier retirement age in redundancy situations or for certain occupations where retirement is typically at an earlier age. Once a PRSA contributor has made a decision to take some or all of the benefits from his PRSA, there should be two options open to him (assuming he wishes to maximise tax free cash).

Firstly, he can choose to take up to 25 per cent of the accumulated fund being used at that time in the form of a tax free lump sum and to use the remainder of the fund to purchase an annuity payable for the rest of his life. Secondly, instead of buying an annuity for life immediately, he can buy a temporary annuity which provides a level of (taxable) income for a period of up to five years and returns the full capital for reinvestment at the end of the term. At that time, the capital would have to be used to purchase an annuity for life or reinvest in another temporary annuity if the pensioner is still below age 75. These temporary annuities could be provided by life offices or other investment or deposit institutions.

In the event of death before all benefits have been taken as annuities for life, the balance of the fund (including any capital still invested in temporary annuities) would be payable to the individual's estate subject to the taxation provisions set out above under the heading on Death Benefits.

44. The Board recommends that it should be possible to take benefits from a PRSA from age 55 and to do so in stages if so required. It should be possible to take as a tax-free lump sum 25 per cent of that part of the accumulated fund being used on that occasion. The balance must be used to buy an annuity payable for life from age 75 at the latest - prior to this it would be permitted to buy temporary annuities (providing income and a full return of capital for re-application at the end of the term) for periods of up to 5 years at a time.

6.3.3 Tax Treatment of Trust Schemes

A major question arises as to whether it is practical in fact to have a single system applying to all pension provision or whether other types of existing arrangements should have different limits to allowable contributions than would apply to PRSAs.

For example, a particular complication arises for defined benefit schemes where there may be no identifiable cash contribution in a given year for the benefits accruing for a specific member (although a notional contribution could be determined).

The principle of not undermining existing arrangements entered into in good faith comes into play - this can be interpreted as saying that tax relief should continue to be allowed in respect of levels of benefit currently permitted.

Simplicity of administration is also an issue, particularly if there is a trend towards self-assessment and with little likelihood of people breaching the limits in practice.

An option would be to allow existing occupational schemes to continue as at present, even though this is quite different to the PRSA rules. A variant would be to allow existing members of occupational schemes to continue as at present but to require new members to follow the new rules. An alternative would be to force existing schemes and PRSAs into a single system where there would be undesirable features affecting one or both types of provision.

- 45. The Board recommends that a twin track approach should be pursued as follows:
- for defined benefit schemes, benefit limits should continue to apply and contributions to fund such benefits should continue to be allowable as at present. The 15 per cent limit for employee contributions should remain unchanged;
- for defined contribution schemes, overall contribution limits, as proposed for PRSAs, should apply.
 The 15 per cent limit for employee contributions would, however, remain. Greater employer contributions could be paid in an individual case, provided total benefits remain within existing benefit limits;
- limits for additional voluntary contributions made under a trust scheme should follow the treatment for the main scheme benefits (defined benefit or defined contribution as appropriate) and an overall employee contribution limit of 15 per cent of earnings would apply.

However, there is scope to simplify the detail of the limits, in particular, by basing benefit limits on attained age (effectively a total career perspective rather than the present approach of looking at the time with the current employer).

46. As a simplification measure and in order to assist the interface with PRSAs, the Board recommends the career-based limits approach for defined benefit schemes (and defined contribution schemes choosing a benefit-limit approach).

In practice, career-based limits could be achieved most simply by relating them to the employee's age. Under this approach, it would be automatically assumed that a member of a trust scheme commenced his career at age 20 and would be allowed to build up a maximum pension from all sources (i.e. including retained benefits from previous trust schemes, current or previous PRSAs etc.) of 1/60th per year between age at retirement (or otherwise exiting the scheme) and age 20. This translates into a maximum pension of 30/60ths on retirement at age 50, 35/60ths on retirement at age 55 and so on. An overall limit of 40/60ths would continue to apply. Other benefit limits would remain as at present but, where relevant, would relate to the revised career-based limits.

Tax-free Lump Sum Benefits

At present there are two regimes for making tax-free payments to retirees. Currently, under trust schemes, up to 150 per cent of pensionable remuneration can be paid, provided a member has completed at least 20 years in his final employment. Under PRSAs (and retirement annuity contracts at present) the proposed tax-free cash entitlement is a maximum of 25 per cent of the accumulated fund. The Board considered simplification by using one or other of these different regimes but came to the conclusion that this would not be practical. The Board's recommended approach contains elements from both of the existing approaches.

47. It is recommended that in the first instance, everyone would be entitled to convert 25 per cent of their accumulated retirement fund, or value of retirement benefits in the case of a defined benefit scheme, into a tax-free cash amount; trust scheme members only should have the further option of applying salary based limits.

It is recognised that this approach would create potential for some abuse involving, in particular, late switches from PRSAs into trust schemes in order to maximise cash entitlements. In order to mitigate this risk, it is recommended that consideration should be given to ways of preventing abuse.

Death Benefits

It is acknowledged that it would be possible for individuals to have death cover under both a trust scheme and a PRSA. In such circumstances it is considered that the overall existing trust scheme limits should apply. It would be impractical to police this requirement during a person's lifetime, especially in cases where there were two distinct sources of earnings.

48. Therefore, it is recommended that a test should be applied at the time of death. Excess benefits should be used to purchase a dependant's pension if there is a surviving spouse or, where paid as a lump sum, should be taxed at the standard rate of income tax with an appropriate credit against any Capital Acquisitions Tax liability.

Administration of Limits

It is the responsibility of Revenue to monitor tax reliefs available for pension provision and to police the limits set. However, the Board believes that there is scope for a good deal of simplification and that achieving this would be very important for realising the objectives of the Initiative. In particular, the Board considers it to be very important that Revenue regulators should take account of the following:

- excessive controls should not be imposed on schemes' trustees or PRSA providers;
- many retirees receive modest benefits, which are well below the maximum limits and most such people are in no position to breach the limits; and
- regulation should focus on those who have the potential to accrue unreasonably or unnecessarily high benefits, e.g. controlling directors and others in a position to manipulate their own remuneration.

In advance of a decision being taken on the implementation of the approaches recommended in this section, examination of the detail should be undertaken by the expert group referred to in this Section 6.3.

6.4 Improving Access to Pension Coverage

6.4.1 Providing Universal Access to Employees

Looking at gaps in coverage, the specific segments of the employed sector which have the lowest incidence of coverage are those in smaller companies, the lower-paid, atypical workers, and those outside the main urban areas as well as many employees in full-time employment. These are precisely the sectors which have been the least attractive for commercial providers or distributors to reach in the past.

In the context of PRSAs, it would be possible to make access to pension provision available to all employees by requiring that employers must offer facilities for their employees to make contributions through deduction from salary if the employees wish to do so.

In the case of pension contributions of employees, there is a case for strengthening the status of the deductions so that the employer will take their prompt remittance very seriously. The investing institution will not give value for money until it has been received (by contrast with the other deductions where late receipt has generally little effect on the individual staff member). The improving standards of administration now mean that more institutions can give real time information to their clients, so the risk of being exposed for not doing so is much more real.

49. The Board recommends the introduction of universal access to pensions via payroll deductions by the employer with discussion to decide which PRSA provider should be chosen; this requirement to apply to all employers where an occupational pension scheme is not already being operated. Accordingly, it is proposed that such employers should be obliged to make salary deductions and remit them to the chosen PRSA provider. This would mean a joint employer/employee decision where the employer is making contributions, but one made solely by employees if no employer contribution is being made. The employer should be obliged to ensure that annual communications are made to all employees about the features and operation of the facility being provided, although, as previously stated, the employer should be under no obligation to contribute.

The Board recommends that these access and deduction arrangements be reviewed after a reasonable initial period so as to assess any operational difficulties.

The Board also recommends the introduction of a legal requirement (broadly similar to that regarding PAYE and PRSI) to remit employee pension deductions in respect of all types of schemes within thirty days of the end of the month in which the deductions were made. Trustees already have obligations to collect such contributions and PRSA providers would be expected to show the Board what alerting procedures for non-receipt of deductions they propose to adopt.

The choice of PRSA provider should be capable of being changed (by the same parties) but there should be an accompanying requirement to provide certain information to ensure risks of abuse are minimised. It should be open to an employer to make remittances to more than one PRSA provider although the employer would not be under an obligation to do so.

The concept of universal access could be applied more widely than to employees only. It could be a valuable way to encourage coverage among contract workers (especially those paid through the PAYE system) or those placed by employment agencies on a temporary basis.

50. The Board recommends that employees on a contract basis or employed via employment agencies should also have access to pension provision via deduction from pay.

These proposed initiatives, containing as they do a much clearer focus on the needs of this sector, have the potential to make inroads where coverage is weakest.

6.4.2 Permanent Part-time Workers

These represent an important and growing category of workers generally with low levels of pension coverage. The ESRI Survey 1995 found that there were about 60,000 people in permanent part-time employment in the public and private sectors. An EU Directive for equal treatment of such employees in respect of employment conditions in general was adopted at end 1997⁴. It appears that the Directive, which is to be implemented not later than 20 January 2000, will involve a certain amount of national interpretation in its implementation. This is due to be discussed by Government and the social partners and it is expected that specific detail will be agreed for legislation.

⁴ Council Directive 97/81/EC of 15 December 1997 concerning the Framework Agreement on part-time work concluded by UNICE, CEEP and the ETUC.

It should be noted that the Social Welfare system already covers most part-time workers; Social Insurance was extended to part-time employees from April 1991. The present position is that all employees earning £30 or more, per week, are covered by PRSI and, subject to satisfying the standard contribution conditions, will be entitled to Social Welfare Contributory Old Age/Retirement Pensions from 2001 when the first group satisfies the 10 year contribution requirement.

51. In the context of the EU Directive relating to part-time work and any other relevant EU Directives being implemented in national law, the Board recommends that consideration of the workers to be covered in the national legislation should include part-time, seasonal and other atypical workers.

6.4.3 Umbrella Schemes

The Board considers that it has made several recommendations which should go a considerable way towards making it easier for organisations to establish viable umbrella schemes designed to bring a standardised pension offering to a large number of potential participants in a simple and cost-effective way.

Previous efforts to establish umbrella schemes in Ireland have been, mainly, in relation to groups of individual arrangements (particularly for members of a specific profession) or occupational schemes for workers in industries where there is often lower pay and high mobility. In both cases, there are difficulties and costs arising from the inability of the schemes to deal easily with changes in employment status.

As a result, most such schemes have not succeeded. By contrast, what can make a difference is groups where there are large numbers of workers and where scheme membership is mandatory (or effectively so). The prime example in Ireland is the Construction Industry Federation scheme which is effectively compulsory. The industry-wide schemes which created coverage levels of 80 per cent or so in the Netherlands and Denmark are also essentially not voluntary - they are part of the national wage negotiation structures and all employers in an industry are effectively obliged to join.

Of particular note is the fact that PRSAs can continue irrespective of employment status. Previously many people in low coverage sectors would have had to make complicated and expensive changes to their coverage every time they changed from self-employed to employee status or stopped working for a period. This would no longer be an obstacle to making pension provision. Universal availability of deduction from salary and the steps recommended to facilitate coverage for small contributions are also of particular relevance, as are the quality steps recommended in 6.5. However, in a voluntary environment, even though the PRSA would deal with many of the technical issues, there cannot be a guarantee that umbrella schemes will result in a widespread increase in coverage.

Turning to what might happen in practice, there are different types of organisations who could consider offering an umbrella scheme:

- classic affinity groups such as professional or occupational associations (several professional bodies have schemes, some of which have been moderately successful) or interest groups (e.g. the GAA, farming bodies);
- special groups with similar employment characteristics, such as those in the voluntary sector, where
 there have been great problems in the past arising from frequent changes in employment. In this case,
 there has also been a problem in the lack of funding for pension provision which could be addressed
 by a common approach to contributions from the budget holders for voluntary workers;
- those with large customer banks including financial institutions not involved in pension provision today such as credit unions or An Post, as well as, for example, card operators, Telecom or the ESB; and
- organisations with wide access and trust such as trade unions and industry associations, such as ICTU, IBEC, or particular affiliates.

There is wide variation between those mentioned, in terms of their degree of possible interest, credibility with their potential membership and ability to negotiate good terms and ensure quality delivery. Some may aspire to offering an umbrella scheme but may have limited appetite for doing this on their own account or may not relish the obligations to satisfy the regulatory requirements.

Schemes could work in different ways. Some organisations may want to set up their own PRSA provider. This would require a significant commitment of financial or management resources, even if a number of the technical functions were outsourced (investment being an obvious one).

More likely is that sponsoring organisations would negotiate with a PRSA provider, who would do all the administrative and technical work, while the sponsor concentrates on the branding and promotional aspects. This is likely to be a much lower risk operation and less dependent on reaching critical mass.

In the current environment, umbrella schemes provided by professional bodies offer better terms than a member could get from a provider of his/her choice. However, it has normally been necessary to appoint a broker remunerated by commission to sell the product. Commission naturally makes it that much harder to improve the terms. This may well be the key to getting increased take-up in the future - simpler products which can be promoted much more easily and cheaply without diminishing the quality of the advice or product.

More widely applicable pension products still need distribution and it is expected that a number of umbrella schemes will be developed. The Board cannot directly ensure their success but can be involved, at least in approving organisations as providers or promoters. The issue arises of whether there is much that can be done to improve their likely success.

52. Accordingly, the Board recommends that umbrella schemes should be encouraged to develop in the normal commercial way but that Government should also make use of National Agreements or other structures such as Joint Industrial Councils and Joint Labour Councils whereby they invite employers and unions to discuss the establishment of umbrella schemes.

The Board is encouraged by the fact that IBEC is currently in the process of preparing an umbrella scheme, to be established later in 1998, and that ICTU, together with several of its affiliated trade unions, is also engaged in a similar process.

Looking at what has happened in other countries where high coverage has been achieved within a voluntary environment, collective agreements, often with underpinning by Government, is the key distinguishing factor. It is also consistent with the recent partnership approach in Ireland between Government, employers and trade unions. Finally, such an approach offers scope to develop specific solutions appropriate to industries where coverage is very low and, in particular, to arrange risk benefits on a group basis which could not be done at the individual level.

6.5 Establishing Quality Measures

While the Board recommends many steps which should improve pension provision, especially through the introduction of the PRSA, it is setting a framework within which providers can develop products rather than setting out a standard design to be adopted by all providers. This means there will still be product differences which customers will have to take into account when deciding what product best suits their needs. The Board has seen from the submissions that many customers are not confident in approaching pension decisions. Therefore, it has considered what it can do to create that confidence.

The Board believes that there are certain minimum standards which reasonable pension provision should adopt. These relate to the general terms and conditions which set out the scope and flexibility provided, the information provided about what level of provision is being made, clear statements of charges, and appropriateness of investment choice. Each product offered could be examined by the Board to see whether it includes the required elements under these headings and, if so, the provider could be allowed state that the product carries a kitemark. The provider would be required to demonstrate to the Board that the relevant standards are maintained in practice.

The Board does not believe that all products need qualify for a kitemark but its existence would prompt questions about the appropriateness of a product recommendation not carrying the kitemark.

53. It is recommended that the concept of kitemarking should be adopted and applied to PRSAs in the first instance but with the possibility that some elements could be applied to other forms of pension arrangements. Its purpose should be to underpin good practice rather than merely to confirm legal compliance.

Approval would not mean or imply that the Government underwrites failure to deliver on kitemarked products.

6.5.1 Terms and Conditions

The general terms and conditions of PRSAs would relate mainly to what can or cannot be done by way of contributions, investment and benefits.

54. The recommended approach is to allow providers set their own terms and conditions but to have a list of minimum requirements which would determine the benchmark. The Board would have to determine whether a particular set of conditions satisfied the benchmark.

An outline list is contained in Appendix L.

In practice, the various pension contracts currently available are believed to be reasonably consistent and should form the base from which to develop the kitemark standard.

6.5.2 Information - at Point of Sale and in Other Circumstances

Information would need to be provided at various times. These include the point at which someone takes out a PRSA, proposes transferring benefits from another arrangement, stops contributing, arranges or ceases using their PRSA for risk benefits at regular intervals, or is considering retirement etc. A common approach and a standard basis for all these would need to be established for use by all providers. This would enable like-for-like comparisons to be made.

Ensuring that people have the relevant information in a form they can understand when they need it, is seen as a key to providing the required degree of confidence and trust in the product. As a general rule greater efforts should be made by providers to avoid jargon and use plain language in all written material relating to pensions.

55. As part of its implementation process, the Board proposes to check the standard basis for providers' written material with non-specialists in order to confirm clarity.

The Board believes that customers should be given a certificate of reasonable expectation by their pension provider which would be a simple statement showing the level of benefit which could reasonably be expected from their contributions. While this has been highlighted as a need when a person starts pension provision, there are other circumstances where information is needed (and there are grounds for setting standards). These include:

- at regular yearly intervals;
- on requesting current value of benefits;
- on changing employment;
- on changing provider;

- on a major change of benefits (e.g. reducing contributions);
- on changing investment mandate;
- on an increase in charges;
- prior to taking benefits; and
- before transferring from a trust scheme to a PRSA.

Issues revolve around whether these are all the circumstances where there should be a standard form of information provided and the extent to which the wording should be prescribed.

56. The Board recommends that for each of these circumstances, there should be a prescribed minimum set of information and explanations which must be provided and that the method used for deriving the numerical data should be standardised (including treatment of investment returns, how to show the result in terms of the real level of prices or earnings at retirement and the cost of any additional life cover being provided). Additional information may be provided if desired.

6.5.3 Value for Money and Cost Aspects

The Providers' Perspective

Different types of providers (e.g. insurers and banks) can have quite different views about how they express their costs and the degree of uncertainty which they can tolerate. For example, life assurers distribution typically has heavy initial costs and their charging structure reflects this. Their products often include explicit or implicit guarantees which have a cost and imply that solvency has to be demonstrated.

By contrast, banks taking deposits traditionally work off interest margins which are rarely explicit and never guaranteed for any significant length of time. Consequently, customers rarely think their deposit accounts bear heavy charges but in fact they may well be far more significant than life assurers' margins taken over a long period. Banks have been prepared to live with a mismatch between initial costs and margins earned over a long future period.

This is changing, especially as new competitors enter and reduce the possibilities of cross-subsidisation and the certainty of future margins. This is likely to result in a steadily changing approach to pricing but differences are likely to remain for quite a while yet.

However, all providers are likely to seek to pass much of the risk back to customers and to minimise their capital requirements.

57. The Board recognises that different approaches to charging and sharing risk are possible. However, as part of its regular supervision of providers, it would propose to review promotional and other material to ensure that it clearly expresses the way these are conveyed to customers.

Lowering the Cost Base

Many financial services have borne heavy costs in the past but these are now coming under severe and sustained cost pressures. This is currently a feature for many of the likely PRSA providers and cost will undoubtedly remain an important competitive ingredient. Too great an insistence by the Board on rapid improvements in value for money or setting arbitrary targets to be achieved in a short period of time would carry excessive risks - since these might only be delivered by putting service standards at risk.

This does not mean that ambitious targets cannot be achieved or that significant commercial pressure should be prevented or slowed down. However, the Irish market is small by comparison and while there are similarities with the United Kingdom, there is really very little that can be transferred in terms of traditional products or administrative systems without considerable tailoring. This makes it difficult for many players to be sure of generating sufficient volume to gain economies of scale.

New types of product and simplified distribution and service, coupled with better designed processes and technology, have enabled new entrants to offer far lower cost levels. This is also happening in the United Kingdom. By and large, there is always a balance between low cost, easy access and simplified (and limited) choice.

6.5.4 Charges

The Board has considered the question of setting maximum levels of charges (covering all costs including commissions). However, in a market for new pension products, it would be difficult to predict where prices would settle. Setting a maximum level too high may well mean that it would become a norm. On the other hand, setting it too low could prevent potential new providers from entering the market. Accordingly, it is considered that the best course is to rely on competitive market forces coupled with clear illustrations of the effect of charges.

58. There should be no maximum levels of charge but powers to introduce them should be retained.

At present, different types of charge are made by the various providers. For example, in the case of unit fund vehicles these are generally specific (but sometimes potentially confusing - e.g. bid/offer differential, fund management charge). Some are implicit, e.g. in with-profit life assurance where they are usually only reflected in the eventual proceeds.

Confusion over charges and potential for mistrust are considerable while there are grounds for believing that there is scope for quite significantly reduced charges for simple products. There is a balance to be struck between simplifying the range of charging mechanisms and enabling providers reasonable prospects of covering their costs together with an appropriate margin. The Board has already recommended that costs expressed in cash terms should not be permitted in order to help ensure better value for money for those making small contributions.

59. It is recommended that all charges should be explicitly stated and that only charges which are expressed as a percentage of contributions and/or a percentage of fund should be permitted (except for any per capita fee to be payable under the Pensions Act). However, providers should be allowed have charges which vary over time in an explicit way.

In particular, the effect of early discontinuance or of transferring to another provider should be required to be shown.

It is recommended that the Board should be required to review the actual costs charged by PRSA providers from time to time.

Charging is an area where there is potential for abuse. In order to minimise such practices, it is recommended that a professional obligation should be placed on the Appointed Actuary of the PRSA provider to disclose the details of illustration methods and to certify that actual practice accords with what is stated.

As an example, it is envisaged that a provider could state "that there would be a charge made of X per cent of each contribution to the PRSA and a charge of Y per cent each month would be deducted from the fund in which the contributions are invested". These charges would be taken into account in projections showing how the amount built up through contributions would grow, when applying set rates of investment return and expressing returns in terms of constant prices and/or earnings. The growth of a person's PRSA could be shown at different periods (including the effect of transferring to another provider) and the effect of different investment returns also could be shown.

6.5.5 Commissions

Commission is likely to be paid by some providers but not necessarily all. For example, banks may not need to pay explicit commission but they still have distribution costs which could be substantial. This immediately leads to debate about what should be the key measure to be considered. There is no easy answer which compares like with like.

One view is that it is the total level of cost borne by the customer which is relevant and this should certainly be disclosed. Also disclosing a part of the costs (but not all of them) can be both confusing and potentially misleading. On the other hand, commissions are a form of incentive and they may lead to pressure to recommend sales of one product or one institution rather than another. There is potential for abuse as a result of commission.

It has to be said that attempts to control commissions are notoriously difficult to enforce. Furthermore, a certain level of commission may well be necessary in order to develop the potential of a market.

The Board is aware that the Department of Enterprise, Trade and Employment is in discussion with industry and customers in relation to a disclosure regime for life assurance policies. In particular, the Board is aware of the ongoing debate about whether the commission content of life assurance should be disclosed separately.

- 60. While the Board's position is that it would not favour attempts to control levels of commission or require that they be approved or be disclosed separately, it believes it is not useful to have a second debate on these issues The Board also recognises that there would be advantages in aligning the pension requirements with the requirements for life assurance and for this purpose it recommends that the Board and the Department of Enterprise, Trade and Employment maintain contact on this issue.
- 61. The Board recommends that the principles for disclosure of commission for PRSAs should follow that adopted for life assurance. In the event of commission costs being disclosed, the Board recommends that all providers, including those who are not life assurers, must make equivalent disclosure.

6.5.6 Investment Choice

The investment aspect of PRSAs could be handled through a range of different investment vehicles. These include unitised funds (e.g. life assurance unit-linked funds, unit trusts and various other forms of investment vehicles run on similar lines), traditional with-profit or deposit administration life policies, where the net result of investment and expense emerges piecemeal over time and where there may be considerable cross-subsidisation, or bank deposits.

The Board recognises the merits of each of these but puts great store on three aspects:

- 1. the overriding requirement to ensure that the assets underlying a PRSA are secure, properly managed; and administered;
- 2. the need to be able to identify at any time the assets underlying a PRSA so that actual investment performance and risk profiles can be explicitly measured at any time and can not be manipulated; and
- 3. the need to see clearly what level of expense is incurred by a PRSA holder.
- 62. The Board recommends that only funds which can demonstrate that they meet the first criterion above should be allowed for investment of PRSAs. Specifically, these funds may be life assurance funds or other types of investment vehicle provided that, in all cases, they fall under the prudential supervision of a regulator in Ireland or a regulator elsewhere which is subject to mutual recognition with its Irish counterpart.

The Board recommends that the second and third criteria above form part of the conditions for a fund to be allowed to carry a kitemark.

6.5.7 Investment Mandates

The choice of investment mandate is one of the most critical factors in getting best value for money from pension contributions. In large defined benefit schemes, these decisions are made generally by or on behalf of the trustees who can take a long-term view of the scheme finances and are not personally directly affected by the outcome.

In defined contribution schemes under trust, the investment decision is much more transparent and can be made either by the trustees or by a member from a limited choice made available by the trustees. Although the investment objectives are broadly similar to a defined benefit scheme, frequently more conservative choices are made. In individual arrangements (where the person makes the decision essentially on his/her own), more conservative choices still tend to be made.

While there is limited objective evidence, it is fairly clear, from the funds actually selected by individuals where they have a choice, that individuals' investment choices tend to be conservative. Of course, different choices will result in varying investment returns - the more conservative choices occasionally will produce better returns but this would not be expected to be the norm over the longer term.

In principle, there is no reason for a different investment strategy for an individual investor in a PRSA as distinct from an individual who is a member of a group defined contribution scheme. However, the member of a group defined contribution scheme may have access to a range of advice not normally available to the individual. Furthermore, defined contribution schemes will have the added dimension of the control of trustees, who have obligations to discharge under the Pensions Act.

It also seems clear that the individual can be helped considerably by having appropriate mandates available which different managers can work to, while also being told that there are risks of fluctuation to be borne. Funds with greater levels of guarantee may be attractive to individuals - these would raise additional issues for prudential supervision.

In summary, there is an important issue about how to ensure that, as far as possible, people make informed choices about their investment funds. Experience shows that reasonably strong guidance is needed and effective.

63. It is recommended that a set of standard benchmarks should be drawn up which would be designed to meet the different needs of the main categories of pension investors and which would permit sufficient flexibility to allow competition between managers while limiting the risks assumed in pursuit of these mandates.

In addition, PRSA providers should be required to offer a comprehensive range of funds covering all of the standard mandates, even if this involves some being managed by third parties.

PRSA providers will be allowed offer other investment funds provided it is explicitly stated that this is a specialist fund not following a standard mandate and is not kitemarked by the Board.

If this recommendation is adopted, the Board expects that four standard mandates will be deemed appropriate – one based predominantly on a portfolio with a particular emphasis on investment in equities suitable for maximising long-term returns; one based on a mixed portfolio comprising a high proportion of equities, but also fixed interest stock and other assets; one based on fixed interest stock, in order to counterbalance the risk of falling annuity rates; and one based on short-term cash instruments. As these are all likely to produce quite different long-term rates of return (reducing as risk levels are reduced), the Board recommends that there should be a specified corresponding difference in the standard assumptions used for information purposes.

6.5.8 Application to Trust Schemes

Whereas kitemarking is being introduced in order to ensure quality of PRSAs, some of the concepts are likely to be of relevance elsewhere. For example, it is considered that the information requirements which are recommended to apply to PRSAs should apply largely to defined contribution schemes also and, in some cases, to defined benefit schemes.

64. Accordingly, it is recommended that quality standards should be introduced for pension products other than PRSAs and particularly for defined contribution schemes. The standards proposed by the Board with regard to PRSAs are considered to provide a suitable model for consideration in this wider context.

6.6 Annuity Purchase and Index-Linked Securities

6.6.1 Annuity Purchase

Over the recent past, there has been considerable comment on poor experience with a number of aspects of annuity purchase in defined contribution schemes and retirement annuity contracts - in particular, about the rigidity of having to purchase an annuity from life assurers, the rapidly falling annuity rates and how it would have been much more beneficial if people could simply draw income from their own portfolios. These same issues would arise with PRSAs. Whether the comments are justified or not, there is no doubt that customers find it very difficult to get a sense of value for money and the effect of life expectancy on annuity values. It is also clear that many people do not realise that there are already options to choose an annuity most suited to their needs.

Table 6.2 Changes in Fund Values and Annuity Rates 1994-1998

Date	Yield on long gilts %	Annuity rate per £100 fund ⁺ £	Value of fund* £	Resulting annuity p.a.▲ £
1.1.94	6.62	9.479	100.00	9.48
1.1.95	8.68	10.989	96.00	10.55
1.1.96	7.69	10.259	112.90	11.58
1.1.97	7.03	9.777	130.28	12.74
1.1.98	5.75	8.852	174.83	15.48

⁺ Typical annuity rate per annum for each £100 purchase money for a man aged 65 with a guaranteed minimum of 5 years pension payments and no allowance for escalation.

Many submissions pointed to the fall in annuity rates in recent times. It is quite true that they have been falling - however, this stems principally from falling interest rates which also have a strong tendency to push up asset values. The twin effect of increasing asset values and decreasing annuity rates can be seen from *Table 6.2* which shows how the annuity emerging from a fund of £100 at 1.1.1994 would have changed since as a result of changing interest rates and investment growth on that original £100.

It is notable that although annuity rates have fallen by 20 per cent between 1995 and 1998 as a result of the 3 per cent fall in gilt yields, the value of a typical fund has risen by very much more that that. The comment should also be made that the advent of EMU may well mean that long-term interest rates will continue to fall and there is no evidence of mortality rates increasing. It is quite likely, therefore, that EMU would reduce annuity rates further, but it should also be borne in mind that there may be some compensating rise in asset prices. The prospect of sustained low inflation under EMU should also mean that the purchasing power of an annuity is at much lower risk of being eroded than was the case under the current structures where inflation has been an ever-present threat to pensioners.

The Board's view is that this example demonstrates that annuity purchase is a difficult area and it is easy to concentrate on just one part of the whole picture. As a result, the Board has considered how to ensure that people are protected against simple misjudgements or poor advice and, in particular, that their retirement income is maintained throughout life at as high a level as possible.

One of the Board's recommendations on kitemarked fund choice would encourage the development of funds invested in long-dated Government stock. This would have a considerable impact in ensuring that the final annuity from a person's fund would not be subject to much short-term variation, as a change in gilt yields should give rise to changes in annuity rates and asset values which to a significant extent would counteract each other.

The Board has considered the system of "drawdown", where an annuity is not bought but the fund is drawn on as required from time to time by the individual pensioner. This may appear attractive when recent history has been especially favourable but it implies a need for continuous individual investment advice. Furthermore, the Board has a responsibility to ensure that good pension provision is not being jeopardised and that for many people the risks that drawdown presents (and the cost) are likely to far outweigh the advantages. Unless the person has a very considerable amount in their fund, it is unlikely that they can afford both the inherent risk and the cost of specialist advice.

no allowance for escalation.

* Based on performance of typical unit-linked managed pension fund.

[▲] Equal to applying annuity rate to value of fund.

As recommended in 6.3.2, the Board proposes allowing deferment of the purchase of an annuity payable for life. This will give greater flexibility but is no guarantee that the contributor will actually get better value. The flexibility in itself may give greater control but it will still be important to ensure that appropriate advice and information is obtained - again, this will have some cost and the Board would review the deferment option if there were evidence of its being abused by advisers.

The Board believes that the pension system would be fundamentally undermined if annuities could be offered by companies which did not have to demonstrate to the extent required by EU life assurance regulations that they can meet the long-term risks of improving longevity and investment returns.

If there were evidence of abuse of market power by those life assurance companies offering annuities, the Board would support an investigation by the competition authorities. However, there are several companies competing in the annuity market and the Board sees no evidence of cartel behaviour. There is no reason why specialist annuity companies could not be set up to compete with the existing providers but none have done so. The Board does not see any reason to recommend that the State should offer annuities on non-commercial terms.

There is limited awareness of the choice possible with annuities. The simplest straightforward life annuity means that those who die prematurely will balance out the greater amount paid to those who live longer than average. This uncertainty can be reduced considerably by taking an annuity which, although somewhat lower, is guaranteed to be paid for a minimum number of years (often 5 but sometimes 10) and as long afterwards as the annuitant survives. A joint life annuity can also be bought which will be paid for as long as the annuitant or their spouse is alive. Also, a product which combines an annuity payable for life with a lump sum payable on the death of the annuitant has recently been launched on the market.

In the past people have had the option of escalating annuities but have almost invariably opted for higher initial income, whereas with increasing longevity, maintaining long-term levels of income should be a priority.

Most annuities have explicit amounts payable. There are variations possible such as "with-profit annuities" which guarantee a lower annuity but expect to add to it over the years if investment and mortality experience is better than expected, and "unit-linked annuities" where the amount payable is expressed as a set number of units each month and the actual amount payable depends on the value of those units. Both these forms will offer a lower initial payment and, as with escalating annuities, this is probably the reason for their lack of popularity.

The Board's recommendations are geared at giving a certain extra degree of flexibility in taking benefits and ensuring that contributors are sufficiently well informed to take advantage of the flexibility available to them and to consider how to maintain long-term purchasing power and to cater for their dependants. In terms of the structure of annuities, the Board believes that the kitemarked fixed interest fund will be valuable but that more research should be carried out to investigate other ways of improving guaranteed income - the development of more index-linked gilts would help here.

The Board is also very conscious that in years ahead there are likely to be many more people retiring with relatively modest funds accumulated through PRSAs or existing arrangements and that it is important they should have annuity options which are relatively straightforward and cost-effective. A fixed administrative charge per annuity payment could weigh quite heavily on a small pension providing a valuable top-up to the Social Welfare pension. These charges are currently driven by the existing market structures which are geared very much towards the actual cost of payment and the associated tax administration.

It is possible to imagine alternative approaches such as allowing contributors to exchange smaller amounts accumulated for supplementary pensions for a percentage increase in their Social Welfare pension and to pay this through the PRSI system. The Board is not making any recommendation about such approaches as it believes the State should not take on any functions purely because the private sector does not find it commercially attractive. It does, however, believe that there may be circumstances under which the State can facilitate in a way not open to the private sector.

A small expert group should be established to investigate alternatives to current annuity designs and ways of handling payments including several specific suggestions outlined in the submissions. This investigation should include consideration of security and solvency as well as increasing choice and improvements in value for money and service.

- 65. The Board recommends that the following steps should be pursued:
 - flexibility to defer the purchase of an annuity payable for the rest of the pensioner's life (see 6.3.2);
 - promotion of investment funds designed to reduce the risk posed by the timing of annuity purchase (see 6.5.7).

In all cases, an annuity should be illustrated which escalates at a fixed rate, of say 3 per cent, although level annuities may also be shown. Illustration should be given also of a dependant's pension. There may not be a need always for a dependant's pension, for example, if the dependant has an independent pension entitlement.

It is considered that a small expert group should be charged with looking at any other ways whereby the value for money could be improved or at alternative forms of annuity including a potential role for the State in facilitating better choice for those with smaller benefits. Also, a booklet dealing with annuities and explaining the issues should be published by the Board.

The changes recommended in this section should also be applied to defined contribution schemes and, where appropriate, to existing retirement annuity contracts.

6.6.2 The Role of Index-Linked Securities

There are two specific areas where index-linked securities, if they were more widely available, would have a valuable role in facilitating better pension provision. In both cases, they would enable a liability which is index-linked to be matched with lower risk than relying on other types of asset such as equities or property.

The first is index-linked annuities. These have already been highlighted as being very desirable but simply cannot be provided today without significant mismatching and solvency costs.

The other is in defined benefit schemes where the liabilities are related to future growth in salaries. Again, index-linked securities would be a natural matching asset.

It would be important that any supply would be sufficient in terms of both volume and range of product to ensure a reasonable market developed so that managers could trade efficiently.

There is a very limited supply of index-linked gilts in Ireland today and reliance on securities issued by other EMU members will only work if Ireland remains in the EMU until the liability being matched by the security is extinguished.

The two situations above are ones which the Board considers simply cannot develop without appropriate assets.

66. The Board recommends that fresh consideration should be given to issues of index-linked Government stock.

6.7 Proposed Reforms Specific to Occupational Schemes

6.7.1 Vested Rights

Many occupational schemes include a vesting period during which there is no entitlement to benefit from an employer's pension contribution in the event of leaving service. This can clearly have a significant effect on the pension entitlements of those who change employment frequently. While the Pensions Act introduced a maximum vesting period of 5 years, the Board considers that a further reduction in the maximum is now warranted.

67. The Board recommends that the maximum period of reckonable service required to qualify for preserved benefit should be reduced from 5 years to 2 years. This change should apply to those leaving after 1 January 2001.

6.7.2 Preservation and Revaluation of Benefits In Respect of Pre-1991 Service

This also is widely regarded as a desirable extension of the current preservation requirements. The financial impact on schemes varies and some could have problems with rapid implementation. There is limited benefit in introducing preservation without revaluation and the latter is assumed to be on the same basis as for post-1991 service.

The pattern established for the introduction of the original preservation requirements seems appropriate, but perhaps a slightly shorter timescale could be adopted. It may take until as late as 2011 to allow all schemes to have fully funded the extended preserved and revalued benefits. However, many schemes will be adequately funded prior to this date and it would be hoped that such schemes would introduce this preservation and revaluation sooner.

68. The Board recommends that preservation of benefits for pre-1991 service should be introduced by 1 January 2001, revaluation by 1 January 2006 and that funding standards in respect of these must be fully met by 1 January 2011.

If the above recommendation is implemented, employees leaving after 1 January 2001 would have a statutory right to the preservation (and revaluation from 1 January 2006) of benefits earned by pre-1991 service.

There remains the question of whether those who left prior to 1 January 2001, and although not a statutory requirement, were given or opted for a deferred pension in respect of pre-1991 rights, should also qualify for a revaluation of these rights. In considering this issue the Board held the view that the ideal should be that all deferred or preserved benefits should be revalued in order that they would hold as far as possible their real value prior to payment. However, in making the above recommendation, the Board was aware that if a statutory requirement to revalue all pre-1991 rights was placed on schemes, the additional costs involved for schemes with many deferred pensioners and few current members could, in percentage of payroll terms, be considerable. Furthermore, the placing of an unplanned financial burden could, in certain circumstances, threaten the solvency of a scheme.

Thus, while for the reasons stated the Board is unable to recommend that there should be a statutory requirement to revalue all pre-1991 rights, it would urge employers to consider the revaluation of such benefits (where they remain within the scheme) on a voluntary basis in line with the statutory requirements for other rights, where circumstances permit.

6.7.3 Leavers

At present, those leaving service have the right, generally, to a preserved benefit or may be able to transfer their benefit to another scheme, a buy-out bond or, if introduced, a PRSA. Currently the choice as to which option to take must be made within two years of leaving service and there may be some confusion about the possible forms of benefit which can be taken.

69. The Board recommends the introduction of a provision allowing such transfer at the discretion of the member at any time after leaving service and that the member be given the same freedom in choice of benefit that would apply to owners of PRSAs.

6.7.4 Additional Voluntary Contributions

There are a small number of schemes which do not have explicit provision for additional voluntary contributions. However, the introduction of the PRSA would permit access to additional voluntary contributions for all, but some administrative complexity will remain (as at present).

70. Accordingly, it is recommended that all employees who do not currently have the right to make additional voluntary contributions should be permitted to do so by deduction from salary to a single PRSA provider chosen by the employee.

If so desired, any employee should have the right to make additional voluntary contributions to a different provider of his/her own choice but he/she would not have the right to have contributions deducted from salary.

6.7.5 Trustee Responsibility for Investment in Defined Contribution Schemes.

This is a matter of some concern as trustees are responsible for ensuring that appropriate investments are made. At the same time, these is an understandable demand that individual members be given a choice regarding investments and the practice has developed in this direction. An issue is the possibility that trustees may be liable if sued by members on account of inadequate returns.

A similar issue arose in the United States. There the matter has been dealt with by specifying certain conditions which, if adopted, limit the responsibility of trustees for the results of poor investment performance. The conditions centre on ensuring that there is a reasonable range of appropriate funds, that members can switch easily between funds, and that they are provided with a certain level of information so that they can make informed decisions.

The Board is of the view that such an approach has merit and indeed some of these conditions would be addressed by the proposals made in relation to kitemarking.

- 71. Additionally, the Board recommends that trustees of a defined contribution scheme should not be liable for the results of poor investment returns in cases where the employee has chosen the investment fund, provided that:
 - there is a choice of funds available which cover at least the full range of kitemarked mandates;
 - switching between funds is available on a regular basis within normal kitemarked limits;
 - information is provided to members at the outset and at least at yearly intervals up to kitemark standards:
 - trustees inform all members if their (i.e. the trustees') choice of recommended funds changes.

These recommendations, if implemented, would protect against most risk but there is still a question of choice of fund manager (rather than just choice of fund). Arguably, trustees should not be given automatic protection if there is a question that they made a poor or careless choice of a single fund manager. Overall, however, the Board considers that it is not necessary to require that there should be a mix of investment managers. Rather it is considered that the kitemarking standard should be used as a guide which trustees apply when choosing fund managers.

This recommendation could be implemented by a suitable amendment of the Pensions Act, 1990 and, if necessary, by Regulations.

6.8 Regulation

There would be a need to establish a regulatory framework for PRSAs. This also would need to incorporate the various quality measures which the Board recommends should be implemented and which may be applicable to other types of pension provision.

In the Board's view, a balanced approach needs to be taken to supervision and policing in regard to pensions (including the taxation provisions). There is a tendency in such a complex area to police every transaction whereas the Board believes that a much more effective use of resources is to concentrate on those areas which pose the greatest risk.

Ultimately, regulatory costs are borne by the customer in terms of both monetary charge and in increased complexity and inaccessibility to products. If injudiciously implemented, these could militate seriously against the success of the Initiative. Therefore, the Board has developed a regulatory framework which meets the needs of lightness of administration with thoroughness and pressure on suppliers to demonstrate proper professional conduct.

The current statutory role of the Board is restricted to occupational pension schemes. Personal pension products, such as retirement annuity contracts and buy-out bonds, do not currently come under any regulator with specific pensions responsibility. In relation to the proposed PRSA regime, which would subsume other forms of personal provision, the Board believes that it has the experience, structure and skills most appropriate for the PRSA regulatory framework. It also believes that the most effective and cost efficient route would be to continue all pensions regulation under one statutory body i.e. the Board.

6.8.1 Supervision of PRSA Providers

The appropriate supervisory regime for PRSAs would be very different from that which currently applies to occupational schemes.

The main features required would be that a PRSA provider would be subject to regulation of its pension activities by the Board and would specifically have to:

- satisfy the Board that it has appropriate professional and administrative experience and expertise in place to ensure it could meet its obligations;
- submit annual returns to the Board including directors' certificate that it has sufficient funding
 available to ensure its continued viability (as the linchpin of the PRSA operation not in terms of
 the financial aspects of actual PRSA contracts which are dealt with below);
- have each of its products designated as either meeting kitemark standards (or not);
- have an Appointed Actuary who would be required to certify each year (under professional guidance notes) that it has operated in line with kitemark requirements or to whistleblow if in breach;
- to ensure that each of the main financial aspects of the operation (e.g. investment or insurance) are carried out by properly authorised entities and that these demonstrate solvency and satisfaction of other prudential requirements to the appropriate regulator (e.g. Department of Enterprise, Trade and Employment or Central Bank);
- report annually on investment performance against mandates; and
- ensure that any intermediary with which it transacts business is properly authorised.

There is a reasonably close parallel with life assurance where individual customers have long-term contractual relationships with a financial institution and where security and proper operation needs to be validated.

In essence, this means that supervision of the entire body of PRSA provision would be done by the Board supervising a limited number of large providers. This is in clear contrast to the current situation whereby tens of thousands of schemes are directly supervised by the Board.

A schema is set out in Appendix I, showing the proposed roles and responsibilities of the different parties that would be involved. Most of the actual work would fall to other existing regulators who would supervise the actual transactional activities. The Appointed Actuaries of the PRSA providers would certify most of the other pension aspects, under professional guidance notes, and auditors and directors of the PRSA providers would be required to certify other returns.

The fact that much would be undertaken by others would not in any way reduce the need for the Board to take responsibility for appropriate decisions. In particular, at the outset, the Board would have to decide whether to grant a licence to the provider. This will require some judgement, especially in terms of administrative capability and management.

In addition, at regular intervals, there would be a requirement for formal returns to be made to the Board, and reporting on relevant business activities including declarations by the Appointed Actuary about the conduct of the provider and by directors about its ability to continue as a going concern. These returns and actual operations would need to be examined on a regular basis.

Therefore, a supervisory relationship between the Board and PRSA providers and possibly other organisations, such as those involved in the promotion of umbrella schemes or in administration of the pensions aspect of PRSAs on behalf of an investment company who had established a PRSA provider, seems inevitable.

72. In this regard, the Board considers that it should retain responsibility for all pension aspects and for overall supervision of PRSA provision.

However, it should rely on other regulators in respect of the functions normally carried out in respect of their existing functions and new functions that would arise as a result of further developments.

The Board considers that there should be a single channel of approval involving both the Board and the Revenue Commissioners who would separately consider the authorisation of PRSA providers or approval of their contracts, respectively.

The Board recommends that the additional cost of supervision should be borne by the PRSA providers and should not fall on existing occupational pensions schemes.

Fees charged to providers should be based on a flat fee plus a fee based on volumes of business.

6.8.2 The Role of the Appointed Actuary

The Board has noted that the financial aspects of life assurance business (also based on contract law and involved in long-term financial commitments) are supervised by the Appointed Actuary system in both the United Kingdom and Ireland with considerable success. The Appointed Actuary has clear responsibilities to customers of his organisation and the general public as well as the regulator and the actuarial profession.

In many cases the Appointed Actuary is employed by his organisation in a senior executive position. A formal professional relationship of confidentiality and independence of advice applies between the Appointed Actuary and his Board of Directors, and it is always made clear when he is giving advice as the Appointed Actuary and when he is acting as an executive, and this distinction is underpinned by professional guidance. Indeed, in order to minimise further any potential conflicts between the professional demands of the role and the commercial demands, it is increasingly common for the Appointed Actuary to be a separate person from an executive with primary responsibility for the profitable management of the enterprise. Of course, the Appointed Actuary can be quite independent of the company for which he acts.

The Appointed Actuary is increasingly involved with the conduct of the business to ensure it complies with marketing and customer requirements. This role is strongly supported by explicit and detailed professional guidance notes and formal communication with the regulator.

73. Therefore, the Board recommends that discussions be held with the appropriate professional body to see how the role of the Appointed Actuary should be developed and extended in order to carry out the additional administrative supervisory activity that would result from the Board's proposals. The discussions should include consideration of any potential conflicts of interest between the professional demands of the role and commercial demands on the individual.

6.8.3 Approval of PRSA Providers

74. The Board would have to establish a standard approval process and recommends that it should be required to consider approving only applications where the actual investments made under a PRSA product are provided by institutions who are authorised by another prudential regulator (e.g. in respect of insurance or investment business) in Ireland or another EU country which is subject to mutual recognition.

The Board considers that it should be required to review applications from other organisations to establish their own PRSA provider on condition that the relevant financial functions are provided by a suitable financial institution. Even so, a "fit and proper person" filter would be valuable.

6.8.4 Prudential Supervision

Supervision of the assets and liabilities of PRSA providers should continue to remain with the Central Bank, or other competent authority. However, there would be a need still to ensure that all the non-financial aspects are also in order.

75. In this regard, the Board recommends that there should be a spot check made of new PRSA products offered by all existing established providers and a full review of all products brought to the market by new entrants.

6.8.5 Sales and Marketing Activities

When drawing up detailed conditions necessary to grant a licence to a PRSA provider, the Board intends to consider whether it would be appropriate to set stronger standards and procedures in regard to sales and marketing activities than those currently applied by other regulators of intermediaries. The need for and scope of this will be affected by any developments in the near future to reorganise the supervision of intermediaries.

76. In addition, the Board recommends a "cooling off" period when a PRSA contract is first effected.

The Board also recommends that there will be a requirement for all PRSA holders to sign-off their acceptances in a standard letter designed by the Board which sets out the holder's rights at point of entering the contract.

6.9 Integration

6.9.1 Integration - Effect on Members of Occupational Pension Schemes

A number of the submissions received by the Board expressed dissatisfaction with the impact of integration on occupational pension schemes. In integrated schemes, account is taken of the person's PRSI entitlements, so that the occupational pension effectively "tops up" the Social Welfare pension to provide the total pension specified in the scheme's rules. However, if the person's pensionable pay is very low, the Social Welfare entitlement may comprise a very large component of the total pension, perhaps even all of it.

The main factors which give rise to difficulties and dissatisfaction are:

- lower pay;
- the way in which integration applies to part-time and other atypical workers;
- some design features;
- inadequate information.

Other contributory factors, which can cause individual problems, include the definition of "pensionable pay", i.e. which elements of total remuneration are included and which are excluded? and is the pension based on gross earnings or are such components as shift pay, overtime, bonuses, commission and other "fluctuating emoluments" omitted?

Lower Pay

The Board recognises that lower pay frequently leads to low pensions for workers whose wages do not rise significantly with long service or seniority. This may be the case, for example, for male manual workers, or for women in part-time, temporary employment with little or no career progression. For those on lower pay at retirement, this can give rise to very small levels of occupational pension. This may be unsatisfactory both in absolute terms and in relation to the contributions the person has made.

The Board notes that the issue of lower pay is being addressed, at least partially, through a statutory minimum wage approach. When it becomes clear what this approach entails and how it will operate in practice, the implication for pensions should be explored further by the Board.

Part-Time Workers

A separate but related issue is the impact of integration on the pensions of part-time employees. Most occupational pension schemes have been designed for traditional employment situations characterised by permanent, full-time status and career progression. By and large they were not designed with atypical workers in mind. The application of the full Social Welfare offset in the case of a part-time employee will result in a disproportionately lower occupational pension compared to his/her full-time counterpart. In many cases where the position held is a lower paid one, a nil occupational pension is the outcome despite many years of membership of an occupational scheme; in a public service scheme even where a nil occupational pension is the outcome, a lump sum is always payable.

Any special treatment for a part-time employee to alleviate the problem of the Social Welfare offset (e.g. the application of a pro rata offset) would create other anomalies. For example, it is possible that a full-time employee would be paid no more than a higher skilled or more senior part-time employee. The application of a pro rata Social Welfare offset for the part-time employee would have the effect of giving the latter a higher occupational pension than the full-time person on similar earnings and service.

On the other hand if the part-time employee has two part-time jobs, both of which are pensionable, he will be at a disadvantage relative to a full-time colleague if the application of the full Social Welfare offset is made by both schemes.

In some cases, where a person's social insurance record is particularly patchy, he may not even qualify for the full Social Welfare pension. If, despite this, the full amount is offset (because the scheme rules provide for this), such a person will be even further disadvantaged. The latter scenario does not arise in the public sector where under standard scheme rules a supplementary pension is payable where a person whose benefits are integrated fails to qualify for the full Social Welfare pension.

Design Features

Schemes have been set up voluntarily and designed according to perceived needs at the time. Furthermore, features of schemes are a matter for negotiation between employers, employees and their respective representatives. However, changes in work organisation mean that there may now be aspects of schemes which could be reviewed by employers to check their effect on lower paid employees, if this has not already been done. Examples of how schemes could be altered to cater for those on lower pay include:

- consideration could be given to setting a minimum level of pension expressed by reference to the member's contributions;
- consideration could be given to including additional elements of pay in the definition of pensionable pay. For some lower-paid workers, items such as overtime or shift allowances may form a more significant proportion of gross pay than would be the case for higher earners, so this would act to their advantage;

- for many part-time employees in occupational pension schemes, the Social Welfare offset is the same as for full-time employees even though some of them may not, ultimately, qualify for maximum Social Welfare pensions. For those who do not qualify for the maximum Social Welfare pension, consideration could be given to introducing a proportionately reduced offset, reflecting the lower number of hours actually being worked; this could have a positive and significant impact on the pensionable pay of such workers and hence their ultimate retirement benefits. Although such a proportionate offset would be particularly appropriate in the case of a person with two or more pensionable jobs, it is recognised, however, that it may give a part-time employee a larger overall pension than a full-time colleague in receipt of the same earnings and with the same service;
- in some schemes, it may be possible to build in a *minimum level of benefit* for employees whose pay remains low, or perhaps falls, as they approach retirement; and
- another way to improve the position of lower-paid employees would be for scheme rules to apply a "floor" on pensionable pay as a proportion of total earnings. Thus, for example, if a scheme required a person's pensionable pay to be a minimum of (say) one-third of gross earnings, a person earning £9,000 per annum would be deemed to have a pensionable pay of £3,000 per annum. This would compare with a figure of £2,526, i.e. £9,000 less (£83 x 52 x 1.5), which would otherwise apply. Such a "floor" could be adjusted, as appropriate, to cater for particular groups in the employment concerned. This approach would have the advantage of treating all lower-paid members of a scheme equally, whether they work full-time or part-time. However, by the same token, it would not necessarily give part-time workers more favourable treatment, if this is the objective in a particular case.

In circumstances where any of these suggested approaches could give rise to gender discrimination, it would not be appropriate.

The effects of integration have not always been clearly recognised. However, the inclusion of more manual workers and other lower-paid groups of employees in occupational schemes, the improved availability of pensions information, and the fact that employees generally pay more attention to scheme benefits as they approach retirement age, have combined to bring greater focus to these difficulties. Furthermore, the issues involved are complex. Also, in many cases, the quality of information provided as a matter of course is still not always as good as it should be and some pension scheme members are unaware of the exact entitlement which their scheme membership will, in fact, bestow.

Information

In this context, a simple requirement for all scheme members to get an annual statement outlining their own personal accrued amount and prospective level of pension must be seen as an absolute minimum. Ideally the statement should go further and should include the total level of pay received and the current levels of Social Welfare pension (both personal and for dependants). This could present practical difficulties where details of total pay are not held by scheme trustees; also, it may be impossible to specify each individual's actual entitlement to Social Welfare benefits since neither the employer nor the trustees would have each employee's PRSI record. However, a general statement could be included specifying the requirements for maximum and minimum Social Welfare pension and what the current amounts are. Particular care should be taken to specify the reduced and "pro rata" provisions where these are likely to apply. Also, in cases where large numbers of employees are on the same grade – as in the public service – it may be necessary to issue "grade statements" rather than personalised statements, at least initially.

- 77. The Board recommends that annual statements must be provided automatically which, in addition to giving personal benefit information, would address as many of the relevant points relating to Social Welfare pensions as is possible. Standard wording describing integration should be prepared by the Board for inclusion in such statements, member booklets etc. Also, a booklet dealing specifically with integration and explaining the issues should be published by the Board.
- 78. The Board also recommends that in cases where there is a change in terms of employment which may lead to a reduction in pension entitlement (for example, a reduction in pay or a change in the pay that is pensionable), the employer must ensure that the relevant information is supplied to each person affected, showing the effect of the change, prior to its implementation.

This recommendation would involve a requirement additional to that in Section 5 of the Terms of Employment (Information) Act, 1994 under which an employer must notify an employee of any changes to his/her terms of employment as soon as may be after the change occurs, but no later than one month after the change takes effect.

It should also be noted, in this context, that any improvements in the preservation and revaluation of benefits in respect of pre-1991 service may be of particular relevance to lower-paid employees. More information on this matter could, therefore, also prove helpful.

6.9.2 Integration - the Public Sector

Integration also applies in the case of public servants paying the full "Class A" rate of PRSI contribution. Most manual grades already pay "Class A" and all new public servants recruited since April 1995 must pay the full rate of PRSI. Hence, a growing number and proportion of public servants will have their pensions integrated with Social Welfare pensions when they retire.

The design of the typical occupational scheme operating in the public sector differs, however, from the design of the typical private sector scheme. On retirement, the public sector scheme provides a pension based on an accrual rate of 1/80th of pensionable pay per year of pensionable service, with a separate additional gratuity based on a 3/80ths accrual rate. The typical private sector scheme provides a pension based on 1/60th per year of service, with the option of exchanging part of this pension, at retirement, for a lump sum or gratuity. In the public sector, integration applies to the pension only, with the application of an offset of twice the maximum personal rate of Social Welfare pension; the lump sum in the public sector is non integrated i.e. it is based on full pensionable earnings. In the private sector, integration applies to the pension before part of it is exchanged for a lump sum, and the offset is one and a half times the Social Welfare pension. Where all other things are equal, and the same commutation rates are used to compute the lump sums and reduced pensions, the overall value of the two packages will normally be the same.

It is sometimes believed that because a higher offset applies (twice the Social Welfare pension as opposed to one and a half times) the public servant suffers a greater reduction due to integration than the private sector counterpart. Whereas this is true in relation to the retirement pension, the Board considers that such comparisons must include both the pension and the gratuity. As the example in *Table 6.3* shows, where both are considered and where the private sector employee elects to receive the same lump sum (and where the pension is reduced by 1/9th of the lump sum, as has been common practice), the two are identical in total value. Indeed, where earnings are below twice the Social Welfare pension (i.e. below £166 per week, from June 1998) the public servant has a greater total benefit.

Table 6.3 Comparison of Integration between Public Sector and Private Sector

		Public Pension	Sector Gratuity	Private Sector Pension
1.	Annual Earnings	15,600	15,600	15,600
2.	*Social Welfare Offset	8,632	<u>-</u> _	<u>6,474</u>
3.	Reckonable Earnings (1-2)	6,968	15,600	9,126
4.	Pensionable Service (years)	40	40	40
5.	Retirement Pension (before commutation)	3,484	-	6,084
6.	Retirement Gratuity/ Lump Sum	-	23,400	23,400
7.	Retirement Pension (after commutation)	3,484	-	3,484

Integration in public sector pension schemes, and in particular its impact on lower-paid employees, is one of the issues being examined by the Commission on Public Service Pensions. As this Commission is due to report to Government during 1998 the Board did not consider it appropriate to make any specific recommendations in relation to integration in the public sector, other than the general recommendations made in 6.9.1, under the heading Information.

6.9.3 Integration - Effect on Employers

The proposed increase in Social Welfare pensions will have direct knock-on effects on integrated pension schemes. A simple illustration of these can be made by looking at the change in the benefits which integrated schemes would have to provide at different salary levels. Taking a scheme with a 1/60ths accrual rate (the typical private sector defined benefit scheme), the effects would be as shown in *Table 6.4* below.

In a typical scheme of this type, the average salary of a member of a pension scheme is about 125 per cent of average industrial earnings, currently about £291 per week. This means that increasing the level of Social Welfare pension from 28.5 per cent to 34 per cent of average industrial earnings would produce a drop in pensionable salary from 66 per cent of actual salary to 59 per cent for the "average" member. This would mean that the liabilities of a scheme would decrease by 10 per cent, as would the required contributions from employers (and, if the scheme is contributory, from employees).

Table 6.4 Impact of Adjustment in Social Welfare Pensions on Integrated Schemes (1/60ths Accrual Formula)

Salary as %	Current salary level	Pensionable Salary as % of Salary if SW pension equal to		Percentage drop in
of AIE*	£ p.a.	28.5% AIE*	34% AIE*	pensionable salary
50	7,566	14	0	100
75	11,349	43	32	26
100	15,132	57	49	14
125	18,915	66	59	10
150	22,698	71	66	8
200	30,264	79	74	5

In mature schemes, which would have considerable accumulated assets, this would mean that the liabilities in respect of both past and future service would decrease by similar amounts. However, as mature schemes would already have assets accumulated to cover past service liabilities, some of these would no longer be needed for this purpose. If the reserves so released were used to reduce employer's future contributions, the required future level of employer contributions would decrease by a higher amount than the 10 per cent shown in Table 6.4 for someone on 125 per cent of average industrial earnings.

The actual impact would vary considerably, depending on the particular circumstances of schemes. Overall, it is probably reasonable to conclude that the increase in Social Welfare pensions could give rise to savings in pension costs in excess of 1 per cent of actual salary roll, which would be achieved over the period during which Social Welfare increases were introduced. Such savings could, of course, be wholly or partly offset if the proposed increase in Social Welfare pensions results in an increase in PRSI contribution rates.

6.9.4 Integration - Possible Options

The Board has considered a number of possible options to mitigate the negative impact of integration on pensioners, with particular reference to lower-paid workers. These include:

- 1. setting a minimum level of pension expressed by reference to the member's contributions. (This would protect against the total extinction of benefits as a result of falling pay or rising Social Welfare levels which, while rare, is very damaging to perceptions in a contributory scheme). Given that under current Revenue regulations, employers are required to contribute a minimum of one-sixth of the total cost of providing a member's benefit, a minimum benefit valued at 120 per cent of the member's contributions would seem appropriate. It is acknowledged that this option would have no impact in the case of a non-contributory scheme;
- 2. setting a minimum level of pension accrual for defined benefit schemes;
- 3. prohibiting reductions in accrued benefit in cash terms from year to year. (These can arise as a result of drop in pensionable salary, an increase in Social Welfare benefits, or a combination of both);
- 4. the use of a pro rata Social Welfare offset for lower-paid part-time employees, particularly if they do not qualify for full Social Welfare pension but also to improve their pension position generally;
- 5. setting a "floor" below which pensionable pay, as a proportion of earnings, should not fall i.e. requiring that pensionable pay be at least a specified percentage of a person's earnings; and
- 6. increasing pensionable pay by including additional elements of remuneration not already included and/or reducing the Social Welfare offset.

It is recognised that altering schemes in favour of lower-paid employees will generally entail additional costs to a scheme. However, in many cases, depending on the characteristics of the scheme and its membership, the proportionate increase in cost in toto may well be manageable over a period of time. This is particularly so if the recommended improvements in Social Welfare pensions take place, with the resultant savings to occupational schemes detailed in *Table 6.4* above.

However, given that pension provision is voluntary, the Board considers it inappropriate to require the introduction of regulation which could interfere with the freedom of employers and employees (and their representatives) to negotiate arrangements which may suit their own circumstances. Options 2, 3, 4, 5 and 6 above could fall into this category. Therefore, the Board does not recommend compulsory change in these directions.

At the same time, the Board recognises that the emergence of a nil or minimal pension from an occupational scheme will cause the members affected to question the benefit of being a member of such a scheme and could encourage them to seek to opt out or, in the case of future employees, to decline to join. Since one of the core objectives of this Initiative is the extension of pensions coverage, such an outcome, if it happened to any significant extent, would be highly regrettable. It might also deprive members of other valuable benefits (e.g. death benefits) provided by the employer.

Where appropriate, therefore, the Board urges employers to consider the application of a minimum benefit test (and, if the scheme is contributory, a minimum employee contribution test) to alleviate problems arising at lowest pay levels, recognising that there may be other competing priorities from other members.

Option 1 above is rather different as it is based on contributions which have already been made by a member to a scheme and would, therefore, have very limited effect.

79. The Board recommends that contributory defined benefit schemes should be required to provide minimum benefit levels whose value equates to 120 per cent of the member's ordinary personal contributions, with interest thereon. The interest rate, if any, should be the same as that which applies to refunds of contributions on leaving service.

6.9.5 Integration - Current Pensioners

As noted in Section 3.6 the vast majority of members of defined benefit schemes in the private sector have their benefits integrated with the Social Welfare scheme. This process enables employers to provide their employees with an earnings-related pension which might otherwise not be possible. There is logic to this arrangement since both employers and employees are also contributing to their Social Welfare pension through the PRSI system. It is also the practice in most other countries.

From submissions received, the Board is aware of confusion and complaint as to how this integration process operates where occupational pensions are already in payment and in particular how annual Social Welfare pension increases impact on the occupational pension. On foot of enquiries, the Board is satisfied that in the vast majority of integrated schemes the integration takes place at Social Welfare pension age when the then Social Welfare pension is taken into account and the occupational pension is not subsequently recalculated following each subsequent increase in the Social Welfare pension. In other words, the pensioner receives the full benefit of that increase. The Board is, however, aware from submissions that the above arrangement is not always the case and that, in a small number of schemes, the integration process continues after retirement.

The Board fully acknowledges that the format of pension arrangements is one for negotiation between the employer and employees or their representatives, but notes that it is a requirement of the Pensions Act that, once its provisions are agreed, the trustees operate such schemes fully within their rules and provide in full the pension increases (if any) therein prescribed. As stated above, the Board is satisfied that, in the vast majority of schemes where pension increases are guaranteed, the rules define that increase by reference to the occupational pension only i.e. the Social Welfare pension increase is not taken into account. However, under their rules, a small number of schemes seek to protect the value of the combined occupational and Social Welfare pensions by guaranteeing that this total retirement income increases, for example, in line with the Consumer Price Index. The actual amount of Social Welfare pension is then offset to determine the amount of the increase, if any, in the occupational pension.

Where a scheme does not provide for automatic increases to pensions in course of payment, or where increases are defined by reference to the total pension as described in the previous paragraph, it would not be the intention of the Board that increases in Social Welfare pension should be used to reduce the occupational pension then in payment. Based on the Board's enquiries, such a practice of reducing the occupational pension already in payment does not exist.

The ESRI Survey 1995 shows that many occupational schemes do not guarantee to increase pensions whilst in payment but, in practice, they review pensions on a discretionary basis. The Board is satisfied that, under current practice, Social Welfare pension increases are not taken into account generally when considering the level of discretionary increase to be added to the occupational pension following such review. The Board considers that this practice should continue. In particular, it would not be acceptable to reduce the occupational pension already in payment following the review.

The issue of the interaction between occupational and Social Welfare pension increases would become particularly important if the strategy proposed in this Report, which includes a significant increase in the First Pillar Social Welfare pension over a 5 to 10 year period, is implemented. Any move on the part of pension schemes to reduce occupational pensions already in payment arising from the proposed Social Welfare pension increase would run counter to the objective of improving the adequacy of pensions and would, therefore, not be supported by the Board.

Accordingly, the Board recommends that reductions in occupational pensions already in payment, arising from increases in Social Welfare pensions, should be prohibited.

6.10 Education and Awareness

80.

The recommendations contained in the Initiative will need to be supported by an effective education and awareness programme if they are to have the maximum desired effect. The level of understanding and awareness of pensions among the general public appears to be low. Market research included in submissions to the Board shows a primary reason for non-participation in pension arrangements as "never thought about it" and as a lack of appreciation of the importance of retirement planning. Many people have little comprehension of the impact that retirement may have on personal standards of living and give little thought to how they will compensate for an absence of employment earnings. There is a tendency to believe that the State alone will look after them when they retire. This research provides clear evidence that the extension of pension coverage requires more education on the importance of saving for retirement.

Information from overseas shows that countries which are trying to increase pension coverage accept the need for co-ordinated and effective public education to highlight the important aspects of making sufficient retirement provision. In most countries, debate surrounded who was the most appropriate party to implement a public education campaign and how best it should be co-ordinated.

In the United Kingdom the responsibility in relation to public education for pension policy was principally implemented by the Department of Social Security with other more "direct" regulators doing little, if any, active public education. United Kingdom industry association groups do not appear to have had a co-ordinated approach to public education up to now. Responses to the current Pension Review in the United Kingdom have strongly highlighted the need for a better co-ordinated and resourced public education campaign.

Australia's extensive public awareness campaign in the mid-1990s is an example of scale and co-ordination in this area. This was essentially funded and delivered by the Australian Government between 1994–1996. Government agencies played a leading role. Industry bodies also played a role, along with customer groups. It included an intense print and electronic media campaign and was supplemented by leaflets distributed to every Australian household. This public education campaign was monitored by both qualitative and quantitative research to evaluate its effectiveness.

Successful targeting and educational policies used in the United States and Canada have seen a co-operative approach used by both industry and the associated Government agencies. Principally in consultation with industry, the Department of Labour in United States has prepared public education material for customers stressing the need for them to plan for their retirement. The second stage in the United States was an effective distribution system which industry associations provided and they also established "freephone" numbers to assist customers with their enquiries.

The Board has developed an Information Policy, which was agreed by the then Minister for Social Welfare in 1997. This policy covers the statutory roles relating to ensuring that there is requisite information available to members of pension schemes, to trustees and other interested parties. In addition, it encompasses the Board's more general role in promoting awareness and understanding of pension issues with specific reference to sectors where coverage is known to be low e.g. the young and women. Specific aspects of this Policy which were designed to increase pensions awareness include the following:

- targeting of employers and unions by means of an information campaign to introduce or improve occupational pension cover;
- development of closer liaisons between the Board and other employer/management bodies in addition to IBEC;
- development of a more pro-active approach to media relations;
- communication of the benefits of pension coverage for young people and women in the workforce through an effective media relations programme;
- broadening of the distribution network for the Board's information booklets and other material;
- targeting selected conferences/events for Board's information stand;
- extension of the range of contacts for information presentations by Board staff;
- establishment of a website on the Internet for the Board's publications;
- use of a freephone service for particular events; and
- possible provision of pension seminars.

This Board Policy also recognises specifically the Initiative and its importance as a focus for increased pension awareness. A shortcoming of this Policy is that it is currently supported by very limited resources and financing.

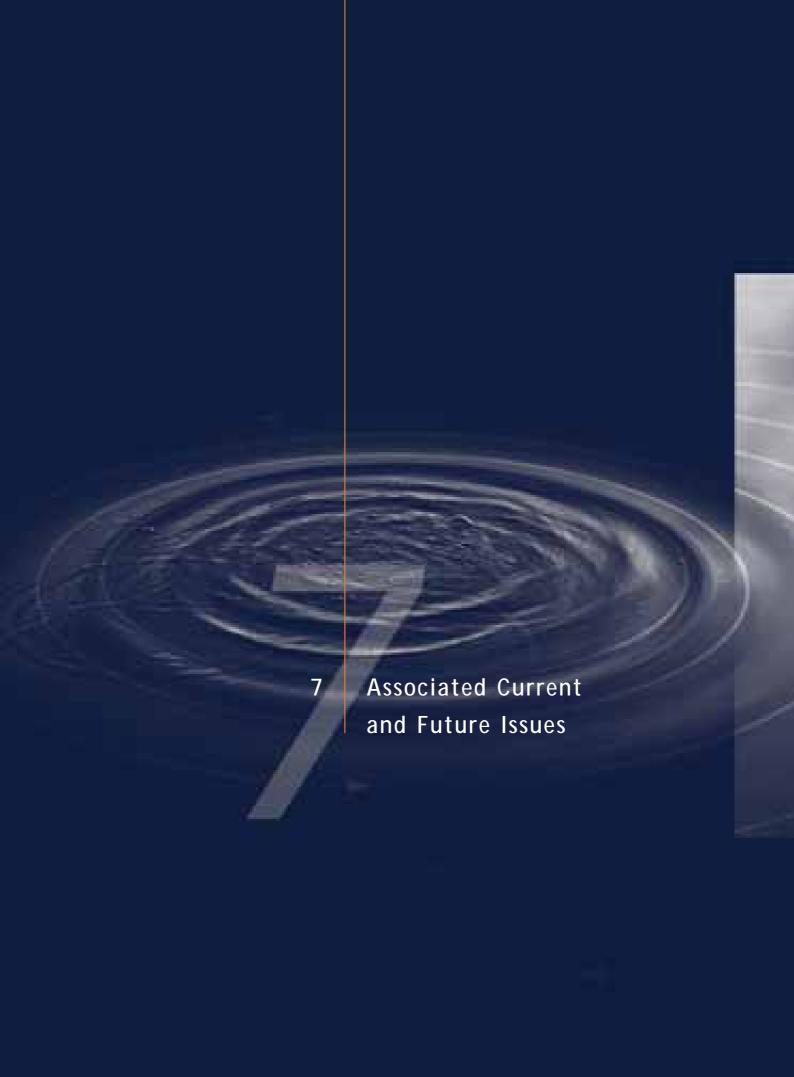
The Board recognises that widespread awareness of the need for pension provision is an essential and basic requirement to the success of the Initiative.

81. The Board recommends a Government-driven pension awareness campaign to be conducted in conjunction with the relevant public and private sector bodies.

This should be organised through current Government agencies involved in pensions i.e. the Board, the Department of Social, Community and Family Affairs, and the Revenue Commissioners. It should involve, and be supported by, industry groups, IBEC, ICTU and selected customer groups. In addition to current activities it should include:

- a media education programme;
- a school level campaign which would incorporate pensions in the national curriculum;
- improved literature and a plain language campaign; and
- the use of P60s or Tax Free Allowance Certificates to point out the possibility of pension provision.

All in all, there will be many opportunities over the next few years to highlight the changed possibilities that the Initiative creates. Many of these need not be expensive and should be considered against a background where there is likely to be considerable commercial publicity as well.



7 Associated Current and Future Issues

7.1 Adult Allowances and Individualisation (First Pillar)

The qualified adult allowance is the additional amount payable when the person receiving the primary benefit has a dependent spouse.

The question of the individualisation of benefits has been raised in a number of fora including the Consultation Document. Several responses to this have been made - many people strongly favour individualisation of Social Welfare benefits, in particular to reflect changing family and career patterns. However, these responses were not confined to the area of pensions and it is clear that any such developments would need to be considered against the background of changes in other Social Welfare entitlements and in taxation arrangements.

The Board is conscious of changes in attitude towards individualisation and that there is considerable debate about the actual meaning of individualisation and how this might be progressed within current structures. The approach could be along a continuum from, for example, the splitting of total Social Welfare payments between the couple to, for example, a reform agenda in which systems move towards a basis of individual entitlements.

The Board is conscious that the extension of Social Insurance and the introduction of disregards in the social insurance pension system for homemaking will, over time, lead to an increase in the number of pensioners receiving a Social Welfare payment in their own right. (These disregards will ensure that time spent out of the paid workforce for childminding or care reasons will not disadvantage a person in relation to entitlement to a contributory pension at retirement.) The Board is also aware that the Commission on Social Welfare recommended that the relationship between the two rates of payment should be around 60 per cent but that others consider this to be too low. Research¹ is being undertaken in this area at present as part of the current work of the Review Group on the treatment of married, cohabiting and one parent households under the tax and Social Welfare codes. This group, which is chaired by the Department of Social, Community and Family Affairs, is expected to report by mid-1998.

The Board considers that taking account of the Social Welfare customer group in question and the aim of many to move towards a pension on an individualised basis, the current relationship between the qualified adult allowance and the personal rate of payment should at least be maintained.

82. The Board recommends that available resources should be used, firstly, to target the basic pension and, secondly, to maintain, at its current level at least, the relationship between the qualified adult allowance and the personal rate of pension.

¹ The ESRI have been commissioned to examine equivalent scales.

7.2 Other Aspects of First Pillar Design

The recommendations of the Board focus on the level of benefits and the manner in which they should be reviewed in future - primarily through the splitting of the Social Insurance Fund, and regular actuarial reviews. However, there are aspects relating to the payment of the benefits which should be reviewed in order to maximise the State's future flexibility in terms of targeting benefits appropriately.

Other possible changes in Social Welfare pension provision for consideration could be:

- the introduction of flexibility in the point at which a person could decide to take his/her benefits by allowing benefits to commence within a specified period before or after current pension age; and
- possible changes in the relationship between the number of contributions (and the associated conditions) needed to qualify for a full contributory pension.

These and other areas were considered in detail in the Final Report of the National Pensions Board.

7.3 Position of Women (Second Pillar)

A number of respondents to the Consultation Document also highlighted the considerable practical difficulties arising from existing occupational pension schemes where the benefits are typically structured around an individual and his/her dependants. This makes it difficult for a dependant to know just what their pension expectation might be, particularly in the event of marital breakdown. The current system does not allow independent provision unless the dependant is working. In defined benefit schemes, dependants' pensions may be automatically provided whereas in defined contribution arrangements, it is usual for the promise of dependants' pensions (if any) to be a decision for the member at the point of retirement. There may, therefore, be no security for a dependant who outlives the member. The Board's recommendation in Section 6.6.1 which would require a dependant's pension to be illustrated when purchasing an annuity would, at least, highlight the issue for the member. There were no suggestions as to how such problems could be dealt with easily and satisfactorily but they were generally seen as part of a wider issue about family rights.

More generally, as noted in Chapter 4, there have been significant increases over recent years in female participation in the labour force. The Board notes, however, that such participation may not translate automatically into occupational pension scheme membership. This arises because this participation tends to be in occupational sectors and in types of employment characterised by low levels of coverage by occupational pension schemes. Perceptions, for example, of being adequately covered by their spouse's occupational scheme may also influence the arrangements (if any) for the retirement provision of married women. On the assumption that the trend of growing female participation in the labour force will continue, the question of adequate coverage of women members of the workforce will remain important. In this context, the Board feels that, as well as the First Pillar developments noted above, the proposals in the Initiative should improve the pension position of women in the workforce, in particular:

• the Second Pillar coverage targets (in Chapter 5, *Table 5.1*) include specific targets for increased coverage for women in both employed and self-employed areas (for example from 54 per cent to ultimately 75 per cent for female employees aged 30 to 65);

- the proposed introduction of PRSAs, in Chapter 6, as flexible pension saving vehicles which are
 neutral as between employment status, should especially assist the position of women with broken
 employment records due to childcare and other responsibilities. PRSAs will, in particular, facilitate the
 continuity of provision for ultimate pension for women who leave the paid workforce (for example, for
 childcare or other care reasons) if they have access to forms of income other than earnings from
 employment; and
- the changes in methods of integration of Social Welfare old age pension and occupational pension scheme benefits considered in Chapter 6 would especially assist women.

7.4 Transitional Arrangements (Second Pillar)

While the thrust of the Initiative is towards new additional pension coverage, many of the steps recommended will affect existing coverage also. It is likely that existing coverage will be examined in the light of developments emerging from the Initiative to see whether it is still appropriate or if new arrangements offer opportunities for improvement.

Given that pension provision is a complex subject, it is easy for individuals to make mistakes when assessing whether they should change arrangements. It is evident that much of current pension coverage is very good and it should not be put at risk for any reason. Nevertheless, as long as the pensions regime remains fundamentally a voluntary one, change will occur. However, it is the view of the Board that those covered by present arrangements should be able to take advantage of new possibilities, provided that they do so with as much information about the consequences as possible.

7.4.1 Existing Retirement Annuities

At present, the conditions of retirement annuity contracts provide they are not transferable or assignable and may not be surrendered. An option would be to leave these conditions in place in respect of existing retirement annuities. This would mean that they would not have some of the additional features of PRSAs (e.g. to transfer between providers) and kitemarking would not apply to them.

An alternative would be to provide by legislation that all retirement annuity contracts be converted automatically to PRSAs. This would mean that the relevant life offices would be forced to amend the terms of their contracts unilaterally without the consent of their policyholders. This could give rise to legal issues if it resulted in a worsening of terms or conditions.

A third option would be to allow life offices to give their customers the option to have their existing retirement annuity contracts amended to become PRSAs. Such an option would probably need to be confined to unit-linked policies where the terms and conditions are already fairly flexible and charging is explicit. It means the existing contractual terms for charging etc. should be maintained without interruption and that the cost should be minimal.

83. The Board recommends that the third option should be adopted (i.e. holders of existing retirement annuity contracts to be given the option for their contracts to become PRSAs).

This would be likely to mean that the holders of most types of retirement annuities would be offered the advantages of PRSAs but that the holders of those contracts for which this would give rise to difficulties would not have PRSAs forced upon them. A consequence of this would be that contracts which converted to PRSAs would then be transferable to other providers if the customer so chose.

7.4.2 Existing One-Member Defined Contribution Schemes

These already have many of the features of PRSAs but they are trust schemes (usually with the employer as trustee) and the tax regulations are those based on benefits whereas the employer and member would normally be thinking in terms of contributions. Furthermore, they are subject to the requirements of the Pensions Act. The increased simplicity of the PRSA may well appeal to both employer and member but a number of these schemes may have conditions attaching to them (such as vesting periods) which may be seen as important by the employer. As these are essentially conditions of employment rather than something determined by the pension provision, it would be difficult to change them.

84. The Board recommends that it would be appropriate to allow one-member defined contribution schemes to remain as trust schemes or to allow them to convert to PRSAs on the same contractual terms as those in force. It should be made clear that it is a matter to be decided by the various parties involved.

Prescribed information would be required to be provided to a member being transferred into a PRSA.

7.4.3 Existing Group Defined Contribution Schemes

Essentially the issues for these schemes are broadly similar to those for existing one-member defined contribution schemes. However, larger group schemes, especially those with member trustees, may well stay in their current trust form as they are large enough to be able to discharge their responsibilities in a way which benefits the individual members. Examples of the advantages of size might be the ability to make better informed choice of investment manager and provide more extensive member communication.

85. It is recommended that existing group defined contribution schemes should have the option either to be retained as trust schemes or transferred to a group of PRSAs.

While there may be little difference in the terms available for the members, their protection still needs to be considered. In fact, the members would be protected by the regulations relating to scheme wind-up. The fact that the employer is staying in business, however, means that some additional protection is needed to ensure members can discuss the actual proposed changes in good time.

86. The Board recommends that the employer in such circumstances should be obliged to ensure that the relevant information describing the impact of the change is made available to members at least two months before it is possible to finally terminate the trust or transfer benefits to PRSAs.

7.4.4 Existing Additional Voluntary Contribution Schemes

Additional voluntary contribution facilities may exist in conjunction with occupational pension schemes and there can be wide variation in the range of such facilities available to employees. In some cases there may be a variety of providers, in others a single arrangement may be available to members of a scheme.

It would be reasonable to allow employers to insist on the existing additional voluntary contribution arrangements being maintained, i.e. as trust schemes and without any wider choice of provider by employees. This course would be likely to be the preferred choice of large employers with carefully chosen additional voluntary contribution arrangements.

Equally, the Board considers that it would be reasonable also to allow the additional voluntary contribution arrangement to be wound-up and the benefits to be transferred to PRSAs, provided that appropriate information was given to members. The degree of choice about PRSA providers available to employees for their additional voluntary contributions should be the same as those applying under the Board's proposals for universal access.

87. The Board recommends that both of these options should be available.

7.4.5 Buy-out Bonds

These are personal contracts which represent benefits provided to a former employee under an occupational pension scheme but which have been transferred into personal ownership. One of their constraints is that the form in which benefits can be taken must follow that in the original scheme even though there is no ongoing connection with the scheme.

88. The Board recommends that all buy-out bonds should be converted to PRSAs - this would allow benefits to be taken with the same flexibility as PRSAs - and, furthermore, that benefits should be capable of being transferred into an occupational pension scheme which the holder may join in the future.

The legal implications of such conversions would need to be considered by those involved.

7.4.6 Risk Benefits

The Board does not consider that there are any significant implications for risk benefits arising from the changes which it is proposing.

7.5 Effects on Existing Schemes and Parties to Pension Coverage

7.5.1 Effects on Attractiveness of Different Types of Scheme

The introduction of PRSAs and simplified access to them will inevitably raise questions about the impact on the attractiveness of other types of pension provision. In Section 6.2.2 the implications of changes, in terms of legal form, were considered and it is concluded that these are likely to be broadly neutral. Other aspects, notably commercial ones, are examined here.

The first concern must be whether PRSAs could pose any threat to the body of existing defined benefit schemes. The Board regards this as extremely unlikely for a number of reasons. These schemes, by definition, provide a replacement income related to salary with a certainty which PRSAs cannot match. Furthermore, they operate on a group basis, pooling several functions to gain economies of scale. While they can be expensive on account of the generosity of the benefits, they often result in superior value for money, as a result of more flexibility in investment perspective and lower costs. It is notable in this context that as the data in Section 3.6 indicate, there has to date been no significant incidence of existing defined benefit schemes (other than very small ones) converting to a defined contribution basis.

Defined benefit schemes are set up with trustees, and many have member trustees. These features, combined with the regulations concerning winding-up of pension schemes, mean that any such proposal is bound to be given serious consideration by scheme members (and probably other employees or their representatives). This Report also recommends that any proposed switch from any trust scheme to PRSAs should trigger information for the members concerned which would enable them compare their prospective benefits in a new situation. Despite these protections, the Board considers that it would be appropriate to monitor any wind-up proposals and, if necessary, regulate in order to give even greater protection.

In relation to group defined contribution schemes, the Board takes the view that there is nothing in its recommendations which would give an employer any financial incentive to switch from a trust scheme to a PRSA and that, if a switch were to be made, the commercial terms available in the (expanded) market should be at least as good as those currently on offer. Consequently, assuming that contribution levels stay at the same level, the change would be a legal one principally and the Board is of the opinion that this is a decision which can be undertaken by employers and members, remembering that there would still be information requirements to be met.

As indicated above, the Board considers that the value for money from a PRSA should be at least as good as that available today and probably better for smaller contributions on the assumption that some new players will decide to enter this sector of the market.

In summary, the Board does not consider that there would be any distortion to the relative "quality" of different types of provision; rather, PRSAs represent a clear improvement over current individual provision on account of the specific quality measures and the indirect impact of competition from a wider range of providers.

7.5.2 Holders of Existing Retirement Annuity Contracts

Holders of existing retirement annuity contracts are likely to respond to the introduction of PRSAs by asking questions about the quality of their existing coverage. Equally, their position will be given a lot of consideration by their providers and it is likely that determined attempts will be made to hold them or offer them attractive terms for new PRSAs. Conditions of existing retirement annuity contracts can only improve through being given extra features.

7.5.3 Members of Existing Occupational Pension Schemes

With respect to members of existing schemes, the position should not change unless the employer seeks to convert the scheme to a PRSA basis. This should be capable of being done subject to the provision of meaningful information about the effect of such a switch. Effectively similar conditions apply in the current situation.

89. The Board recommends continuation of the present position whereby employees may not opt out of an employer's scheme. Accordingly, (as indicated in Section 6.2.5), the Board recommends that it should remain permissible for an employer who is contributing to a pension scheme to have or make it a condition on taking up employment that employees join the pension scheme. (This would include arrangements where the employer agrees to contribute towards a PRSA.)

7.5.4 Employers

Employers can terminate a scheme at any time and it is hard to see how or why this right could or should be removed in a voluntary environment. It should be possible, subject to relevant regulations (such as disclosure of information), to terminate or change an occupational pension scheme. The view of the Board is that this position should continue, provided that there are procedures in existence to allow serious discussion to take place between employees and employers.

7.5.5 Trustees

It is hard to see that there would be any significant direct effect on trustees as a result of the introduction of PRSAs. Their administrative obligations to control benefit payments would change somewhat but should not be complicated unduly by the existence of parallel PRSAs.

7.5.6 Intermediaries

Intermediaries would almost certainly experience change with the introduction of PRSAs. In particular, a major opportunity would be created both for new pension coverage and for switching from existing arrangements. There would be some inherent risks of attempted over-selling in these circumstances. However, the potential scope for this would be conditioned largely by the commission possibilities, the attitude of parent companies (in the case of tied distributors), the regulatory constraints on what is actually permitted and the information requirements applicable in different circumstances.

90. The Board recommends that an explicit ongoing requirement should be placed on PRSA providers to deal only with intermediaries who are fully compliant with the requirements of a relevant regulator.

7.5.7 Pension Providers

Existing pension providers would be affected by the introduction of PRSAs since these would amount to a significant market innovation. However, it is not envisaged that existing contracts would be required to be changed (for example, by requiring benefits to be transferred to another provider without charge). Instead, the momentum of market forces would exert change based on the value added embodied in new products.

It is expected that pricing bases and structures would change to some extent and insurers could face significant lapse and re-entry problems - such consequences are inevitable whenever there is significant market development. An important issue for insurers, therefore, would be pricing and transfer terms.

The emphasis in the industry could change somewhat away from technical and towards a greater emphasis on service, but this change is likely to be gradual.

91. It is the Board's view that additional protection stemming primarily from increased disclosure requirements is sufficient to provide reasonable protection to the different parties currently involved in pension provision and such protection will ensure that the providers are not undermined.

7.6 Implications of Achieving Coverage Objectives

Appendix E sets out in detail the number of employees and self-employed who were covered by pension arrangements in 1995 and the number who will be covered in 5 and 10 years if the coverage targets set in *Table 5.1* are achieved. These can be summarised as follows:

Table 7.1 Implications of Achieving the Board's Targets for Coverage

	Employees	Self-Employed	Total	
Numbers Covered				
1995	470,000	72,000	542,000	
5 Years	704,000	108,000	812,000	
10 Years	797,000	139,000	936,000	
Increases in Numbers Covered				
First 5 Years	234,000	36,000	270,000	
First 10 Years	327,000	67,000	394,000	

Estimating the Revenue implications of achieving the Board's targeted levels of coverage requires assumptions to be made about the quality of coverage for those with new coverage and about their salary levels and rates of tax and PRSI contributions.

The most straightforward way of quantifying the effect of this Initiative is to estimate the Revenue effects which would arise if the coverage in 1995 had been at percentage levels set out in the coverage objectives rather than at the levels found by the ESRI Survey 1995. The actual future Revenue effects would of course be larger on account of the expected continued growth of the labour force from its 1995 level.

To determine the Revenue effect, the distribution of coverage by income decile together with average income levels for that decile and assumed tax and PRSI rates have been combined (as shown in Appendix B). Over time, there would also be the effect of tax exemption of the additional investment income on the funds built up and the tax receipts from the emerging benefits.

A striking feature for employees is that the average income for those with cover already is £19,800 whereas for those without cover it is £10,300. It is assumed that additional coverage will be more slanted to the better off among those without coverage with an average income for these newly covered people of £13,300.

This gives an average pension contribution for newly covered employees of £978 per annum. The Revenue effect of this depends on whether the cost is borne by employer or employee:

- assuming that overall the cost is met equally by employer and employee, the total tax relief would be £251 and loss in PRSI contributions would be £73;
- if it were met entirely by the employee, the average tax relief is £306 with a reduction in PRSI contributions of £146:

• if the cost were met entirely by the employer, with an assumed corporation tax rate of 20 per cent, the tax relief would be £196. There would be no reduction in PRSI contributions.

Taking the average self-employed contribution at its level of £2,200, found by the ESRI Survey 1995, and assuming an average marginal tax rate of 40 per cent, gives an average tax relief of £880.

Applying those to the anticipated additional numbers covered, on the basis set out above, would mean an overall adjustment (over that 5 year period) in tax revenue of a little over £34 million per annum and a loss of PRSI income of less than £3.9 million per annum assuming the objectives for the first 5 years were achieved. In other words, an Exchequer loss of about £7.6 million would need to be taken in each year for five years.

The estimated amounts of tax relief foregone may be lower than expected at first sight - the reason is that the average income and contribution level of those taking up cover for the first time is expected to be well below the level for those who already have cover.

7.7 Other Second Pillar Policy Issues

It might be noted that apart from the recommendations in the Initiative, and any changes in the Board's role which may result from it, the Board has a comprehensive and prioritised policy programme under which a wide range of matters will be examined, in planned stages, during the next three years. This list includes items requested by the Minister for Social Community and Family Affairs, items arising from Partnership 2000, as well as items identified by the Board itself. In addition to the issues in this Report, the Board's policy programme includes the following occupational pension scheme issues:

- treatment of pension scheme surpluses/deficits;
- indexation of pensions in payment;
- review of the minimum funding standard;
- a compensation scheme;
- a Pensions Ombudsman;
- protection of accrued rights; and
- provision for dependants.

7.8 Death and Disability Benefits (First and Second Pillar)

The remit for the Initiative refers to adequacy of income in the event of retirement, death or serious ill-health. Given that these are all covered to some extent by the range of Social Welfare benefits, the Board has concentrated on retirement income. The issue of adequate income in the event of death is similar in many ways to that of retirement income - there is universal provision under Social Welfare and these benefits are taken fully into account in the Actuarial Review and in the recommendations in this Report.

Supplementary provision for those widowed is still valuable. However, the Board notes that the ESRI Survey 1995 found that the vast majority of pension coverage already provides a degree of coverage in the event of death. Almost all occupational pension schemes provide lump sum death benefits expressed as a multiple of salary, even if the member has not yet qualified for vested rights under retirement benefit provision. Many also provide a specific level of dependant's pension which may also cater for the number of dependent children. Spouse's pensions are also very widely available on death of a married member after retirement.

Those with personal pensions coverage (and PRSAs in future) can provide death benefits as part of this structure.

The question of access to death benefits seems to the Board to be virtually identical to that of access to retirement benefits. However, there is some question as to whether individuals have sufficient death cover for their family needs, when account is taken of their entitlements to Social Welfare or scheme benefits. This is a matter of personal judgement and choice and the Board notes that additional coverage is already available from additional voluntary contributions and benefits from the associated tax incentives. Therefore, the issue is one of awareness of the possible need and ways to deal with it. The Board is of the view that this is best dealt with as part of the recommendations under information requirements and a general campaign for education and awareness.

Income in the event of long-term disability is rather different. Firstly, there are Social Welfare benefits available under the PRSI system to most of those at work. Turning to supplementary provision, disability insurance has not been part of the benefit structure of occupational pension schemes up to now but employers have been able to provide it as a separate employee benefit. Some occupational pension schemes (but by no means all) also provide for pensions to be payable in the event of retirement as a result of serious ill-health. Individuals have also been able to provide cover for themselves and benefit from tax relief on premiums up to certain limits.

The main problem with extending the scope and level of supplementary cover is the subjective nature of some disabilities. Whereas many conditions are quite clearly so severe that the person affected will not be able to continue working, there are many others where the evidence is far less clear cut - examples would be stress-related illnesses or back problems. Whatever the reason, insurers have experienced rapidly rising claims rates particularly for certain occupations or illnesses. As a result, cover has been limited, withdrawn altogether or become far more expensive. There are ways to deal with some of these problems, for example, by limiting benefit levels so that they present clear incentives to return to work (high replacement rates do not do this) or by limiting the period for which benefits can be paid.

By definition, many without cover are those for whom cover is likely to be most expensive or the claims rates most unpredictable. The Board is aware of the shortcomings in this, but it does not feel that in a voluntary environment it would be appropriate to force the insurance industry, the State or employers to provide cover, the costs of which may be unreasonable. Making cover mandatory would allow some pooling of risk but would present a huge challenge to controlling the cost of claims. At the present time, the Board does not see merit in such an approach. It would simply make existing cover more expensive and could lead to much of it being discontinued.

There is a technical point that disability cover might be more efficiently administered if it was regarded as an approved type of benefit which could be provided from within a pension scheme (or PRSA). The Board will examine this in due course.

7.9 State Involvement in Second Pillar Pension Provision

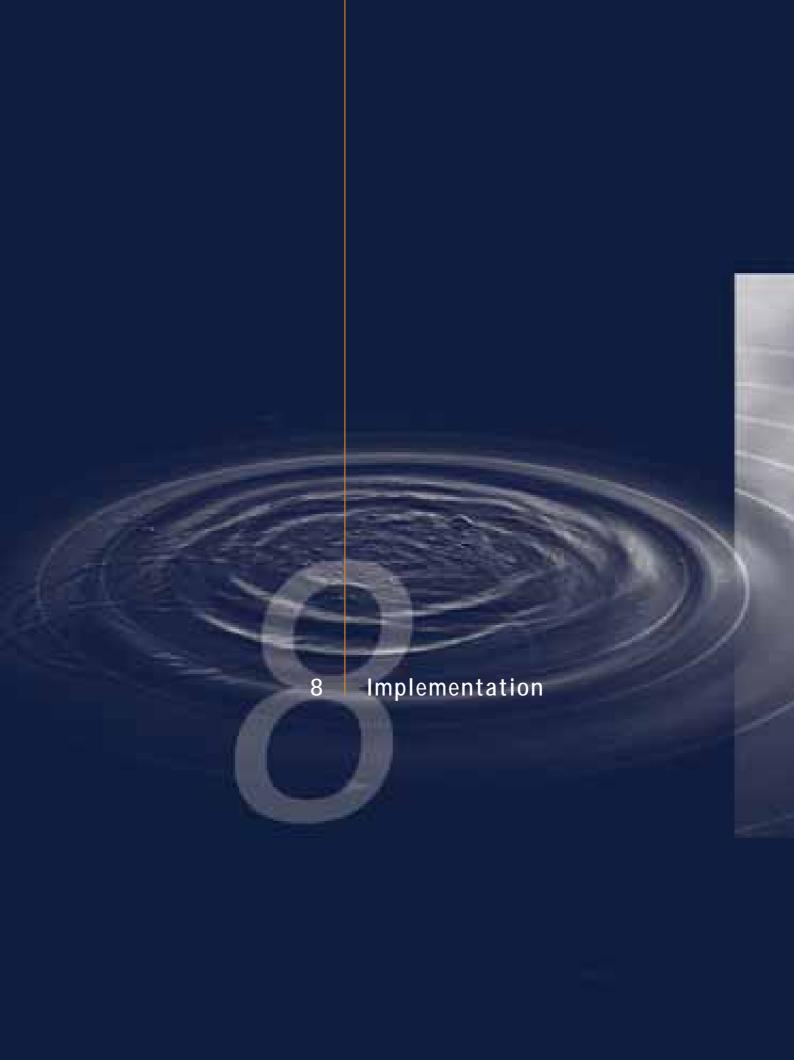
92. The responses to the Consultation Document generally held the view that the State should not be a direct provider of occupational pension benefits although it could facilitate some aspects. The Board concurs with this view.

A specific suggestion was made that the collection system by which employers remit tax, levies and PRSI could be attractive in the context of universal access. The reasons advanced were that this is a relatively simple process with which employers are already familiar and works reasonably well.

The Board has considered this suggestion and come to the conclusion that, given that it recommends that the employer should be obliged to deduct contributions in respect of one provider only, there is no need to make any additions to the existing remittance options (such as direct debit), which are seen as satisfactory. It is also aware that the structure of the tax/PRSI remittance system may not be amenable to transmitting the detailed information needed to accompany the frequent remittance of many individual contributions to the investing institution.

93. However, the Board considers that, should the Revenue Commissioners come to the view that the collection system would be capable of development for other, possibly commercial, purposes, the potential in this area should be re-examined.

A further possible area of State involvement might possibly arise in the event of there being a demand for passive investment funds for which commercial providers did not offer sufficient or appropriate choice. This could happen if there were high demand (perhaps particularly from those contributing small amounts to PRSAs) for index-tracking funds where smaller providers might not have the large funds under management needed to give accurate and cost-effective tracking. A pooled arrangement operated by a State agency might enable all providers compete on equal terms.



8 Implementation

8.1 Putting the New Regime in Place

The Initiative contains a wide-ranging and complex set of proposals regarding the legal and practical environment for pension provision. The Board believes that it has set out principles which need to be followed to achieve successful reform of pension provision. However, it recognises also that much specialist work will have to be carried out to fill out the detail for translation into legislation, regulation, professional guidance etc.

Amongst the areas requiring particular attention the Board has identified the following:

- the framework for PRSAs;
- access for part-timers;
- tax regulations;
- regulation and supervision (including reviewing the operation of The Pensions Act);
- kitemarking;
- investment mandates and structures;
- education and awareness;
- measuring progress; and
- formalising the role and responsibilities of the Appointed Actuary.

These are wide-ranging issues. Consequently, the project management of the whole change process will be extremely important.

8.2 Workload and Resource Pressures

The work outlined in Section 8.1 will fall on several groups:

- the Board;
- pensions industry;
- related professions;
- trustees;
- Revenue Commissioners;
- Government Departments and Legislature; and
- Regulators.

There will be considerable need to ensure that the recommendations in this Report which are adopted, are implemented in ways which are sensible and efficient as well as meeting the objectives. This will require exchanges of views and perhaps different approaches between the parties involved, i.e. Government, employers and labour and industry practitioners. This will place a challenge of effective communication while the changes to the framework are being put in place.

The recommendations are designed to go some considerable way to simplifying much of the current complexity and enabling more straightforward approaches to be taken. It is the Board's view that the revised framework will enable pension provision to be provided with less of an administrative burden in future.

The process of implementation will entail an additional burden on all parties involved in pensions coverage for a period of time, both to put new structures in place and then to make the commercial adjustments necessary. This will present a challenge to those with the necessary pensions expertise in both public and private sectors.

8.3 Risks

Clearly, there are risks to the achievement of the objectives of the Initiative arising from different sources:

8.3.1 Technical Complexity

Change of the nature and scale envisaged is complex and errors in detail are almost inevitable although the Board is confident that these would be minor and not fundamental in nature. These will surface only when changes can be tested in practice. To deal with potential unanticipated problems, agreement is required to review changes and to be prepared to amend provisions where necessary.

8.3.2 Resources

As effective implementation will require resourcing of the official agencies concerned, inadequate provision in this regard would entail risks for the success of the Initiative as a whole.

8.3.3 Timescales

It is difficult at this stage to estimate the overall timescale needed to achieve the required changes. While accepting that the Minister/Departments of Social, Community and Family Affairs and Finance would clearly be interested, the matrix in *Table 8.1* under "Government" does not attempt to anticipate the various Ministers/Departments likely to be involved in assisting Government to make these decisions. Some steps are fairly independent of others, some are inter-related, others demand the involvement of third parties (e.g. other regulators) while others still will require providers to adapt their systems and practices to new demands. It should be an early task to plan the resourcing and timing of change and to identify points on the critical path.

Of all the risk factors, this may be the hardest to estimate and the one most likely to be a problem.

8.4 Role of The Pensions Board

The objective of the Initiative goes beyond the existing scope of the Board in that it covers all Second Pillar pension provision, i.e. including personal pension provision, whereas the current statutory role of the Board has focused primarily on occupational schemes.

In relation to personal provision, in particular, the Initiative recommends that the PRSA regime, which would subsume other forms of personal provision such as retirement annuity contracts and buy-out bonds, would be regulated primarily by the Board. This regulation would include, inter alia, approval and supervision of PRSA providers and setting and monitoring and reporting on progress in the implementation of the overall reforms proposed in the Initiative. This monitoring would also include an assessment of whether the level of regulation is proportionate to achieving its objectives especially in the case of small employers and/or those with defined contribution schemes. Initially, it would be expected that the Board would also be significantly involved in preparations (legislative and otherwise) for putting the reforms in place.

94. As the Board's role would be extended substantially as a result of the recommendations contained in the Initiative, a further recommendation is that the formal remit, operation and financing of the Board should be reviewed on foot of the Initiative.

8.5 Monitoring and Measurement

8.5.1 Strategy

This Initiative contains proposals for the most comprehensive reform of pension provision in Ireland for a generation. Already, pension provision plays a very important role in the economy and in the welfare of people. Consequently, it is essential that appropriate steps are taken to monitor the outcome of the Initiative.

This should extend both to measurement of activities, understanding of attitudes and behaviour of those involved in and affected by the Initiative and obtaining feedback on the effect of the changes in order that they can be improved as they are implemented and applied.

95. The Board recommends that it would be appropriate for a long-term monitoring and measurement strategy to be drawn up by the Department of Social, Community and Family Affairs and the Board.

Possible mechanisms required to measure progress would include the conduct of surveys to measure coverage by Second Pillar arrangements, including the impact of PRSAs.

8.5.2 Milestones and Timescales

It will take a number of years to implement the proposed reform strategy of the Board and some time after that before it could be reasonably concluded whether there is adequate progress being achieved in terms of increasing coverage. In the first instance, the key task of monitoring should be to assess the pace at which change is implemented. Some of the principal recommendations of the Board will require research and legislative changes and amendments to existing provisions of Finance Acts. It is important that a careful and realistic assessment is made of the timescale that will be required for this and of an appropriate sequencing with respect to implementation of the reforms so that the transition will be efficient and smooth.

If the proposed strategy is adopted by Government, the Board considers that it would be appropriate to have a critical time path for the implementation of the reform programme drawn up and agreed in consultation with relevant agencies and Government Departments.

96. When an implementation time path has been agreed, it is proposed that the Board would report on progress annually and highlight whether key reforms are being implemented according to the time path.

8.5.3 Monitoring Changes in Extent and Quality of Coverage

It will be necessary to improve the sources of information currently available on pensions coverage, if progress in meeting the targets contained in the Initiative is to be monitored reliably.

- 97. The following recommendations are made:
- pensions coverage should be measured in a consistent fashion using surveying techniques on a regular basis;
- the current practice whereby employers make returns of income data to the Revenue on the basis of pay less pension contributions should be amended, possibly on a phased basis, to provide both gross pay and the actual contributions deducted - these data are produced as part of any payroll process and would allow better measurement of the actual constituents of pension savings;
- information collected from pension providers should also be standardised and form part of the ongoing supervision;
- particular attention should be paid to monitoring coverage by industry sector;
- membership information collected by the Board could also be used.

8.6 Framework for Implementation

It is not possible to establish at this stage the precise timetable for implementation of the proposals in this Report. This will depend, inter alia, on:

• timing of Government decisions on the proposals;

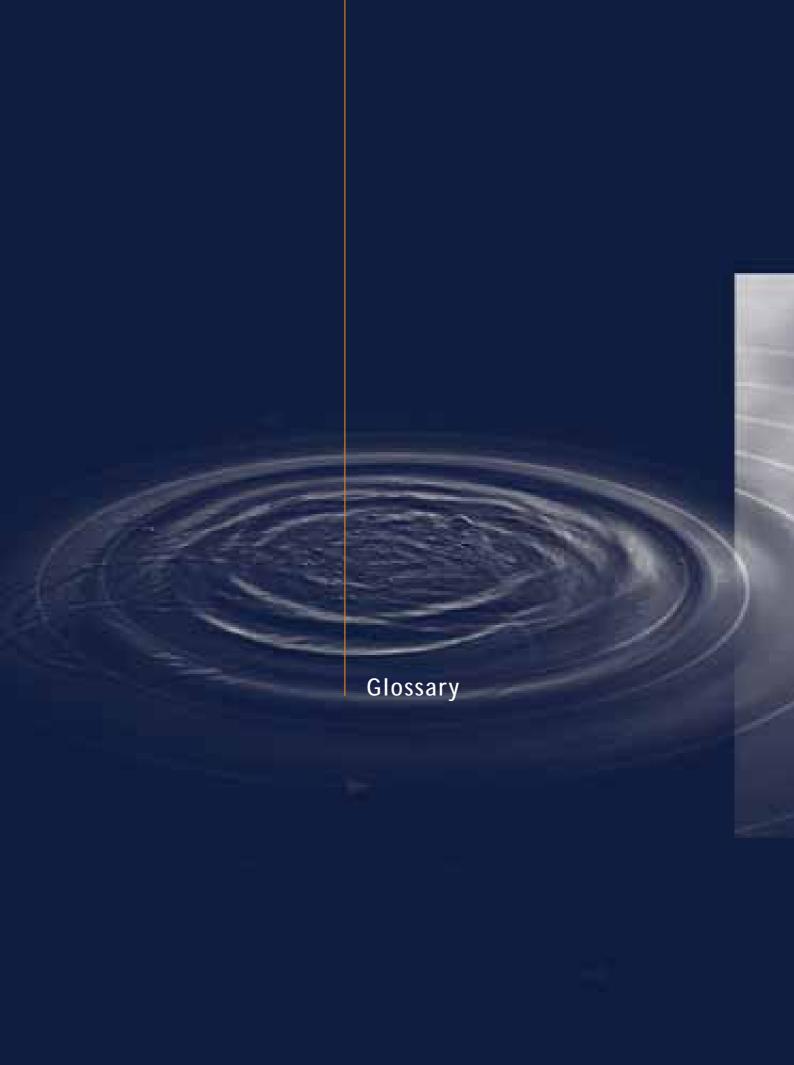
- allocation of time for the necessary legislative provisions within the Government's ongoing legislative programme; and
- consultation with third parties, for example, on operational and technical aspects.

The following matrix, however, indicates how the main components of the proposals might be implemented and the main inter-connections between them.

In the "Decision" column, it is assumed that the normal procedure of Ministerial/ Departmental consultation and input would take place preparatory to Government decisions being taken.

Table 8.1 Framework for Implementation of the Board's Proposals

·		•
Proposals	Decision	Method of Implementation
Recommended future level of Social Welfare pension.	Government	Annual/three year Budgets, and annual Social Welfare Acts.
2. Social Partnership involvement.	Government and Social Partners	Inclusion of level of future real growth of Social Welfare pensions and the sharing of associated costs in future Agreements.
3. Funding of Social Welfare Pension Provision (in part).	Government	As at 1. with legislation also for fund investment agency.
4. Introduction of PRSAs (regulatory framework etc).	Government	Separate legislation, to be prepared in consultation with the Board.
5. Changes in existing pensions legislation (preservation etc).	Government	A Pensions (Amendment) Bill, to be prepared in consultation with the Board.
6. Changes to tax rules (PRSAs and existing pension vehicles).	Government	Finance Bill provisions; these would need to be prepared in conjunction with, but be enacted subsequent to, 4. Their detailed preparation would be undertaken by the expert group referred to in Section 6.3.
7. Separation of Social Insurance Fund into long-term and short-term parts.	Government	Social Welfare legislation; this would best be done in conjunction with 3.
8. Conduct of regular Actuarial Reviews of Social Welfare provision (short and long-term).	Government	To be implemented by the Department of Social, Community and Family Affairs; question of possible legislative basis to be considered.
9. Pensions awareness campaign.	Government	The Board to co-ordinate, in conjunction with relevant interests/bodies in public and private sectors.
 Measures on Integration of Private Sector Schemes and Social Welfare benefits. 	Government	Could be included in legislation at 5. above.
11. Monitoring and measuring progress in implementation of proposals.	Government	To be conducted jointly by the Department of Social, Community and Family Affairs and the Board.



Glossary

Accrual rate The rate at which rights build up for each year of pensionable

service in a defined benefit scheme.

Accumulated fund

The value of assets built up by investing the contributions in a

defined contribution or personal pension scheme, available to

provide benefits.

Actuarial Review The Review entitled "Actuarial Review of Social Welfare Pensions"

published by the Department of Social, Community and Family

Affairs in 1997.

Additional Voluntary Contributions

(AVCs)

Extra contributions which an occupational pension scheme member

decides to make in order to increase his benefits.

Annuity A series of regular payments payable throughout the life of the

beneficiary (and possibly his dependants).

Atypical worker One who is not a full-time permanent worker, e.g. part-time,

temporary or a contract worker.

Average Industrial Earnings (AIE) A standard CSO published measure which estimates, based on a

widely representative sample, the average hourly/weekly earnings (and hours worked) of all industrial (including manufacturing

workers) in the State.

Buy-out bonds The purchase by trustees of a pension scheme of an insurance

policy in the name of a member or other beneficiary, in lieu of entitlement to benefit from the scheme, following termination

of the member's pensionable service.

CPI Consumer Price Index.

CSW Commission on Social Welfare.

Deferred benefits Benefits payable by an occupational scheme at retirement to or

in respect of a member who has left the scheme before normal

pensionable date.

The	Pensions	Board

Defined benefit scheme An occupational scheme where the member's benefit entitlement

at retirement is defined in some way by reference to his salary or

wage, an index or a fixed amount.

Defined contribution scheme An occupational scheme where the member's benefit entitlement

at retirement or leaving service is determined by reference to the

accumulated fund.

EBR Exchequer Borrowing Requirement.

EMU European Monetary Union.

ESRI Survey 1995 The ESRI Survey entitled "Occupational and Personal Pension

Coverage 1995".

First Pillar The retirement benefits payable by the State arising from PRSI

contributions or by means-tested Social Assistance programmes.

Fourth Pillar This refers to pensioners actively increasing their income by

working part-time or starting a new career.

Front end commission The practice whereby most or all of the commission on an

insurance based pension policy is charged in the first year(s)

of contributions being made.

Funding (or pre-funding)/

Funded scheme

The method of financing benefits by putting money aside (and

investing it) in advance of benefits actually becoming payable.

GDP Gross Domestic Product.

GNP Gross National Product.

Indexation The practice of increasing payments at regular intervals in line

with a specified index.

Integration The adjustment of the definition of pensionable salary (or the

pension formula) to produce the desired overall replacement rate at retirement, including the effect of the Social Welfare pension.

Kitemarking The proposed procedure whereby certain pension products

would be approved by the Board as consistent with specified

quality criteria.

Money purchase The determination of an individual's benefits by reference to

contributions paid into his scheme or personal arrangement in his respect, usually increased by an amount based on the investment

return on those contributions.

National Pensions Board (NPB)

The advisory predecessor of the present statutory Pensions Board.

Occupational Pension Schemes 1988".

Occupational pension scheme

An arrangement organised by an employer to provide pensions or

other benefits to employees at retirement or to their surviving

dependants on death.

Pay-as-you-go The approach taken by the existing Social Insurance system and

most public sector pension schemes which finance benefits from

current contributions.

Pensionable salary The amount on which benefits and/or contributions are based in

an occupational pension scheme. For example, it may exclude some elements of earnings, reflect integration with Social Welfare

benefits or be averaged over a period.

to work on account of sickness or accident.

Personal pension See Retirement annuity contract.

Portability The ability to transfer benefit entitlements from one

occupational pension scheme to another on changing jobs

without significant penalty.

PRSI Pay Related Social Insurance.

Retirement Annuity Contract (RAC) A contract effected with an insurance company under Sections

235/235A of the Income Tax Act, 1967. Applicable to the self-employed and to persons in non-pensionable employment.

Sometimes called a personal pension.

Revaluation The practice of regularly increasing a deferred benefit in line with

inflation or some other index before it becomes payable.

Risk benefits Benefits payable on death or disability.

Second Pillar Pension provision made via occupational pension schemes, personal

pension plans or additional voluntary contributions.

Self-administered fund A pension scheme which manages its own portfolio of assets.

SERPS State earnings-related pension scheme.

Social Assistance Payments made by the Department of Social, Community and

Family Affairs to those in need but who have not qualified for

benefits as a result of their PRSI contributions.

Social Insurance Benefits paid by the Department of Social, Community and Family

Affairs to those entitled to them by virtue of a sufficient history

of PRSI contributions.

Social Welfare old age pension or

Social Welfare pension

A pension provided by the Department of Social, Community and Family Affairs Social Insurance or Social Assistance programmes.

Social Insurance Fund The statutory fund into which PRSI contributions are paid and from

which social insurance benefits are paid on a pay-as-you-go basis.

Temporary annuity An annuity (see above) payable for a fixed period or until death

if earlier.

Third Pillar Provision for retirement arising from non-pension private saving

or asset accumulation.

Transfer value The amount of money payable to another occupational scheme

generally on changing jobs in lieu of benefits earned in the

member's former employment.

Umbrella scheme A pension scheme in which a number of entities, employers, and

employees participate in order to provide benefits, as distinct from

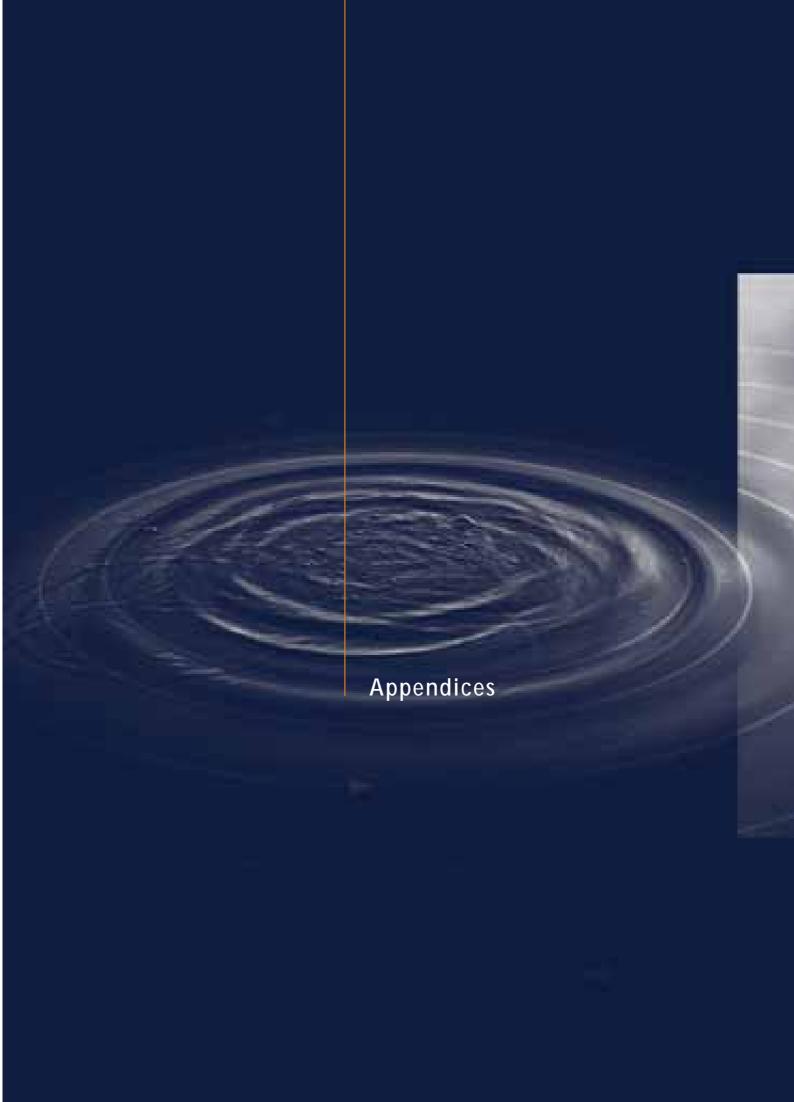
a scheme based on a single employer.

Unfunded An arrangement or benefit where no advance financial provision

has been made. (See pay-as-you-go).

Vesting period A period during which there is no entitlement to benefit from an

employer's pension contributions in the event of leaving service.



Appendix A

Summary of Submissions

Overview

The 143 responses made to the Consultation Document covered a very wide range of issues - some were strategic and others technical or practical. There was also considerable variation in the nature of the responses - the majority addressed only some of the issues raised and usually did so from the perspective of the respondent's direct experience.

Having said this, most submissions are based on deep, if somewhat narrow, experience of dealing with the needs of individuals and employers in respect of pensions provision and of the means currently available to address them. However, a small number of respondents, generally the larger organisations or firms with substantial resources to draw on, were able to prepare submissions which covered in depth all questions raised in the Consultation Document.

The nature of responses was constructive but there were few radical or unexpected suggestions. There was considerable concern for the common good and few were based on overtly commercial or sector interests.

The submissions brought some new information to the debate, while a number of information gaps also were identified.

The 79 organisations and experts who responded fell into a number of clear categories:

- Employers 6 submissions;
- Trade unions and staff associations 6 submissions;
- Government Departments 4 submissions;
- Pensioner and Social Interest Groups 15 submissions;
- Pension Funds and Trustees 9 submissions:
- Financial Institutions 11 submissions:
- Pension Consultants and Intermediaries and other Pension Specialists 16 submissions;
- Other Experts and Organisations 12 submissions.

There is reasonable consensus among the submissions from each of these main categories of respondent. There is a good deal of common ground also among those with a pensions industry background (where there is a lot said about delivery and technicalities) while the non-industry respondents put somewhat more emphasis on overall objectives for the Initiative and major directions.

The 64 submissions from individuals were usually very short and tended to focus on particular shortcomings or barriers to coverage based on personal experience, although there were a number which had quite extensive suggestions for reform.

Summary of Responses to Key Questions

Key Issue 1 What should be the overall objective for a national pensions policy? You should express this as explicitly as you can.

Many responses concentrated on detailed aspects rather than the objectives for the whole Initiative. The objectives outlined in the Final Report of the National Pensions Board were frequently quoted as being desirable. However, there were views that there was no longer any justification for the caveats expressed by the National Pensions Board at the time about why mandatory cover should not be recommended.

The need for an adequate First Pillar was mentioned frequently as a means to achieve targets recommended by the Commission or Social Welfare, and to meet the goals of the National Anti-Poverty Strategy and those contained in Partnership 2000. This covered both the level of benefits and the approach to indexation - a high number supporting a formal link either to earnings or to prices with additional regular reviews.

Increased Second Pillar coverage was a clear goal for almost everyone, with particular attention focused on lower-paid, atypical workers, young persons and those employed by small companies.

Limited attention was paid to death benefits for dependants. There was a lot of reference to permanent health insurance and long-term care, with equal numbers feeling they should be inside or outside the scope of the current Initiative. However, by and large, there seemed to be a view that long-term care is really an additional need for income in retirement rather than something that a pension system should cater for formally. Permanent health insurance is seen as more mainstream.

Some softer objectives were proposed, such as increasing the sense of personal responsibility for pension provision, or in encouraging or stopping further explicit redistribution via pensions provision.

Some groups stated that the effect on the lower-paid should be the key criterion for assessing new measures. Otherwise, little was said about criteria other than by Government which emphasised the need to minimise the burden on the general taxpayer and the need to ensure that long-term sustainable employment is not jeopardised.

Key Issue 9 What is your overall view of the existing arrangements for retirement provision across society as a whole?

A general concern was expressed regarding the levels of First Pillar benefit and to a lesser extent, its inclusiveness. The approach to indexation is regarded as unsatisfactory both for the beneficiaries and as a basis on which to build Second Pillar coverage.

The current Second Pillar system is credited widely with providing many people with valuable entitlements which should not be jeopardised, although there is concern about whether people really understand the value of defined contribution benefits. The reasons it has not been perceived to be more successful are either economic - the employer simply cannot or will not provide a scheme - or arise from what is seen as excessive complexity and administrative cost (including high commissions), no clear feeling of ownership or value for money by members and an unfriendly customer image. Tax relief is seen as a vital ingredient in encouraging long-term deferment of consumption.

The detail of Revenue regulations regarding contributions and benefits, which were founded at a time when people had jobs for life, are regarded as unsuitable to current conditions and they pose distinct practical problems. Apart from the issue of tax free lump sum retirement benefits (which a few would question), most practitioners see that regulations based on contribution limits are more meaningful and would be sufficient to protect against abuse. There is also a common view that career-based limits might be useful and more relevant to people's actual earnings and cash flow patterns.

Annuity risk is seen by both individuals and others as a particularly difficult issue, with the rise in defined contribution schemes and the drop which has occurred in interest rates as contributing factors. Several suggestions were made to allow benefits to be drawn down in stages, within certain limits, before an annuity is finally required to be purchased. There were some suggestions that people should be free not to buy an annuity at all and that any unused fund at death should pass to their estate.

There are two views on Third Pillar provision - one refers to the overall totality of such assets, while the other concentrates on its skewed distribution and its irrelevance to most people. There is a widespread view that a home should be excluded from any assessment of adequacy of financial needs in retirement.

Key Issue 10 What should be regarded as desirable and realistic levels of Second Pillar coverage in the different sectors of the population (such as lower-paid employees, other employees, the self-employed, those not at work, etc.)? You should comment on both the extent of coverage and its adequacy.

There were broadly three groups of responses in respect of the employed sector:

- those who proposed a mandatory approach;
- those who proposed that there is not a major coverage problem (apart from some obvious areas)
 and set no targets; and
- a few, mainly pension companies, who proposed that the voluntary approach should be developed further and expressed the view that coverage levels of 75-80 per cent of economically active people would be a reasonable and achievable target for the next five years.

There was not widespread concern expressed about the breadth of coverage in the self-employed sector. The view was expressed that levels of coverage in this sector could be improved by freeing up some of the regulatory constraints to allow more freedom over contribution patterns and to reflect changes in employment status.

As far as adequacy goes, this was seen generally as satisfactory where cover exists (with a few exceptions). It is clear that the effect of integration is not well understood (or the difference between actual pay and what is pensionable) and it is, therefore, likely that Second Pillar benefits will be smaller than is anticipated by many. Suggestions were made that the integration formula could be adjusted for the lower paid (but apparently there is not awareness that this can be negotiated at present). There was also widespread recognition of the effect of leaving a scheme and there was support for earlier vesting, for (sometimes rapid) implementation of preservation of pre-1991 service and for revaluation of deferred benefits.

Replacement rates of 60 per cent or so were quoted as satisfactory, although a few took the National Pensions Board Report literally and expect 100 per cent. Little was said about target replacement rates for the lower-paid - the concentration here was on the First Pillar floor.

Recognising the problems of underwriting permanent health insurance in some cases, there was a suggestion that a certain level of cover should be provided for everyone through a Social Welfare scheme on the basis of a community rate.

Key Issue 11 What new incentives or initiatives might encourage increased coverage? Who should be targeted?

Certain groups were identified widely as having low coverage. Apart from the low paid and atypical workers, the young and those in small companies, there were a number of references to the voluntary sector (and the lack of funding available for pension provision), the long-term unemployed and homemakers and carers. The latter might be in a position to save something for retirement but are excluded from access. The concept of breaking the formal link between earnings and pension provision was mentioned both explicitly and implicitly.

There was a broad view that permanent part-timers could easily be included by right (and will probably have to be as a result of EU legislation).

Specific incentives were rarely mentioned other than in the context of encouraging younger people, the lower-paid or smaller employers to start pension provision where a limited initiative to start making provision could be worthwhile.

The majority of initiatives suggested were indirect, such as:

- widespread education and awareness programmes;
- more meaningful information such as certificates of reasonable expectation;
- wider distribution, especially to encourage more low-cost products;
- the development of umbrella schemes;
- simplification of the tax regulations;
- use of plain language;
- schemes where the employer provides access but does not necessarily contribute.

Key Issue 24 Should pension provision be structured on the basis of each individual having their own personal entitlements or on the basis of a pension scheme member with dependants? What might be done about existing entitlements?

There is a trend towards greater individualisation, which was widely noted and expressed, particularly by social interest groups, but problems were foreseen with dealing with existing dependency benefits, additional costs, and doubts about acceptability. Overall there was little demand for change as part of this Initiative.

Key Issue 25 In view of changing work patterns, do we need new pension vehicles based on the individual's career rather than on each particular job held?
If so, what type of vehicle would you favour?

There was virtually unanimous recognition of the potential benefits that should flow from simplifying Revenue regulations, by basing them on career rather than each employment, and by allowing schemes cover different types of employee and, above all, introducing PRSAs and enhancing the sense of ownership and value.

The growing number of people working abroad for a period could be reflected by allowing transfer values to be paid to and from overseas arrangements or by direct contributions to an Irish scheme.

Retirement is widely viewed as a changing concept and much more flexibility is considered to be needed in catering for both formal early retirement and as to when benefits can be taken on a cost-neutral basis. (This applies to both First and Second Pillar)

Key Issue 29 In what broad directions do you consider future policy should move in order to minimise any problem of long-term sustainability in overall pension provision across the First and Second Pillars?

There was broad consensus that there are no sustainability problems - at least for a considerable time and not to a greater extent than many of Ireland's trading partners. However, a partnership approach should help ensure that any such problems are addressed jointly. Care would be needed to ensure that any new initiatives did not create such risks.

Key Issue 31 Should there be a mandatory element in Second Pillar provision? What should its objectives be?

Employer and pension industry respondents were opposed to a mandatory element but there was support from trade union and social interest groups who proposed this as the most effective (or even only) way to reach the lower end of the labour market - contribution levels of 4 per cent and 2 per cent of pay from employer and employee respectively were indicated as being appropriate.

However, the concept of mandatory cover was interpreted to cover a range of possibilities - it extended from a proposed requirement for an employer to provide an occupational scheme of certain quality, or to subscribe to an umbrella scheme or to provide access for employees to pension products without necessarily being required to contribute himself. The issue of self-employed and some atypical workers was not developed by respondents but there is recognition of the grey border between what can and cannot be. A mandatory system that can be avoided easily or that would lead to a lowest common denominator approach was seen as of little overall benefit by anyone.

There were some suggestions that certain aspects should be compulsory such as providing spouses' pensions, having an additional voluntary contribution facility or ensuring index-linked and/or joint life pensions are quoted at retirement.

Key Issue 32 What involvement should the State have in regard to pensions? How should it be organised?

Apart from its ongoing role in setting policy, regulation and providing appropriate incentives, there were a number of roles suggested for the State, although almost all were facilitative rather than as a direct provider (where the VHI model was referred to). Examples included:

- education and awareness;
- use of National Agreements to promote coverage;
- use of PRSI system for transmission of contributions;
- the setting up of a Pensions Ombudsman;
- the introduction of a clearing house for small benefits or a register of entitlements;
- a role for the National Treasury Management Agency in managing various "national" schemes (e.g. for additional voluntary contributions);
- the bearing of annuity risk;
- the kick-starting of some steps.

Key Issue 33 To which broad initiatives would you give highest priority? Which should be discarded? Why?

There was virtually no support for SERPS (other than from a very few individuals), but all other ways forward received varying degrees of support. However, it should be said that different respondents did not necessarily view, say, industry-wide schemes or PRSAs in the same way, although by and large there was a great deal of common ground in the understanding of these concepts.

As mentioned above, there was a lot of support for improvement in both the First and Second Pillars although, the broad relationship between them seems to be felt satisfactory.

Among Second Pillar steps proposed (and not already mentioned) were the abolition of front-end commissions, transparent charging structures and standardised illustrations which would show the effect of differences in expected return and costs of different investment choices. Free-standing additional voluntary contributions were proposed but these could be simply part of PRSAs. Limited access to funds from (or secured by) pension funds was felt by a number of those operating at the smaller end of the market to overcome the fear many self-employed have of locked-up assets for very long periods.

Industry-wide or umbrella schemes struck a chord particularly among employers and trade unions where they can be structured in a way which would genuinely expand cover. Past experience of such schemes provides some comfort in this regard but practitioners have limited confidence. Setting these up in partnership was frequently mentioned and may be more acceptable rather than having a number of competing schemes. It seems likely that limited choice together with simplification and other changes to the Second Pillar would be a prerequisite for their success.

PRSAs are widely seen as offering great potential if they can be delivered as simple and low-cost products. New providers and wider distribution would be expected to emerge as a result of their introduction. PRSAs did not warrant much mention among those who favoured a mandatory approach.

Key Issue 34 For each of the broad initiatives in which you see merit:

- what would represent a successful initiative?
- what are the main practical issues?
- how could it be improved?

Little was said about what would represent success, or in detail about how outline concepts could be improved but individual organisations are clearly thinking about these issues. Some practical issues were identified, such as:

- the legal basis for PRSAs and their effect on existing financial products (including savings);
- reviewing the effectiveness of current Board supervision (especially for small schemes);
- simplifying Revenue regulations;
- the role of trustees in defined contribution schemes;
- the administrative burden on small employers;
- how to provide index-linked investments and annuities;
- regulation of new providers;
- reasonable charges and illustration bases;
- the benefits and problems of standardising transfer values.

Key Issue 35 What other major initiatives should be considered?

Equity release was identified as a way to provide many people with greater retirement income but currently there are no attractive means of achieving this and there were no concrete proposals made for its development.

There were some suggestions that there should be an additional voluntary contribution facility contained in the First Pillar.

Key Issue 36 What do you see as being a realistic sequence and time-scale for the initiatives you would like to see carried out?

Little was said on this subject by most respondents, although a number did suggest that changes should be pushed through fairly quickly (within a year or two). It was felt that there are a number of discrete areas of change which are likely to emerge and that the implementation process should be managed accordingly.

Key Issue 37 Are there any other major issues you feel are essential to the development of a national pension system or have a bearing on the whole National Pensions Policy Initiative?

Again, little was proposed although a number of respondents, particularly the social interest groups, said that First Pillar pensions need to be seen in the wider context of all Social Welfare benefits.

Submissions were received from the following individuals:

Gerald Baigel Hazel Elliott Dr. Giles Baily Paul Feighery Godfrey Barthistle Harold Flewett David P. Bedden James Hannon David Bourke Liam G. Hayes **Gerard Brady** D.W. Joyce Denis F. Bugler Jim Keegan William Campbell Charles G. Kehoe Frank Carolan Gerardine Kennedy Thomas Carr Mary Lee Kenneth Casey Sarah Lloyd Andrew Clarke David McCulloch

Laurence and Veronica Clerkin

E. Coyle Richard Coyne John A. Cullinane

T.P. Daly
Michael Dargan
Edward Delany
John B. Dillon

Anne Dunphy Bridie Dunphy Sarah Lloyd
David McCulloch
Michael McDermott
W.J. McDonogh
Sean McGrath
Thomas McKenna
Rev. James McKeon
M. McMahon
John McNulty
Brona Maguire

Patrick Meade

Charles Mollan

Thomas Murphy Denis W. Murray Marie Nolan Vincent Nordell

Seamus O'Cleirigh et al Dr. Edmond O'Flaherty James O'Mahony John O'Quigley Sean O'Sullivan Michael Power Charles A. Quaid John Rafferty William J. Rawl Patrick J. Ruddock Joseph Sheehan Cllr. Sheila Terry Martin Treacy Michael Turner Gerald Wall Richard Woulfe

Responses and communications were received from the following organisations and professionals:

ABB Industrial Systems Limited

Age and Opportunity
Anglo Irish Bankcorp

Association of Pension Lawyers in Ireland

ATGWU

Bank of Ireland Group
Bar Council (John Dowling)

Bill Keating, CSO

Canada Life (Jim Kelly) (Roy Brown)

Combat Poverty Agency

Conference of Religious of Ireland

Construction Federation Executives Pension Scheme Construction Federation Operatives Pension Scheme Consultative Committee of Accountancy Bodies - Ireland

Council for Social Welfare

Co. Wexford Retired Nurses Association

Coyle Hamilton Damian Smyth Danny O'Leary David Millar

Department of Enterprise and Employment Department of Equality and Law Reform

Department of Finance
Department of Social Welfare
Disability Federation of Ireland

Eagle Star

Eastern Health Board

Equitable Life Assurance Society
Executive Benefits Limited

Fyffes Ireland Pension Trust Limited

Gearoid O'Ceallaigh

General Medical Services Superannuation Plan Institute of Personnel and Development Insurance Corporation of Ireland Pension Scheme Members

Irish Association of Investment Managers

Irish Association of Older People Irish Association of Pension Funds

Irish Aviation Executive Staff Association

Irish Brokers Association

Irish Business and Employers Confederation

Irish Congress of Trade Unions

Irish Co-operative Organisation Society Limited

Irish Farmers Association Irish Forestry Unit Trust

Irish Institute of Pensions Managers
Irish Institute of Training and Development

Irish Insurance Federation

Irish Life

Irish Mortgage and Savings Association

Irish National Organisation of the Unemployed

Irish Pensions Trust

Irish Property Owners Association Irish Senior Citizens Parliament

James R. Kehoe

Jefferson Smurfit Group plc

John Maher KPMG

Law Society of Ireland Retirement Trust Scheme

Mercer Limited

MSF

National Council on Ageing and Older People

National Economic and Social Forum National Women's Council of Ireland

Nestlé Ireland

New Ireland Assurance

Newcourt Pensioneer Trustees NUJ - Retired Journalists Pensions Settlement Bureau

Professional Insurance Brokers Association

Prof Noel Mulcahy

Retired Staff Association, Southern Health Board

Retirement Planning Council

Sean E. Quinn

SIPTU

Small Firms Association

Society of Actuaries in Ireland

Standard Life

TEEU

Watson Wyatt Winstons

Appendix B

Earnings Distribution of Employees

In order to estimate the impact of increased pensions coverage, it is necessary to make assumptions about earnings distribution of employees. Statistical data have been obtained from Department of Social, Community and Family Affairs records for the 1995/6 tax year, based on returns made by employers to the Revenue Commissioners. The number of records in different categories is shown in *Table B1*. It can be seen that the sample is likely to give an accurate estimate for private sector employees where the numbers are high and there is relatively good age data.

Table B1 Summary Data from Department of Social, Community and Family Affairs based on 1995/96 PRSI Returns

RSI Class escription	A Private Sector	B,C,D,H Public Service	All Other Classes	No Class	All
Number in Sector by age:					
Numbers aged 21-30	250,508	17,401	28,067	53,169	494,616
Numbers aged 31-65	401,516	76,241	92,926	172,353	851,651
Other/unknown age	26,645	81,675	137,454	27,556	362,575
Numbers - all ages	678,669	175,317	258,447	253,078	1,708,842

Table B2 Earnings Distribution PRSI Class A, Age 31-65

Analysis of the data shows quite different income distribution patterns for those working in different sectors of the economy, especially as between the public/private sector and for different age bands. As far as the latter goes, the income for those aged below 30 is noticeably lower than for those over age 30, but the average does not change very much as age rises from 30 to 65.

The other feature of the data is the large number of people with nil or very low levels of earnings. Some of these either have not worked at all or only for a limited time during the year. Many of these are young.

As a result, the most relevant distribution for the purposes of assessing the impact of increased coverage is taken to be that of contributors in Class A, the main private sector category, aged 31 to 65 and who earned at least £5000 in 1995/6. The average earnings in each decile for these is shown in *Table B2*.

Decile	Average
1	£6,081
2	£8,021
3	£10,281
4	£11,250
5	£13,361
6	£14,933
7	£17,295
8	£20,952
9	£24,700
10	£39,495
Overall (ages 31-65)	£16,637
Overall (all ages)	£14,476

Appendix C Alternative Estimates of Minimum Adequate Income, Single Person, 1994, 1995 and 1996

	1994	1995	1996
CSW Methods	£ per week	£ per week	£ per week
average industrial earnings	89.92	94.10	95.75*
national accounts average earnings	85.00	87.16*	88.70*
medical card limits	73.68	77.65	80.70
tax exemption limits	69.23	71.15	75.00
minimum wage ^x	77.33/88.38	79.27/90.59	83.41/95.33
(average net household income for 2 adult/			
2 child household: 60 per cent/65 per cent	84.08/91.09	86.22/93.40*	87.75/95.00*
Other Methods			
stated minimum income, single person households			
depending on social welfare: elderly/non-elderly	79.17/87.17	81.18/89.38*	82.60/90.95*
stated minimum income, 2 adult/2 child households			
depending on Social Welfare	72.02	73.85*	75.11*
average net household income, all households:			
50 per cent [†]	64.50/68.50	66.14/70.21*	67.50/71.50*
60 per cent [†]	77.40/82.20	79.36/84.25*	80.75/85.75*

x Joint Labour Committee (JLC) for adult agricultural workers. Source: A Review of the Commission on Social Welfare's Minimum Adequate Rate, p.69, ESRI (1996).

Appendix D

Net Replacement Rates at Retirement

Table D1 Replacement Rate - 1998 Tax and Social Welfare Benefit Levels - Married Couple, One Earning

	Income before retirement £	Income after retirerment £
Salary	15,132	0
Social Welfare Pension	0	7,275
Occupational Pension	0	4,329
Less Pension Contributions	-433	0
Gross Taxable Income	14,699	11,604
Less Tax Free Allowances		
Personal	6,300	6,300
Age	0	800
PÄYE	800	800
Taxable Salary	7,599	3,704
Deductions from Gross Income		
Tax at 24%	1,824	642*
Tax at 46%	0	0
Total Tax	1,824	642
PRSI Contributions	437	0
Levies	331	0
Total Deductions	2,582	642
Net Income	12,117	10,962
Value of Free Schemes	0	300
Disposable Income	12,117	11,262
Replacement Rate		93
* tax at marginal rate for those just above exemption limit.		

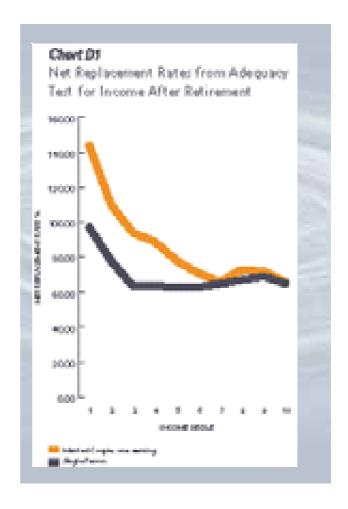
It is quite straightforward to show the effect on disposable net income before and after retirement as a result of the effects of changing tax and PRSI, free schemes etc.

Factors which have a significant bearing on the net effect are marital status and, if married, whether there are two incomes or not. This has a direct impact on the tax/PRSI position but is also a differentiating factor in terms of what the likely level of income is in the first place, which is also clearly a key factor.

Table D1 gives an example for a person retiring at age 65, who is married, with one income to the household and who previously earned average industrial earnings (£291 per week). It is assumed that the person had 30 years service as a member of an integrated defined benefit pension scheme with a 1/60th accrual rate, towards which the member contributed 5 per cent of pensionable earnings to the pension scheme. Any other income or benefits before or after retirement are ignored.

If the previous level of earnings had been 125 per cent or 200 per cent of average industrial earnings, the replacement rates would be 85 per cent or 75 per cent instead of 93 per cent.

Chart D1 shows the result of carrying out calculations for the net replacement rates provided by income after retirement of the minimum adequacy test set out in Section 5.1.7. i.e. 50 per cent of pre-retirement earnings, subject to a minimum of 34 per cent of average industrial earnings together with any associated Adult Dependant's Allowance.



Appendix E **Projected Growth in Labour Force and Coverage Numbers**

		1995 (ESRI)	5 yrs	10 yrs	1995 (ESRI)	5 yrs	10 yrs	1995 (ESRI)	5 yrs	10 yrs	Ultima
Men at work											
Self-employed	Up to 29	21	25	23	5	7	7	24	28	32	32
	30-65	205	224	240	60	85	106	29	38	45	45
Employees	Up to 29	184	224	210	54	78	74	29	35	35	35
	30-65	343	429	481	249	322	361	73	75	75	75
All men		753	902	954	368	492	548	49	54	58	59
Women at work	<										
Self-employed	Up to 29	6	6	6	0	1	2	1	16	32	32
	30-65	35	45	55	7	15	22	20	33	40	45
Employees	Up to 29	173	225	215	50	79	75	29	35	35	35
	30-65	217	347	410	118	226	287	54	65	70	75
All women		430	623	686	175	322	386	41	51	56	61
Total at Work		1,184	1,525	1,640	543	813	934	46	53	57	60
Self-employed		265	300	324	72	108	139	27	38	43	44
Employees		917	1,225	1,316	470	704	797	51	58	61	64
Private sector		640	949	1,040	240	455	548	38	48	53	58
Public sector		276	276	276	230	249	249	83	90	90	90

Appendix F

Estimated Revenue Implications of Increased Coverage

Table F1 shows the estimated Revenue impact of higher coverage rates for employees. It is based on coverage percentages for each income decile as given by the ESRI analysis undertaken for the Irish Association of Pension Funds (as shown in Appendix J) but the income figures used here are those obtained from actual Department of Social Welfare data for Class A contributors aged 31-65 and earning over £5000 in 95/96, as in Appendix B.

If the coverage targets for the first five years of the Initiative were achieved, this would imply an extra 52,710 employees of the 1995 workforce would have been covered. The Initiative will not be equally successful at attracting cover for people of different income levels. At the lowest levels, there is less demand on account of the good replacement rates provided by the Social Welfare pensions and, crucially, less money available. At the highest levels, there is likely to be high awareness already of the possibility of pension saving and there may be other factors influencing the few who do not have coverage which the Initiative will not be able to address.

Accordingly, the degree of success in attracting those without cover into the net will increase from very low levels for the least well paid to quite high penetration for the better than average earners, but tailing off a little for the very top earners. For those who do take up coverage, the contribution level as a percentage of salary is expected to rise as income rises.

It is assumed that new contributions are paid 50 per cent by employees and 50 per cent by employers. If paid entirely by employees, the personal income tax relief and all PRSI relief would double and the corporation tax relief would disappear. The average total relief would increase from £324 to £452 per head.

For example, the 2,597 people in the lowest income decile who take up cover represent 2.9 per cent of the 97 per cent of the decile who have no cover today. The example assumes that the total contribution rate for them is 4 per cent of their pay, split 2 per cent from the employer and 2 per cent from the employee.

Table F1 Estimated Revenue Implications of Increased Coverage

Income Decile	Number of employees	Coverage percent	Take up of new cover*	Total with new cover	Average income	Contrib. rate as % salary	Average contrib.	Total new contrib.	Perso relie (per h		Employe (per h	
									Income	PRSI	Corporat	ion
									Tax		Tax	PRSI
1	91,680	3	2.9	2,597	6,081	4.0	243	632	29	5	24	10
2	91,680	7	5.8	4,979	8,021	4.0	321	1,598	39	7	32	14
3	91,680	20	8.8	6,425	10,281	4.5	463	2,972	56	10	46	20
4	91,680	41	11.7	6,318	11,250	5.0	563	3,554	68	15	56	24
5	91,680	52	14.6	6,425	13,361	5.5	735	4,721	88	25	73	39
6	91,680	58	20.4	7,870	14,933	6.0	896	7,052	108	30	90	54
7	91,680	72	29.2	7,495	17,295	7.0	1,211	9,074	176	41	121	73
8	91,680	78	29.2	5,889	20,952	8.0	1,676	9,871	285	57	168	101
9	91,680	89	23.4	2,356	24,700	8.0	1,976	4,655	385	44	198	114
10	91,680	89	23.4	2,356	39,495	8.0	3,160	7,443	727	36	316	0
Total	916,800			52,710				51,572				
Average		50.9	11.7		16,637	6.0	978		153	27	98	46

Appendix G

Illustrative Operation of Proposed Fund

The operation of the funding mechanism to smooth the costs of the First Pillar is illustrated in *Table G1* below. The illustration is based on a pension level of 34 per cent of average industrial earnings in 2003 together with ceilings for PRSI contributions of 7 times the single person's pension benefit for employer contributions and 6 times for employee and self-employed contributions but keeping PRSI rates at their current level. The Exchequer outflow is limited to 3.8 per cent of GNP which allows a fund to be built up reaching 26 per cent of GNP in 2026, before declining as the benefit bill continues to grow.

In this illustration, the fund is sufficient to allow smoothing of overall pension costs to the economy up to 2046. In practice, the funding level would need to be reviewed regularly and may be adjusted upwards over the later years in order to continue the benefits of funding over a longer period. Such reviews would consider factors not allowed for here such as changes to PRSI rates and other developments likely to be considered over the coming decades such as increasing the retirement age. The projections are very sensitive to the early levels of GNP, the amounts contributed to the fund in early years, the level of PRSI contributions, and to the level of GNP growth.

Table G1 Illustration of Proposed Funding Mechanism

		Norma	Welfare Cost to	Operatio Exchequer Payment		Operation	on of Fund Fund at Year End			
	GNP	Pensions	quer of and admin. s of Conts.	Actual cash flow to (from) fund		Exchequer tflow	Size of fund	As % of GNP	As multiple of pension benefits	
	£m	£m	% GNP	£m	£m	% GNP	£m	% GNP		
1996	37,000	599	1.6	0	599	1.6	0	0.0	0.0	
2001	51,283	1,033	2.0	250	1,283	2.5	808	1.6	0.3	
2006	65,451	1,421	2.2	500	1,921	2.9	3,255	5.0	1.1	
2011	75,876	1,877	2.5	1,000	2,877	3.8	8,517	11.2	2.3	
2016	87,961	2,603	3.0	740	3,343	3.8	15,660	17.8	3.3	
2021	97,116	3,447	3.5	243	3,690	3.8	22,527	23.2	3.9	
2026	107,224	4,551	4.2	(476)	4,075	3.8	27,745	25.9	3.9	
2031	118,384	5,718	4.8	(1,219)	4,499	3.8	30,250	25.6	3.5	
2036	130,705	7,163	5.5	(2,196)	4,967	3.8	28,468	21.8	2.8	
2041	144,309	8,843	6.1	(3,359)	5,484	3.8	20,048	13.9	1.6	
2046	159,329	10,856	6.8	(4,801)	6,055	3.8	1,794	1.1	0.1	
Note	1	2		3	4		5		6	

Notes

- 1. GNP is taken as £44.3 billion in 1998, growing at 5 per cent per annum until 2006, by 3 per cent per annum from 2007 to 2016 and by 2 per cent per annum thereafter.
- 2. This is the excess of benefits and expenses over contribution income, ie the amount of the Government subvention each year to pay pensions.
- 3. This is the actual cash flow into (or from) the fund based on the proposed level of payments (i.e. £250 million per annum from 1999 to 2003, £500 million per annum from 2004 to 2008 and 50 per cent of contribution income each subsequent year) limited by the overall cap on total Exchequer outflow.
- 4. This is the total Exchequer outflow incorporating the cap of 3.8 per cent of GNP.
- 5. This is the accumulated fund, built up by annual flows in or out and investment income of 5 per cent in real terms (i.e. in excess of CPI).
- 6. This expresses the accumulated fund as a multiple of the yearly pension bill (including administration costs).

Appendix H

Comparative Statistical Profile of Pensions: Ireland vis-à-vis Selected Other Countries

Table H1 shows specimen replacement rates of after-tax income in a number of countries in 1997. It is clear that Ireland has a very low First Pillar replacement rate, but the inclusion of typical (defined benefit) Second Pillar benefits brings Ireland closer to the top. The implication is that occupational pensions in Ireland are of good quality, for those who have them.

Table H1 Specimen Replacement Rates - Net Pension as Percentage of Net Earnings

	for Salary Level of		for Salary Level of		
	100% NAE	200% NAE	100% NAE	200% NAE	400% NAE
Austria	82	54	82	70	59
Belgium	77	49	86	70	64
Denmark	69	43	84	87	73
Finland	64	63	73	71	70
France	77	72	77	72	72
Germany	72	51	94	77	64
Greece	103	96	103	96	52
Ireland	47	27	84	82	80
Italy	95	99	95	99	93
Japan	59	39	70	55	47
Luxembourg	91	83	91	83	79
Netherlands	59	36	82	86	80
Portugal	80	83	80	83	93
Spain	89	64	89	69	58
Sweden	82	71	81	71	73
United Kingdom	61	36	77	76	80
United States	65	36	88	70	60
Average Net Replacement Rate	75%	59%	84%	77%	70%
Ireland Rank	17/17	17/17	8/17	7/17	3/17

While the costs of mandatory social security provision (including pension and other benefits) vary considerably between countries, the total costs are more even when typical voluntary Second Pillar pension costs are included. *Table H2* shows typical cost levels borne by employers, based on a male employee with national average earnings.

Table H2 Typical Employer Costs of Mandatory and Voluntary Benefits as Percentage of Salary

Projections of First Pillar and Public Sector Pensions expenditure in several countries underline the much lower level of Social Welfare commitments in Ireland and how the demographic pressure occurs a good deal later.

	Mandatory Provision	Mandatory and Voluntary Provision
Country	%	%
France	47	49
Germany	22	28
Ireland	12	24
Netherlands	13	21
United Kingdom	8	20
United States	9	23

Table H3 First Pillar and Public Sector Pension Expenditure (Percentage GDP in 1994 Prices)

	1995	2000	2010	2020	2030	2040	2050	2060
Pensions Indexed to Prices								
Australia	2.6	2.3	2.3	2.9	3.8	4.3	4.5	4.6
France	10.6	9.8	9.7	11.6	13.5	14.3	14.4	14.2
Ireland	3.6	2.9	2.6	2.7	2.8	2.9	3.0	2.6
Spain	10.0	9.8	10.0	11.3	14.1	16.8	19.1	17.6
United Kingdom	4.5	4.5	5.2	5.1	5.5	5.0	4.1	3.6
United States	4.1	4.2	4.5	5.2	6.6	7.1	7.0	7.2
Pensions Indexed to Wages								
Ireland*	3.6	2.9	3.0	3.7	4.2	5.2	6.2	6.2
United Kingdom*	4.5	4.5	5.9	6.2	7.8	8.5	8.3	8.4
Germany	11.1	11.5	11.8	12.3	16.5	18.4	17.5	16.5
Denmark	6.8	6.4	7.6	9.3	10.9	11.6	11.5	11.6

^{*} Hypothetical cost if First Pillar benefits were to be indexed to wages from now on. Source: OECD Economics Department Working Paper No 168, pp17,18.

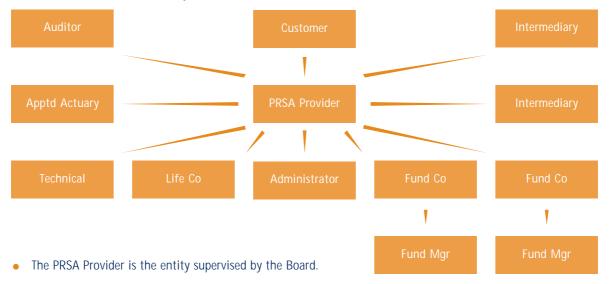
Table H4 shows three groups of countries with distinct bands of Second Pillar coverage in the private sector: those where it is mandatory or a standard part of collective bargaining, where there is 80 - 100 per cent coverage, less than 20 per cent coverage where First Pillar benefits are very high and 30 - 50 per cent coverage in countries with a purely voluntary system, as in Ireland.

Table H4 Second Pillar Coverage Levels of Private Sector Employees

Country	Coverage in Private Sector %	Characteristics
Switzerland	100	Mandatory
France	90	Collective bargaining and for executives
Netherlands	85	Company and industry-wide funds through collective bargaining
Denmark	80	Company and other funds through collective bargaining
United Kingdom	48	Voluntary
Germany	46	Voluntary
Ireland	40	Voluntary
Belgium	31	Voluntary
Luxembourg	30	Voluntary
Portugal	15	Voluntary, mainly for executives
Spain	15	Voluntary, mainly for executives
Italy	5	Voluntary, mainly for executives
Greece	5	Voluntary, mainly for executives

Appendix I

General Schema for Supervision of PRSAs



- The Promoter of the PRSA operation is the entity whose brand is on the PRSA. It may be a PRSA provider
 which they control or it may be underwritten by an independent PRSA provider with whom it has
 made arrangements.
- The customer's PRSA is a contract with the provider and contributions are paid to the PRSA Provider's account.
- The PRSA Provider employs an Administrator who arranges the collection of contributions and transfers them to the Fund Manager's account.
- The Administrator arranges for deductions from the customers account to be transferred to the Life Company to pay for risk benefits. The Life Co is supervised by the DETE.
- The Administrator also prepares all communications for the customer and anything necessary for the Intermediaries or other parties (e.g. employers).
- The PRSA Provider employs Technical Advisors to design products, marketing campaigns, specify administrative requirements etc.
- The PRSA Provider can either establish its own Fund Company or use funds run by an independent Fund Company or Life Company. These would report to the Central Bank or DETE in the usual way to demonstrate solvency etc.
- The Fund Company contracts with a Fund Manager to manage the assets.
- The PRSA Provider appoints Intermediaries with which it is prepared to do business. Some of these may be
 independent (e.g. brokers), others may be part of the PRSA Provider's organisation (salesmen or branches)
 or controlled by them (tied agents). Intermediaries are currently regulated by IBA or the IICB but there
 are proposals for the Central Bank to take over these functions.
- The PRSA Provider contracts with an Appointed Actuary and an Auditor to perform statutory functions
 concerned with control of the operation. It will prepare formal returns to the Board in respect of the PRSA
 provider as will the PRSA Provider (signed by directors). Auditors and Actuaries are subject to their own
 profession's formal supervision.

Appendix J

Additional Coverage Data

Some additional analyses have been produced by the ESRI of the coverage data in their Report on Occupational and Personal Pension Coverage 1995. Coverage by sex and age for the main categories of private sector workers are given in *Table J1*.

Table J1 Coverage Rates for Various Segments of Private Sector Workers

Age Range	All private sector employees	All permanent full-time private sector employees	Self-employed	
	Men Women %	Men Women %	Men Women % %	
Below 30	24 21	31 29	24 1	
30-39	59 43	64 64	30 38	
40-54	66 38	71 60	39 16	
55-65	66 35	77 44	19 6	
All ages	44 31	53 44	29 17	

Coverage by income decile for households (including public and private sector employees and the self-employed) as found by the Living In Ireland Survey is presented in *Table J2*.

Table J2 Coverage by Income Decile

Income Decile	Coverage percentage
1 2 3 4 5 6 7	3 7 20 41 52 58 72 78
9 10	89 89

Appendix K

Comparison of Terms of Different Types of Individual Pension Provision

General Availability and Operation of Different Types

Feature	PRSA	Retirement Annuity	Individual occupational scheme (Defined Contribution)
Who can take out	Anyone.	Self-employed or those in non-pensionable employment.	Employees provided that employer sets up and (currently) agrees to contribute.
Who can contribute	Person and employer or person only. Can also accept transfer values.	Person only.	Employees and employer but currently employer must pay at least 1/6 of cost. Can accept transfer values in.
When contributions can be made	Any time regardless of employment status.	Only when in receipt of "relevant earnings".	Only as long as still in employment. Scheme rules usually permit AVCs.
Permitted providers	Authorised by the Board.	Life assurers.	As trustees decide - usually life assurers for individual arrangements.
Switching between providers	Allowed.	No.	If trustees so decide.
Access to funds	No direct access to funds but PRSA can be used as collateral for up to lesser of 25 per cent of fund and £25,000.	No direct access.	No direct access.
Risk benefits	Life cover can be provided and cost met out of accumulated fund. PHI arranged separately as at present.	Life cover provided under same regime. PHI arranged separately.	Life cover provided under same regime. PHI arranged by employer or personally.
When benefits can be taken	Between 55 and 70 whether or not still working.	Between 60 and 70 whether or not still working	At retirement from job (after age 50) or reaching Normal Pension Date.
Phased retirement	Yes.	Can be achieved by having several separate plans.	No.
Form of retirement benefits	25 per cent of fund as tax free cash. Rest to buy annuity with deferral option.	25% of fund as tax free cash. Rest to buy annuity.	Part of fund as tax free cash (often more than 25 per cent). Rest to buy annuity.

Applicable Regulation and Control

^F eature	PRSA	Retirement Annuity	(Defined Contribution)
_egal form	PRSA, contract law.	Life policy, contract law.	Trust, trust law.
Prudential regulation	Pensions Board with Appointed Actuary of PRSA provider. Other specific financial aspects (e.g. investment, life cover) covered by other relevant regulators.	DETE with Appointed Actuary of life assurer. None on pension aspects.	Pensions Act requirements, onus falls on trustees.
Regulation of Intermediaries	Provider to ensure compliant with appropriate regulator (IBA, IICB)*.	Separate regulators (IBA, IICB)*.	None.
Consumer protection	Normal range of consumer legislation. Appointed Actuary has responsibility to ensure kitemarking works in practice.	Normal range of consumer legislation.	Pensions Act places responsibility on trustees - member has recourse to trustees. Trustee often the employer.

Aspects of PRSAs covered by kitemarking

Feature	PRSA	Retirement Annuity	Individual occupational scheme (Defined Contribution)
Terms and Conditions	Standard minimum set of conditions to allow general flexibility - companies can use own approved wording. Plain language requirement.	Each set of contract terms approved individually by Revenue to be in accordance with legal requirements.	Each individual arrangement approved separately by Revenue to be in accordance with legal requirements.
Investment	Standard set of investment funds but other choices available to customers if required.	No standard benchmarks.	Trustee responsibility, but some individual choice usually allowed.
Information on benefi	ts Specified information to be given in a variety of situations on a standard basis - benefits expressed in real terms.	Information at point of sale must follow IIF guidelines (expressed in nominal terms). Regulations being introduced.	Specified information available on request under Pensions Act. Does not include estimate of emerging pension.
Charges	Limited form of charging structures allowed. Full disclosures required.	No explicit controls.	No explicit controls.

Brief Outline of Revenue Limits

Feature	PRSA	Retirement Annuity	Individual occupational scheme (Defined Contribution)
Basis of Revenue limits	Based on contributions.	Based on contributions.	Based on benefits related to "final remuneration" and service with employer.
Maximum contributions	No explicit limit but there is a limit to what can be claimed for tax relief in any year- the greater of £1,200 or a percentage of "net relevant earnings". The percentage is 15 per cent for those up to 30 increasing by 0.5 per cent for each year of age to 30 per cent at age 60 or over. Unused relief may be carried forward indefinitely (or back for one year).	No explicit limit but there is a limit to what can be claimed for tax relief in any year-15 per cent of "net relevant earnings" (20 per cent for those aged over 55). Unused relief may be carried forward indefinitely (or back for one year).	Determined by reference to contributions deemed necessary to comply with overall benefit limits. Limit to personal contributions of 15 per cent of earnings.
Maximum retirement benefits	No explicit maximum. 25 per cent may be taken as tax free lump sum.	No explicit maximum. 25 per cent may be taken as tax free lump sum.	Maximum benefits (pension and lump sum) depend on "final remuneration" and length of service with that employer. Overall maximum inclusive of benefits from retirement annuities and previous employments.
Maximum life cover benefits	Cost of life cover is included in overall contribution limits. Specific limits for cover to be decided based on options identified by Board.	Cost of cover must not exceed 5 per cent of "net relevant earnings" each year and is included in overall contribution limits.	Maximum levels of lump sum benefit (4 times remuneration) and dependant's pension. Limits separate to those for retirement benefits.
Other aspects	Investment funds exempt from tax. Personal contributions paid by deduction at source from pay gain immediate tax relief and give relief from PRSI contributions and levies.	As PRSA.	As PRSA.

Appendix L

Terms and Conditions for PRSAs

The terms and conditions specifically covered under PRSAs which carry a kitemark would include the following areas:

- What the PRSA is and how it works in broad terms;
- Contributions what types of contribution can be made (personal, employer, additional voluntary contributions, transfer etc);
- Obligation on employer to remit deductions promptly;
- When benefits can be taken and the forms allowed (lump sum and annuity);
- Taking benefits forms of annuity allowed, deferment option, transfer to another annuity provider;
- Investment of contributions fund choices and their general purpose, switching between funds, unit pricing;
- Transferring to another PRSA provider;
- Using the PRSA to provide life cover;
- Charges which are explicitly stated;
- Use of the PRSA as collateral;
- Circumstances in which information must be provided;
- Customer protection which applies to the PRSA and how to raise an issue; and
- What carrying a kitemark means.

Appendix M Levels of Social Welfare Benefits

Maximum Weekly Rates from June 1998	Weekly Personal Rate	Adult Dependant	Each Child	
Social Insurance Payments				
Retirement/Old Age Contributory Pension				
under age 80	£83.00	£56.90*	£15.20	
aged 80 and over	£88.00	£56.90*	£15.20	
Widow's/Widower's Contributory Pension				
under age 66	£74.10	-	£17.00	
aged 66 and under 80	£76.10	-	£17.00	
aged 80 or over	£81.10	-	£17.00	
Invalidity Pension				
under age 65	£72.20	£46.50	£15.20	
aged 65 and under 80	£83.00	£46.50	£15.20	
aged 80 or over	00.88£	£46.50	£15.20	
Disability Benefit	£70.50	£41.20	£13.20	
Social Assistance Payments				
Old Age (Non-Contributory) Pension				
under age 80	£72.50	£41.20	£13.20	
aged 80 or over	£77.50	£41.20	£13.20	
Widow's/Widower's (Non-Contributory) Pension				
under age 66	£70.50	-	-	
aged 66 and under 80	£72.50	-	-	
aged 80 or over	£77.50	-	-	
* Adult dependant aged 66 or over (under 66 rate - £52.50).				

Appendix N¹

The Poverty Line

The view that poverty has to be seen in terms of the standard of living of the society in question has led policy analysts to frame poverty lines explicitly, and purely, in terms of relative income. This involves setting the poverty line at a particular percentage of average income, for example, 50 per cent. This poverty line can be seen as an adequacy standard. The general rationale is that those people falling below this average income level in the society are unlikely to be able to participate fully in the life of the community.

Clearly, considerable care has to be exercised in applying this methodology; however, it does have the appeal of simplicity and transparency; it yields results which can serve as a starting point for the analysis of poverty, the relative position of low income groups and the composition of these groups. The method does not produce a unique poverty line because the choice of cut-off is arbitrary. Most analyses have used 50 per cent of average income but there is no firm basis for the selection of any particular ratio to serve as "the" poverty line. The use of a range of relative lines (for example 40 per cent, 50 per cent, 60 per cent) has the advantage that it shows the sensitivity of the results to the precise location of the line.

This relative poverty line approach has been adopted in a number of studies by the OECD and the EU Commission. In Ireland, similar work has been undertaken by the Economic and Social Research Institute (ESRI).

The most recent ESRI research is based on their 1994 Living in Ireland Survey which is the Irish element of a European Community Household Panel. The survey covers a representative sample of 4,048 households comprising some 14,000 individuals. Average weekly household disposable income is estimated from the sample (£280 per week in 1994). This is then converted to average weekly disposable income per adult equivalent (£129 per week in 1994) with a scale that allows 1 for the household head, 0.66 for each other adult and 0.33 for each child. A purely relative income poverty line or adequacy standard for a single person in 1994 terms would therefore be £77.40, £64.50 and £51.60 at the 60 per cent, 50 per cent and 40 per cent standard respectively.

¹ Based on Poverty in the 1990s, Chapter 2, ESRI, 1996

Appendix O

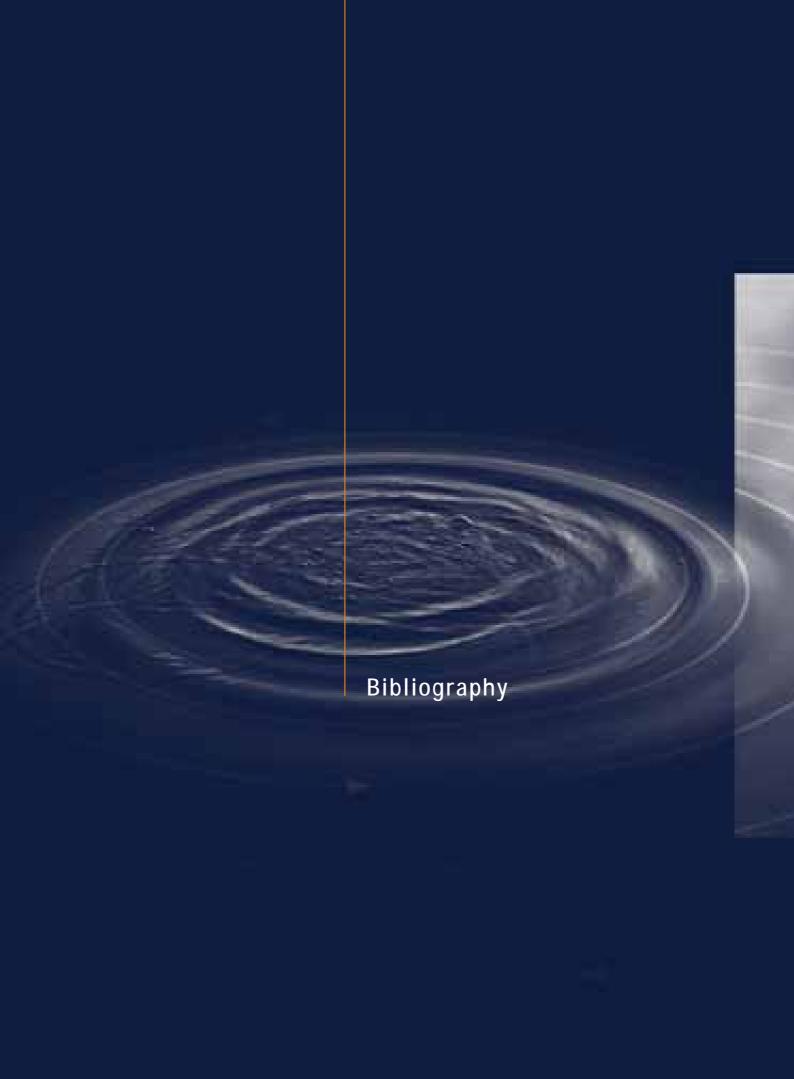
Percentage of Households Receiving/Relying* on Social Welfare Schemes
Below Relative Income Poverty Lines, 1994 (and 1987)

		% of households receiving payment who are below income poverty line				% of households relying on payment who are below income poverty line			
overty Line	50%		60%		50	50%		60%	
	1994	(1987)	1994	(1987)	1994	(1987)	1994	(1987)	
Jnemployment Benefit	20.2	(25.4)	35.8	(45.6)	48.5	(53.8)	84.4	(79.1)	
Inemployment Assistance	41.6	(46.8)	61.7	(61.0)	69.5	(83.4)	90.7	(92.4)	
Disability Benefit	21.4	(24.7)	61.7	(61.0)	57.2	(53.7)	80.2	(80.3)	
nvalidity Pension	32.6	(10.4)	51.3	(51.3)	66.1	(13.4)	91.0	(81.0)	
Old Age (Con) Pension	2.5	(0.9)	33.5	(11.8)	1.6	(1.3)	45.4	(15.1)	
Old Age (Non Con) Pension	18.6	(11.2)	56.2	(28.2)	30.4	(18.6)	85.2	(46.4)	
Vidow's (Con) Pension	9.4	(3.1)	47.9	(20.0)	16.5	(4.6)	75.0	(31.0)	
Deserted Wife's Ben/All.	41.3	(30.1)	64.2	(63.0)	59.1	(39.3)	75.7	(82.3)	
one Parent's Allowance	48.0	(20.6)	64.3	(58.2)	74.5	(18.0)	85.2	(100.0)	

²⁴⁷

Appendix P
Increases in Social Welfare Pensions, Prices and Earnings

Year Weekly Pension			Percentag	je Increas	e 	Real Incr	Real Increase in Pensions relative to			
			Weekly	Pension			Prid	ces	Earn	ings
	Contrib.	Non Contrib.	Contrib.	Non Contrib.	CPI	Average Earnings	Contrib.	Non Contrib.	Contrib.	Non Contrib
	£p.w.	£p.w.	%	%	%	%	%	%	%	%
ar by	Year									
77	13.90	11.75								
78	16.05	13.60	15.47	15.74	7.58	14.48	7.33	7.59	0.86	1.10
79	18.60	15.80	15.89	16.18	13.31	18.14	2.28	2.53	-1.91	-1.66
80	24.50	21.00	31.72	32.91	18.13	12.32	11.50	12.51	17.27	18.33
81	30.65	26.25	25.10	25.00	20.47	20.32	3.85	3.76	3.97	3.89
82	40.25	34.45	31.32	31.24	17.11	11.21	12.13	12.06	18.08	18.01
83	45.10	38.60	12.05	12.05	10.47	12.27	1.43	1.43	-0.19	-0.20
84	48.25	41.30	6.98	6.99	8.63	10.33	-1.52	-1.51	-3.03	-3.03
85	51.40	44.00	6.53	6.54	5.44	7.64	1.03	1.04	-1.04	-1.03
86	53.45	45.75	3.99	3.98	3.77	9.70	0.21	0.20	-5.21	-5.22
87	55.10	47.10	3.09	2.95	3.16	4.56	-0.07	-0.20	-1.41	-1.54
88	56.80	48.50	3.09	2.97	3.67	6.71	-0.57	-0.68	-3.40	-3.51
89	58.50	50.00	2.99	3.09	2.51	4.90	0.47	0.57	-1.82	-1.72
90	61.50	53.00	5.13	6.00	3.31	4.60	1.76	2.60	0.51	1.34
91	64.00	55.00	4.07	3.77	3.21	4.47	0.83	0.55	-0.39	-0.66
92	66.60	57.20	4.06	4.00	3.11	4.13	0.93	0.87	-0.07	-0.13
93	68.90	59.20	3.45	3.50	1.44	6.64	1.98	2.03	-2.99	-2.95
94	71.00	61.00	3.05	3.04	2.32	2.37	0.71	0.70	0.66	0.65
95	72.80	62.50	2.54	2.46	2.52	3.26	0.01	-0.06	-0.70	-0.78
96	75.00	64.50	3.02	3.20	1.72	2.55	1.28	1.45	0.46	0.63
97	78.00	67.50	4.00	4.65	1.45	4.03	2.51	3.15	-0.03	0.60
Year P	eriods									
77-82			190	193	103	103	43	44	42	44
82-87			37	37	35	53	1	1	-10	-11
87-92			21	21	17	27	3	4	-5	-5
92-97			17	18	10	20	7	7	-3	-2
Year	Periods									
77-87			296	301	175	211	44	46	28	29
87-97			42	43	28	53	10	12	-8	-6
) Year	Period									
77-97			461	474	253	376	59	63	18	21



Bibliography

Bradley J.B, and Fitzgerald J.

The ESRI Medium-Term Economic Model of the Irish Economy.

Central Statistics Office (1995)

Population and Labour Force Projections 1996-2026.

Central Statistics Office (1997)

Labour Force Survey.

Combat Poverty Agency (1995)

Collecting and Using Survey Information on Household Assets. Some Lessons from Irish Experience.

Commission of the European Communities (1992)

Council Recommendation on Common Criteria Concerning Sufficient Resources and

Social Assistance in Social Protection Systems, 92/441/EEC.

Commission on Social Welfare (1986)

Report of the Commission on Social Welfare.

CSO Household Budget Survey

Department of Social, Community and Family Affairs (1997) Actuarial Review of Social Welfare Pensions.

EFRP

European Pension Funds (1996).

ESRI (1993)

General Research Series Paper No. 162.

ESRI (1994)

Living in Ireland Survey.

ESRI (1996)

A Review of The Commission on Social Welfare's Minimum Adequate Income.

ESRI (1996)

Poverty in the 1990s.

ESRI (1997)

Occupational and Employment Forecasts 2003; FÁS/ESRI Manpower Forecasting Studies No. 6.

ESRI

Medium-Term Review No. 6.

ESRI

Occupational and Personal Pension Coverage 1995.

European Commission (1996)

The Demographic Situation in the European Union.

European Union (1997)

Council Directive 97/81/EC of 15 December 1997.

European Union

EU Third Life Directive (Council Directive 92/96/EEC of 10 November, 1992).

Franco. D. Munzi. T (1996)

Public Pension Expenditure Prospects in the European Union in European Economy No. 3, 1996.

Government of Ireland (1994)

European Communities (Life Assurance) Framework Regulations, 1994. S.I. No. 360 of 1994.

Government of Ireland (1995)

EU (Unfair Terms in Consumer Contracts) Regulations, 1995. S.I. No. 27 of 1995.

Government of Ireland (1997)

Sharing in Progress.

Government of Ireland

An Action Programme for the Millennium.

Honohan, Patrick

The Financial Assets of Households in Ireland.

IAPF

Irish Pensions - At the Cross Roads, A Submission by The Irish Association of Pension Funds to the Pensions Board on the National Pensions Policy Initiative.

National Pensions Board (1993)

Final Report - Developing the National Pension System.

Nolan, Brian (1997)

Collecting and Using Survey Information on Household Assets: Some Lessons from Irish Experience: Conference Paper, University of Essex, June 1997.

Nolan, Brian (1991)

The Wealth of Irish Households, Combat Poverty Agency, Dublin 1991.

Pensions Board and Department of Social Welfare (1997)

National Pensions Policy Initiative Consultation Document.

Pensions Board

Annual Reports.

Roseveare, Leibfritz, Fore and Wunzel

Ageing Populations, Pensions Systems and Government Budgets: How Do They Affect Saving? OECD (1995): Economics Department Working Papers No. 156 (1995)

Roseveare, Leibfritz, Fore and Wunzel

Ageing Populations, Pensions Systems and Government Budgets: Simulations for 20 OECD Countries. OECD (1996): Economics Department Working Papers No. 168 (1996)

Sedgwick Noble Lowndes (1997/8)

Guide to Employee Benefits and Labour Law in Europe 1997/8.

U.S. General Accounting Office

Pension Plans - Loan Provisions Enhance Participation But May Affect Income Security for Some.

World Bank (1994)

Averting the Old Age Crisis; Policies to Protect the Old and Promote Growth. (A World Bank Policy Research Report).