An tÚdarás Pinsean
The Pensions Authority

Submission to the Pensions Commission from the Pensions Authority

Introduction

The Pensions Authority welcomes the opportunity to make a submission to the Pensions Commission.

The Authority is a statutory body set up under the Pensions Act, 1990. Under the Act, the three functions of the Authority are:

- Regulation - fostering public confidence in pensions by regulating pension schemes and PRSAs effectively and efficiently
- Policy - providing expert advice to the Minister for Social Protection to help inform policy development
- Information - supporting pension scheme trustees and the public by providing guidance and information.

The role of the State pension in the wider pension system

At the outset, it is worth noting that the Authority does not have direct role in relation to the State pension. However, the State pension plays an important part of the overall pension system – for many people the most important part. The goal of the State pension is to protect recipients from the effects of poverty. Ideally the first pillar pension would be combined with individual retirement savings in the form of 'second pillar' occupational pensions and/or 'third pillar' personal pensions. In this way the combined use of public and private pension savings allows employees, employers and the State to each play a part in sustaining standards of living in retirement.

The importance of the State pension in providing retirement income can be seen in figures produced by the ESRI on behalf of the Pensions Council which found average total weekly pension income (including State pension and occupational/private pensions) (using TILDA data from 2010) was €280 for women and €433 for men[1]. The State Pension (Contributory) maximum payment which equates to around 34% of gross average industrial earnings is a significant contribution to retirement income.

While there are proposals to reform the second and third pillar, as set out in the 2018 Roadmap for Pensions Reform, the State pension will continue to play a fundamental role in Ireland's retirement savings system.

The Authority supports the Pensions Commission's focus on the future of the State pension given the importance of the State pension to the wider pension system.

As noted above, the Irish pension system operates as a multi-pillar system. Although the different elements or pillars of the system have different policy oversight and objectives, it will work best and provide optimal outcomes if these elements are aligned with each other and with the relevant provisions of employment law.

[1] GENDER, PENSIONS AND INCOME IN RETIREMENT, ESRI, A Nolan et al, 2019 pg ii.

Unless this alignment is achieved, the pension system as a whole will not achieve its objectives, may create perverse outcomes and inefficiencies, and the system will not operate in the interest of those it is intended to support. Furthermore, without this alignment there is a danger that different retirement dates for different elements of retirement income will add complexity.

Integration of occupational pensions

The Pension Authority has previously provided material to the Pensions Commission on the issue of integration. This submission will not rehearse all of that material.

An integrated pension scheme is an occupational scheme which takes account of the State pension in the design of the benefits provided to employees on retirement. The term is most commonly applied to defined benefit (DB) schemes.

The great majority of DB schemes in the private sector and, since 1995, in the public sector, are integrated with the State pension.

The design of integrated schemes was based on the assumption that the State pension became payable at the same time as the scheme pension. However, in most such schemes, the retirement age was defined as 65 rather than in relation to the State pension age, and this did not change in 2014 when the State Pension (Transition) was abolished, either in the calculation of the integrated post-retirement pension, or in the employer's retirement age.

A gap between leaving work and drawing down the State pension has a significant effect on members of pension schemes: their retirement income will be less than intended and expected between the time that they retire and begin to receive the State pension.

Furthermore, in the case of a defined contribution (DC) scheme retiree they may not be able to draw down their funds in an Approved Retirement Fund (ARF) until such time as they have the guaranteed income that is provided through the State pension.

State pension age impact on those without occupational or personal pension coverage

Increasing the State pension age will have a disproportionate impact on those without any occupational pension coverage and those with very low levels of occupational pension savings. This impact on people without occupational pension savings and who rely wholly on the State pension can be addressed by allowing workers to work until such time as they qualify for the State pension. This issue will be picked up below in the next section which discusses the ability of employers to terminate employment before the State pension age.

Ability of employer to terminate employment needs to be addressed

Traditionally in Ireland people have retired from work at the age of 65. At 65, an employee would retire and, provided they had the required level of social insurance contributions, could receive income from the State Pension (Transition) and any occupational pension they had. The State Pension (Transition) was abolished in 2014, with access to State Pensions – either contributory or non-contributory – remaining at 66 years of age. While there is a pause on future increases to the State pension age, it is likely that, in order to ensure the sustainability of the State pension, an increase to the State pension age will have to be one of a number of policy options considered.

From an occupational pension perspective, it is necessary for members of occupational schemes to have the option to work longer and to draw down their occupational pension entitlements at the same time as the State pension becomes payable. As already mentioned earlier, unless occupational pension scheme members have the option to work longer and draw their State pension and occupational pension at the same time, the pension system as a whole will not achieve its objectives, may create perverse outcomes and inefficiencies, and the system will not operate in the interest of those it is intended to support.

Given the multi-pillar approach to retirement income, income for members of occupational pension schemes will be combined with income from the State pension to provide the total retirement income. Having different commencement dates for different retirement benefits because an employer can terminate employment before the State pension is payable will bring unnecessary complexity in planning for retirement and practical financial challenges. It also undermines the effectiveness of overall pension policy.

A gap between the typical occupational retirement age (65) and qualifying age for the State pension also impacts employees that wish to and are eligible[2] to exercise the ARF option at retirement.

To avail of the ARF option, if under age 75, eligible retirees must have a minimum guaranteed annual pension income ('specified income'), which is currently €12,700[3]. If the specified income requirement is not met, the retiree must choose an Approved Minimum Retirement Fund (AMRF)[4], into which they must transfer a 'set aside' amount, currently €63,500 or the remaining fund balance, if lower, after availing of a tax-free lump sum. The remaining fund balance may be invested in an ARF. Instead of investing in an AMRF, a retiree could purchase an annuity to secure the guaranteed specified income needed to avail of an ARF.

[2] The ARF option is available to: DC scheme members, holders of PRSAs, RACs (set up after 6 April 1999 or in certain circumstances those established earlier than this), BOBs, AVCs (of both DC and DB members), and proprietary directors that are members of a DC or DB scheme.

[3] A pension or annuity which is payable for the life of an individual, including a pension payable under the Social Welfare Consolidation Act 2005 (State Pension, Widow's, Widower's or Surviving Civil Partner's Pension, Invalidity Pension and Blind Pension, regardless of whether the pension is contributory or non-contributory). https://revenue.ie/en/tax-professionals/tdm/pensions/chapter-23.pdf

[4] The report of the Interdepartmental pension reform and tax group have recommended that the AMRF would be abolished.

Therefore, a retiree that is eligible to exercise the ARF option and is in receipt of the contributory State pension would meet the specified income requirement and qualify to use an ARF. However, since 2014, those aged 65 on retirement will not be in such a position and will only qualify to exercise the ARF option if they have some other form of guaranteed specified income[5]. Otherwise, their options are 1) to transfer €63,500 (or fund balance after tax-free lump sum, if lower) into an AMRF, or 2) purchase an annuity to guarantee the required annual 'specified income' of €12,700. At 66, when in receipt of the State pension, the AMRF will become an ARF. Given the popularity of ARFs, the predominance of DC schemes, and the gap between normal retirement and State Pension age, more retirees in the future will be in such a situation.

This could be dealt with by addressing the ability of an employer to terminate employment at 65 where the receipt of the State pension is not due until a later age. There are clear challenges to doing this, but in the absence of tackling the issue, increasing the State pension age and having a gap between normal occupational retirement ages is going to cause difficulties for members of occupational pension schemes.

Link the receipt of state pension with the date at which person started working

Any increase in the State pension age may feel especially inequitable to those who joined the workforce at a young age, compared to those who stayed longer in education. There are a number of issues which may arise: firstly, those concerned are more likely to be in manual employment, and such work may become more difficult with age; secondly, because life expectancy tends to be lower for those in lower socio-economic groups, any increase in the retirement age has a disproportionate effect on those contributors.

The Pensions Authority suggests that the Commission give consideration to some link between the age at which a contributor becomes eligible for a State pension and the age at which they joined the workforce.

Such an approach might address a number of the objections to working longer. People are living longer and healthier lives and many, who are in a position to do so, regard working further into their later years and beyond the traditional retirement age, as something that is both possible and desirable. At the same time, there are many people who will view future State pension age increases with fear given the nature of the work they are involved in.

The Total Contributions Approach (TCA) to qualify for the State pension considers the total number of PRSI contributions paid, instead of when they were paid when being assessed for the State pension. This approach could be adjusted to take account of certain employments to ensure that notwithstanding increases to the State pension

[5] It should be noted that the new Benefit payment for 65-year olds may be available, subject to meeting the social insurance contribution conditions. At the single rate of €203 per week, this would provide income of €10,556 per year. If the retiree has a qualified adult living with them, the income would be €17,560 per year.

age, the State pension can be paid earlier for those with a full PRSI record and 40 years employment. This would deal equitably with those who entered the workforce earlier and because of the nature of work undertaken may not be able to work past a 40 year career.

Conclusion

The Authority welcomes the opportunity to make this submission. The State pension provides an important protection against poverty in old age. The State pension is also a fundamental component of the occupational pension system and provides vital income to those with and without occupational or private pension savings. This role will continue and there is a need to ensure the ongoing sustainability and relative value of the State pension.