Society of Actuaries in Ireland

Have your say on sustainable State Pensions into the future

Response to Pensions Commission

March 2021

Preface

The Society of Actuaries in Ireland ("Society") is the professional body representing the actuarial profession in Ireland.

The Society has a long history (see Appendix) of making submissions and producing papers on the future of the State Pension and welcomes the focus in this consultation on the sustainability of the current arrangements

We note that some of the questions posed in the consultation document are addressed to individuals in the four groups of interest identified, or organisations which represent them, and we have not answered these questions. In responding to the other questions, we have addressed technical actuarial issues but have framed our responses having regard to broader societal or public interest issues.

We would be happy to respond to any questions on this response. Please contact Philip Shier, Head of Actuarial Practice, at philip.shier@actuaries.ie.

Background

The consultation document sets out the issues to be addressed in relation to the State Pension arrangements, in line with the terms of reference given to it.

• *Develop a range of options for the government to consider in order to address the sustainability of the State Pension and the Social Insurance Fund in terms of pension age, eligibility criteria, contribution rates, pension calculation methods and pension payment rates";*

• *Examine how private sector employment contracts specifying retirement ages below the State Pension Age may be impacting on the State's finances and pension system"; and*

• *Consider how people who have provided long-term care for incapacitated dependants can be accommodated within the State Pension system".*

The first bullet point above refers to a broad range of aspects of the State Pension Arrangements but the subsequent discussion focusses on issues related to the State Pension Age and providing for long-term carers. Our response discusses these issues but does not consider other aspects of the current structure; if there are proposals to make major changes in "eligibility criteria, contribution rates, pension calculation methods and pension payment rates" we presume that further and more detailed consultation would take place.

It is clear that action must be taken now to achieve the objective set out in the paper:

"We want to make sure that younger generations can benefit from an Irish State Pension system that is as generous and reliable as the one that they are contributing to fund today's pensioners."

We strongly support the emphasis on intergenerational equity, as this is fundamental to the sustainability of the system. Younger people are less engaged with pensions issues and it is likely that the number of submissions from those in their 20s and 30s will be fewer than those closer to retirement age. Given that the younger generation will also suffer some of the longer term economic and societal impacts of COVID-19, and the effects of climate change if this cannot be mitigated significantly, it is essential that their long-term interests are given appropriate weight in the discussions about the future of the State Pension system, rather than taking action to address short term pressures which may have adverse consequences in the longer term.

The Society's comments on the existing arrangements

- The State pension arrangements as currently structured should continue as the foundation of retirement income for Irish citizens. This should continue to be financed on a pay-as-you-go basis by a combination of PRSI contributions paid by current workers and employers and Government subvention where necessary.
- Although there might be merit in alternative approaches (e.g. advance funding, means-testing, universal pension), the introduction of any such major reform would take a long time to achieve and it would be more practical to look to adjust and enhance the current approach.
- Legislation should provide for the State Pension Contributory to be reviewed annually by reference to an appropriate earnings index, subject to affordability. In a year where there is negative earnings inflation, the pension should not be reduced, but subsequent increases, when there is positive earnings inflation, should be lower than the full inflationary increase to take into account the "overpayment" in the previous year. This approach of legislating for increases in line with earnings inflation would be more sustainable, and less open to political pressures than the current approach of increases being granted (or not) as part of the annual budgetary process.
- We recommend that when referring to the "cost" of an increase to the State Pension Contributory, the increase in the total liability for all future projected payments should be disclosed, rather than the current approach to quoting the "cost" in one year.
- Providing for increases in line with an earnings index, or with increases in the average earnings figure, would ensure that the pension was maintained at the target level of 34% of average earnings, and would enable pensioners to benefit from real growth in the economy. The alternative of linking to a prices index would maintain the purchasing power of the pension but would make no allowance for real growth.
- The State Pension should be enhanced by an automatic enrolment (AE) system which provides additional retirement benefits funded in advance by contributions paid by workers and employers. The Society was broadly supportive of the Strawman AE proposal published in 2018 and would encourage the Department to progress the development of this proposal so that it can commence as soon as is practical.

How to meet the sustainability challenges

- The consultation document shows that dependency ratio i.e. the ratio of the working age population (15-64) to those aged 65+ is expected to fall significantly by 2051. We would comment that this dependency ratio is a little misleading as (a) the majority of those in the age range 15-21 are likely to be students whose PRSI payments (on part-time or summer jobs) are likely to be relatively low and (b) the upper age limit should be increased to the expected State Pension Age. Nevertheless, even adjusting for these issues, the dependency ratio is going to fall significantly with consequences for-pay-as-you go financing of the State pension.

- The projected decrease in the dependency ratio, and the expected increase in longevity of retirees, means that the State Pension system will likely prove more difficult to sustain as time goes on, unless some changes are made. These changes could be one, or a combination of:
    - Increasing the level of PRSI contributions which finances the pension
    - Reducing benefits
    - Increasing the State pension age
    - Restricting eligibility for the State Pension

- The report[1] prepared by Milliman on behalf of the Society and PublicPolicy.ie in 2015 gives a detailed analysis of the possible approaches which could be adopted to making the State Pension sustainable.

- The Minister has stated that there will be no reduction in the level of the pension and whilst this commitment does not bind future Governments, it is recognised that any reduction in the level of the pension is socially and politically unacceptable.

  As the document points out, increasing the proportion of PRSI contributions which is used to finance the State pension in future years means that Government spending on other benefits would have to be reduced. The alternative of continually increasing PRSI contributions is also unattractive and inequitable to future generations

  The Society has consistently argued that the most equitable way to make the State Pension affordable and sustainable is to gradually increase the age at which the pension becomes payable, having regard to the increase in projected life expectancy, and providing sufficient notice of each future change to give individuals <u>and employers</u> the opportunity to plan appropriately.

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[1] https://web.actuaries.ie/sites/default/files/story/2015/12/milliman_-_sai_state_pension_report_2015-08-20_-_with_sai_preface_added.pdf

- This was the approach recommended in the Pensions Roadmap published in 2018, which the Society fully endorses

  (C) Linking Future Changes in the State Pension Age to Life Expectancy

  1.7. Ensure that there will be no further increase in the State pension age prior to 2035 other than those already provided for in 2021 and 2028.

  1.8. Ensure that any change to the State pension age after 2035 will be directly linked to increases in life expectancy. This will begin with an actuarial assessment of life expectancy in 2022 to include a review of the proportionality between time spent in working life and retirement. At that point, informed by the review and assessment, a notice period of 13 years will be given in respect of any planned changes to the State pension age before implementation occurs. ***2022 (DEASP)***

  1.9. Undertake an actuarial assessment of life expectancy every five years to inform State pension age decisions (i.e. the next assessment after 2022 will take place in 2027) with the same condition of at least 13 years notice regarding any proposed changes. ***(DEASP)***

- The Society recognises that the appropriate retirement age will differ between individuals, depending on a range of factors such as state of (physical and mental) health, type of employment, personal financial position, family issues and others. In addition, many employees may have contractual retirement ages which their employers wish to apply, even in circumstances where the individual wishes to continue to work.

- The Society supports the concept of fuller working lives to enable those who wish to continue to work beyond a specified retirement age to be able to do so. Accordingly, we believe that employers should no longer have the ability to impose a contractual retirement age (or at least one earlier than the State Pension Age).

- There will still be situations where individuals are unable or unwilling to continue to work up to State Pension Age. The Society's view is that these situations should be addressed by the payment of a supplementary benefit in the period from the date of ceasing work to State Pension Age. This would be a more efficient approach than reducing (or not increasing) State Pension Age to cater for these cases as it would avoid the payment of the State Pension to those who are willing and able to continue to work.

- The recently introduced "Benefit Payment for 65 year olds" is set at the level of the Jobseeker's Allowance, but there is no requirement for the individual to sign-on or be available for work. The level of this benefit is a policy issue, but clearly it should lie between the lower bound of the Jobseeker's Allowance and the upper bound of the State Pension Contributory.

Flexibility

- The Society recommends that where an individual continues to work but on a part-time or less well remunerated basis, he or she should, if their income is less than the supplementary benefit outlined above, be entitled to a partial benefit in addition to their wages; we would suggest that individuals could be incentivised to continue to work, even for relatively low wages, by reducing this benefit by, say €1 for each €2 that they receive by way of earnings. We would support the concept of phased retirement, whereby an individual can choose to continue to work at a certain level and draw (part of) their retirement income (both State and supplementary) to provide an appropriate level of income during that period.

- The Society also supports the provision of flexibility in relation the deferral of the State Pension where an individual wishes and is able to continue earn an income after that age. As proposed in the Roadmap, such an individual could be given the option to defer receipt of the State Pension and receive an actuarial enhancement ("late retirement uplift") to the pension when it commences. We would suggest that if they have not made sufficient PRSI contributions to be entitled to the full State Pension, they should be able to continue to make such contributions and earn additional benefits.

- It would seem logical for PRSI contributions to continue to be paid if the individual is working after State Pension Age, but consideration should be given to reducing the level of PRSI contributions payable if the individual has already accrued entitlement to the full State Pension.

- If there were no supplementary benefit (e.g. the "Benefit Payment for 65 year olds" referred to in the previous section) in the period from the date of ceasing work to State Pension Age, then the Society would support the flexibility to commence the State pension early (albeit reduced) as there will be those who are unwilling or unable to continue to work to State pension age. The Society notes the concern expressed in the document that applying an actuarial reduction to the State Pension in such cases could in some instances lead to poverty in later years. For example, the reduction to the pension which would be actuarially "cost neutral" if the pension were taken 5 years early is likely to be in the range 15% to 20%. Consideration would need to be given to the circumstances in which early retirement with a reduced pension should be permitted so as to minimise the possibility that hardship cases would emerge during the payment of the reduced level of pension, requiring the payment of additional social welfare benefits at that time.

- The eligibility for additional benefits such as the Household Benefits Package, medical cards etc would need to be addressed in circumstances where an individual could, to some extent, choose the date on which their State Pension commenced.

Eligibility

- The Society fully supports the provision of a State Pension on an equitable basis, having regard to diversity and inclusion. In particular, the rules for entitlement to a pension, and the level of it, should recognise that those who are unable to work in remunerated employment or self-employment due to health or caring responsibilities should have equal rights to those who are able to earn an income.

- We support the use of a Total Contributions Approach as being the most equitable basis to the determination of entitlement to, and the level of, State Pension Contributory benefits going forward. This would lead to lower benefits for those who pay contributions (and/or qualify for "carer credits") for a relatively short period but are entitled to a full State Pension Contributory under the current rules.

- That change will generate savings for the Social Insurance Fund due to the reduction in pension entitlements of those entering the workforce after the Total Contribution Approach is introduced. Those savings will be reduced to some degree by the need to pay additional means-tested social welfare benefits in some cases.

- The Society does not have sufficient insight into the situation of long-term carers to comment on the specific questions posed in the consultation document, but would presume that such cases can be appropriately addressed by application of the Total Contributions Approach, although special arrangements may be needed to deal with some existing cases.

- The Society believes that it will be important to put in place a system that reflects the accruing entitlements of those providing long-term care or unable to work due to ill-health etc, parallel to the recording of contributions being made by those in paid employment. This will give clarity to those individuals, promoting inclusion in the State pension system, and also support the broader macro-economic analysis of emerging State pension commitments.

Appendix: Society public statements on State Pension (since 2003)

1. Older Retirement Age Most Effective Way to reduce Cost of State Pensions – September 2003
https://web.actuaries.ie/sites/default/files/story/2003/09/_Older_Retirement_Age_Most_Effective_Way_to_Reduce_Cost_of_State_Pensions/030925-pr_older_retirement_age.pdf

2. Submission on National Pensions Review – August 2005
https://web.actuaries.ie/sites/default/files/story/Submission_to_the_National_Pensions_Review/050805_submission_by_sai_to_national_pensions_review.pdf

3. Submission to the Department of Social and Family Affairs on the Green Paper on Pensions – May 2008
https://web.actuaries.ie/sites/default/files/story/2008/05/Submission_to_the_Department_of_Social_and_Family_Affairs_on_the_Green_Paper_on_Pensions/080528_sai_reponse_to_green_paper_on_pensions.pdf

4. Letter to Irish Times in response to editorial on "Elderly take over" – Jan 2010
https://web.actuaries.ie/sites/default/files/story/2010/01/100115_letter_to_the_irish_times_in_response_to_the_editorial_on_the_elderly_take_over.pdf

5. Financial Sustainability of the State Pension in Ireland - August 2015 (Milliman) commissioned by the Society and PublicPolicy.ie.
https://web.actuaries.ie/sites/default/files/story/2015/12/milliman_-_sai_state_pension_report_2015-08-20_-_with_sai_preface_added.pdf

6. Initial Views on the Government's Roadmap for Pensions Reform 2018-2023
https://web.actuaries.ie/sites/default/files/story/2018/06/180628%20Initial%20Views%20on%20Pensions%20Roadmap.pdf

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