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Pension Provision in Ireland

A paper for the Citizens' Assembly

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Introduction

The purpose of this paper is to provide the Assembly with an overview of pension provision in Ireland. The paper will provide an outline of the State pension system and the private pension system.

Retirement income is a very important issue. According to the CSO life expectancy at the age of 65 was 10.8 years for males in 1900. This rose to 12.6 in 1980. This figure rose to 13.4 by 1990 and has since risen to 17.7 years in 2010. For women life expectancy at the age of 65 was 10.6 years in 1900. By 1980 this figure had risen to 15.7 years and to 20.6 years in 2010.

These figures illustrate the importance of retirement income. On average, a man can expect to live 17.7 years beyond retirement and a woman can expect to live 20.6 years. We are living longer and need to fund our retirement years.

The pension system

The Irish pension system comprises of three pillars. The first pillar is the State pension, the second pillar is made up of private sector occupational pension schemes or public sector occupational pension schemes. The third pillar includes personal pensions, Personal Retirement Savings Accounts (PRSAs) and Additional Voluntary Contribution (AVC) arrangements.

State Pension (pillar 1)

There are two types of State Pension:

The State Pension (Contributory)

The State Pension (Contributory) is paid to people from the age of 66 (age 67 from 2021 and 68 from 2028) who have satisfied certain PRSI conditions. It is not means-tested, meaning you can have other income, for example, from an Occupational Pension and still get a State Pension (Contributory). It is taxable but you are unlikely to pay tax if it is your only source of income. You can continue to work full-time after age 66 and collect your State pension (Contributory). There are a number of pro-rata pensions available to people who paid different types of social insurance contributions or who did not pay contributions because of various reasons. The full Single Person's State Pension (Contributory) currently is €238.30 per week or approximately €12,390 per year. Recipients may get an increase in their

payment for an adult dependant (called a qualified adult allowance). The maximum rate for a qualified adult is €213.50. Recipients are paid an extra allowance of €10 per week when they reach 80 years of age. This increase is not paid to qualified adults. Reduced weekly rates are payable to those who have not fully met the required number of contributions and rates payable depend on a yearly average.

State Pension (Non-Contributory)

State Pension (Non-Contributory) is paid to people from the age of 66 (age 67 from 2021 and 68 from 2028) do not qualify for a State Pension (Contributory) or only qualify for a reduced pension based on their social insurance record. A recipient must meet a habitual residence condition and pass a means test. To satisfy the means test your income as assessed in accordance with certain rules, must be below certain levels.

The maximum rate/full Single Person's State Pension (Non-Contributory) currently is €227 per week (or €11,805 per year approximately) for those aged between 66 and under 80 and *€237 per week* (or €12,325 per year approximately) for those aged 80 and over. Again there are potential increases for qualified adults (under 66), and also for a qualified child amounting to €150 and €29.80 respectively.

Private Pension

State support for retirement saving

Ireland's taxation treatment of supplementary savings (pillar 2 & 3) involves an 'EET' system whereby (subject to various limitations) contributions are tax exempt, pension fund growth is tax exempt from income or capital gains tax and pension fund benefits are taxed at an individual's marginal tax rate when the benefits are drawn down. The tax system also allows for a tax free lump sum to be drawn down at retirement.

Occupational Pension Schemes (company pension plans) (Pillar 2)

Occupational Pensions are arrangements set up by an employer to provide retirement and/or death benefit for one or more employees including former employees. There is no legal obligation on an employer to offer access to an occupational pension scheme. The law requires that at a minimum an employer would offer access to a PRSA and facilitate payment of contributions through payroll, but there is no obligation on the employer to contribute to a PRSA.

There are two main types of occupational pension schemes:

Defined benefit (DB), are occupational pension schemes that provide a set level of pension at retirement, the amount of which normally depends on the individual's service and earnings at retirement or in the years immediately preceding retirement. For instance, a DB scheme might provide a pension of 1/60th of final pensionable salary for each year of pensionable service. If an employee retires after 40 years' service, that employee would receive a pension of 40/60ths (or 2/3rds) of their final pensionable salary.

It is usual in a DB scheme for the member's contribution rate to be fixed (for example as a set percentage of salary) and for the employer rate to increase or reduce as needed, to fund

the benefits promised, though in some DB schemes both employer and employee contribution rates change from time to time. However, it is important to know that DB scheme benefits are not guaranteed. If the scheme's assets are not sufficient to pay the benefits, and the employer is not in a position to meet the shortfall, promised benefits may have to be reduced.

Public Sector pensions are operated on a DB basis and are known as ‘pay as you go’ pensions. The current contributions of public sector workers are used to pay the benefits of current public sector pensioners. The contributions from employees and employers are not invested in a fund. Since January 2013, a new Single Public Service Pension Scheme (the “Single Scheme”) for new public servants (e.g. civil and public servants, the President, members of Parliament, Judiciary, Defence Forces, police, etc.) is in place for new entrants to the public service.

Defined contribution (DC), are occupational pension schemes where your own contributions and your employer’s contributions are both invested and the proceeds used to buy a pension and/or other benefits at retirement. The value of the ultimate benefits payable from the DC scheme depends on the amount of contributions paid, the investment return achieved less any fees and charges, and the cost of buying the benefits.

A DC scheme has a set contribution for the employee and a set contribution for the employer. For example, in some DC schemes, the employer and the employee each contribute 5% of the member's earnings, or 10% in total.

The retirement benefits for each member depend on how much money has been built up by the member's retirement date and so it is not possible to know in advance what pension benefits a member will receive. On retirement the DC scheme member usually opts to take a portion of the fund as a tax-free lump sum and the balance to purchase an annuity or subject to meeting minimum requirements, they can continue to invest the funds and drawdown as they see fit.

Pillar 3

Additional Voluntary Contributions (AVCs) are additional contributions paid by employees who are members of their employer’s occupational pension scheme (DB or DC) to provide additional retirement benefits at their own expense. If the pension scheme rules do not permit an employee to make AVCs, the employer must provide access to a PRSA. Employees will often make AVCs as their earnings increase and the percentage of tax relief available on pension contributions increases with age.

Personal Retirement Savings Accounts (PRSAs) are generally low-cost, easy-access, private pension savings accounts with a life insurance company or investment firm. They are designed to give people a flexible way to save for retirement, to be owned by individuals (regardless of employment status) and to be transferable from job to job. If employers do not operate an occupational pension scheme or if certain restrictions apply to their scheme, by law they must ensure that their employees have access to at least one Standard PRSA.

PRSAs attract tax relief on the contributions paid in and the investment returns earned on the assets. If an employer contributes to an employee’s PRSA, these contributions are

considered a benefit in kind; however, the employee can avail of tax relief to offset this. A tax free lump sum is also available at retirement.

There are two types of PRSAs – standard and non-standard. A standard PRSA has a maximum annual charge of 5% on contributions and 1% on assets. Investment is only permitted in “pooled funds”. In a pooled fund, the various investors’ money is “pooled” to buy an asset portfolio, which normally contains a variety of asset classes such as company shares, government bonds and property. A non-standard PRSA does not have any maximum limit on charges and it allows investment in a wider range of funds.

A **Retirement Annuity Contract (RAC)** is the formal name for what is more commonly called a personal pension. A RAC is a particular type of insurance contract approved by Revenue to allow tax relief on contributions made by an individual. RAC provide a tax-free lump sum, within certain limits, and a pension or other benefits at retirement. The value of the ultimate benefits payable from the contract depends on the amount of contributions paid, the investment return achieved less any fees and charges, and the cost of buying the benefits. They are used mainly by the self-employed to save for retirement.

Pension trends

Ireland has seen a steady decline of DB schemes (in common with the international experience). Employers are increasingly opting for DC schemes given the increasing costs of DB schemes and increasing life expectancy as well as changes to international accounting rules which obliged companies to show any scheme deficits on their balance sheet.

The table below shows the fall in numbers of private sector DB schemes since 2012 and the increase in DC schemes over the same time.

Occupational scheme membership data 2012 - 2016

	Defined Contribution		Defined Benefit (private sector)		Defined Benefit (public sector)	
	No of Schemes	Active Members	No of Schemes	Active Members	No of Schemes	Active Members
2012	60,192	232,939	993	197,177	105	335,551
2013	61,123	241,317	890	167,211	107	338,037
2014	61,309	263,261	778	139,877	108	328,435
2015	67,125	281,629	715	125,955	99	339,889
2016	67,703	299,782	677	111,535	101	360,073

The level of private pension coverage in Ireland

The National Pensions Policy Initiative (1998) set a pensions coverage target of 70% of workers aged 30-65. However, pension coverage remains relatively low, especially for certain socio-economic groups. The latest available data (CSO QNHS Q4 2015) indicate that

at the end of the fourth quarter of 2015, only 46.7% of workers were enrolled in an occupational or personal pension plan. This represents a fall as compared with 2008 Q1 (54%) and 2005 Q4 (56%). It is important to bear in mind that the QNHS data includes both public and private sector workers.

Figures show that 42% of workers said they expected an occupational or personal pension would be their main source of income when they retired. But the proportion of workers who expected the state pension to be their main source of income rose from 26% in 2009 to 36% in Q4 2015.

Pensioner support ratio

Population projections indicate that, over time, the proportion of older people will increase significantly while the working age population will fall. This could lead to an increase in the pensioner support ratio, currently about five people of working age to one of pensioner age, to two to one by 2050.

The gap between retirement age of 65 and age of receipt of State Pension at age 66.

There is no single retirement age in Ireland, although 65 is generally regarded as the age most people retire at. This age was tied to the receipt of the State pension.

Occupational pension schemes provide benefits at the scheme's normal retirement age, which is generally a fixed age between 60 and 70. The most typical normal retirement age is 65.

The age of eligibility for the State pension increased from 65 to 66 with effect from January 2014 and created a one year gap for those with a normal retirement age of 65 (under the scheme rules) to the age for qualifying for a state pension which is 66. The qualifying age for the State pension is due to rise to age 67 from 2021 and age 68 from 2028. Those who must retire at 65 are entitled to apply for a Jobseekers payment in the interim and are not required to engage with activation processes.

International approaches to low pension coverage

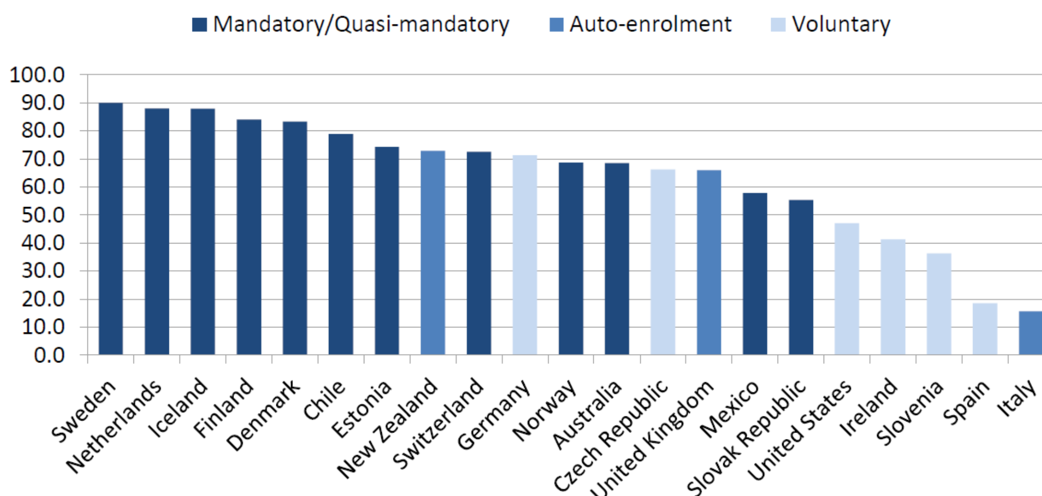
The most effective way of increasing pension coverage is to make enrolment into private pensions mandatory. Coverage tends to be at or above 70% of the working age population where these policies have been implemented. One of the concerns with introducing mandatory pensions is that it may force those on low incomes to become more indebted or divert funds from necessary expenses such as childcare, education or housing.

An alternative approach is auto-enrolment which has gained popularity in the last decade. Auto-enrolment overcomes inertia (one of the biggest factors in people not joining a pension scheme) by automatically enrolling the worker and allowing them to opt-out usually within a certain time limit. Auto-enrolment allows for individual choice, but changes the choice from actively choosing to join to actively choosing to leave. The UK, New Zealand and most recently Turkey have introduced auto-enrolled supplementary pension provision.

The introduction of auto-enrolment has seen an increase of pension coverage in those countries that have introduced the policy. There is a concern with regard to the adequacy of the contributions made. The contributions tend to be low, perhaps 1 or 2% from employers and employees with State support so as to not incentivise the enrolled workers to opt-out. Figure 1 below illustrates coverage levels across select OECD member states.

Figure 1. Coverage of private pension systems

As a percentage of the woking-age population



Note: Coverage rates are provided with respect to the total working-age population (i.e. individual aged 15 to 64 years old) for all countries except Germany, Ireland, Sweden and the United Kingdom for which coverage rates are provided with respect to total employment.
Source: OECD (2015a) and The Pensions Regulator (2016) for the United Kingdom.

Possible future developments in Ireland

The Government has indicated that it is considering introducing a system of auto-enrolment for Ireland in light of the low level of pension coverage.

Alongside the potential introduction of auto-enrolment the Pensions Authority has made proposals around the future of pension provision in Ireland.

The key features of the Authority's proposals are to have a pension system which:

- Reduces costs
- Simplifies the pension environment
- Imposes higher standards on those overseeing pension schemes

These proposals have been submitted to the Minister for Social Protection and if implemented would prepare the pension system for the introduction of auto-enrolment.