MERCER

Sustainable State pensions into the future

Pension Commission Submission
9 March 2021

welcome to brighter

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1 Introduction

Mercer is very pleased to have this opportunity to contribute to the Pensions Commission's consultation on the State pension.

We are long-standing administrators of, and consultants to, an extensive range of occupational pension schemes provided by both multinational and indigenous employers for more than 200,000 current and future pensioners. Many of these schemes are integrated with the State pension in terms of their design.

Mercer has a long history of collaborating with industry bodies, regulators and governments on fundamental reform initiatives such as those under consideration by the Pensions Commission.

Mercer also provides a detailed annual comparative analysis of pensions systems around the developed world, which provides us with important data from other countries that can inform our own debate, as well as significant benchmarking information.

For these reasons, we believe we are in a good position to provide the Pensions Commission with an important, cross-pensions system perspective on how changes to the State pension might be implemented to achieve long-term sustainability.

Please note that comments in our submission are made not just from our perspective as a provider of occupational pension scheme services but also based on our extensive experience in advising current and future pensioners on general pension entitlements and wider financial planning, and our understanding of their expectations and concerns.

We are anxious to ensure that both current and future governments take the right steps to address the coming challenges presented by changing demographics. We call on those governments to make decisions based not on short-term political goals but on fundamental socioeconomic factors, the effects of many of which may not be felt for some years to come.

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What do you expect from the State pension?

In terms of what we believe should be expected from the State pension (contributory) (SPC), we have identified the following:

- In conjunction with the non-contributory State pension, the SPC should provide a **basic level of regular income** paid from an **appropriate retirement age** until the death of the recipient.
- The level of income should be determined by an appropriate **reasonable standard of living,** taking into account country-specific factors.
- The SPC should be **universally available to all** who can meet the qualification criteria, irrespective of their means. It should be payable irrespective of the availability of supplementary pensions, or other incomes, payable from other sources. The SPC system should be **fair**, with no inequitable impacts for any area of society.
- Future pensioners should have **absolute certainty** regarding the age from which the SPC will be paid to them and the amount of the SPC they can qualify for (depending on their employment record), and full confidence that the system will provide this. Current pensioners should feel **secure** in the knowledge that their SPC will continue to be paid on the relevant due dates until their death.
- The design of the **SPC system must be sustainable and robust**, with an appropriate and transparent plan for how it is funded, taking into account our changing demographics and worker-to-pensioner ratio.
- The SPC should provide **reasonable value for money** relative to the contributions that have been paid by the individual.
- The SPC should also provide **protection to individuals from inflationary movements**.
- The SPC system should be **uncomplicated** in terms of both how it is calculated, and how individuals understand their rights to it and what might influence the benefit ultimately payable.
- The SPC system should provide **flexibility** to cater for different working environments and experience.

3
What is working with current state pension arrangements?

Taking into account the above expectations, we have identified the following as positive aspects of our current SPC system that are working well:

- The level of the SPC compares very favourably with that in other OECD countries. Mercer research also shows that the SPC provides a crucial role in supporting a relatively strong pensions system. This means that, taking into account non-State retirement income, total retirement income adequacy levels are very good. According to our research, Ireland ranked fifth out of 39 international pension systems on the adequacy measure in 2020, and first in 2019, in both instances due to its comparatively generous State pension.

- The availability of the State pension from age 66 is well received by individuals who are nearing their retirement.

- Supplementary dependants' pensions are also generous.

- The current system appears to be relatively transparent and understandable, and administration procedures appear to be robust.

- Ireland's numerous international social security treaties and arrangements (either EU-based regulations or other bilateral social security agreements) allow for the combination of social insurance contributions paid in Ireland with those paid in other countries, enabling qualification for a social insurance payment in both Ireland and another country with which Ireland has a social security arrangement.

- The SPC is supported by a strong administrative system that allows for clear, transparent and easily understandable rules. We have also not made the mistake of means-testing the SPC – in our view our taxation system is sufficiently progressive to avoid the need for means-testing and so redresses any perceived imbalance. This allows qualification for the SPC to be unaffected by the availability of income from other sources and determined solely by reference to an individual's working record and PRSI contributions. This removes unnecessary additional complexity from the system. The SPC system also appears to foster a culture of retirement saving by ensuring higher retirement benefit saving does not result in a lower level of SPC.

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What concerns you with respect to current state pension arrangements?

The key concerns identified in our research on Ireland's SPC relate to: (1) sustainability and (2) integrity. These are two sides of the same coin: without evidence of sustainability, future retirees will struggle to trust that the system will be there for them to rely on.

We also have a concern that the SPC system is not flexible enough to accommodate the realities of individuals' working lives and experience.

Sustainability

Ireland's pensions system is ranked in just 24th place (out of 39) in the Mercer Global Pension Index.

As clearly outlined in the Pensions Commission's call for consultation submissions, the ratio of workers to pensioners in Ireland is set to fall from 5:1 today to 2:1 by 2050. This means that there will be fewer workers to fund the State pension in the future. The Social Insurance Fund deficit is already extremely large and will continue to grow given these changing demographics. The additional debt burden arising from the ongoing impact of the COVID-19 pandemic will exacerbate the extent of this growing problem to the State's finances.

The planned increase in the State pension age to 67 in 2021 was designed to help address this imbalance, but, as announced in Budget 2021, this has now been deferred.

The underlying reasons for the original introduction of this legislation in 2011 were debated at length – but, crucially, they have not changed. In fact, the conditions have arguably worsened. We strongly disagree with the decision to reverse the State pension age increase. That said, we are not surprised the decision has been reversed, given that insufficient measures were taken at the time to ensure that the increase could be comfortably incorporated into the existing pensions system in Ireland, with particular respect to acknowledging the realities of working practices.

It is particularly concerning that the State pension age has become a contentious political issue, with significant public scrutiny given to election manifestos on this front. The continued use of the State pension as a political bargaining tool will inevitably lead to short-termism as opposed to the long-term view required for sustainable decision-making. At some point, government will need to make potentially politically unpalatable decisions in the interests of future generations of Irish workers and pensioners.

It is also a source of concern that previous attempts to improve sustainability by putting aside funds through the National Pension Reserve Fund were ultimately abandoned, with the funds repurposed for shorter-term needs.

Integrity

The demographic shift ahead, and the associated uncertainty over the State's future ability to pay the SPC, inevitably contribute to a lack of trust in the system.

Employees planning for their retirement need certainty about what State benefits they can expect to receive, and from when. Lack of confidence about the future level of the State pension, or the retirement age from which it will be paid, creates significant difficulties for employees seeking to determine how much they should be saving and for how long, and when they can afford to retire. Pensioners have much less flexibility than employees in terms of finding other sources of income if needed; the State pension should be their safety net.

Flexibility

As the State pension age increased beyond 65, employment law remained unchanged. No meaningful supports were provided to either employees or employers regarding work beyond age 65. This divergence was part of the difficulty in implementing and sustaining the increase in retirement age.

There remains a significant degree of uncertainty for both employers and employees about whether an employer can enforce contractual retirement ages. At present, retirement can be mandated where this is objectively justifiable by reference to a legitimate business aim – but this is a very subjective position that, ultimately, only the Workplace Relations Commission (or the courts) can determine.

There is a lack of integration between the end of the working life and the start of the State pension. Currently, individuals may receive both a State pension and income from employment (and even income from their company pension scheme) should they choose to work past State pension age.

There is also a significant degree of uncertainty for members of occupational pension schemes that are integrated with the SPC (where the benefits received, or the contributions paid, are linked in some way to the current rate of the SPC). Schemes designed in this way will pay out an amount from the scheme's stated retirement age, which will be lower than the member would have expected and, perhaps, planned for – simply because their State pension age and their scheme retirement age are no longer aligned. At present, our experience is that there is a wide range of different options taken by scheme members, which has a direct correlation to the age from which they are entitled to receive the SPC.

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How best to accommodate those who provided long-term care for most of their working lives?

As a general comment on this section, it is important to note that our areas of expertise are outside of the realm of long-term care.

However, we would say that all carers perform a crucial role in supporting society and this is an essential policy aspect to consider. No carer should be negatively impacted by virtue of performing a role outside the scope of the employment and social insurance environment.

The gender retirement savings gap is also well documented, and the majority of long-term carers are women. Clarifying the future State pension entitlements of this group will not on its own solve the gender retirement savings gap but will be a significant step in the right direction.

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What specific policy, provision or other changes are needed to make state pension arrangements sustainable into the future?

We believe the following high-level policies and changes should be considered:

(a) Sustainability of the SPC should be significantly improved where we can achieve increased private pension coverage and increased adequacy of private pension savings. As such, following through on the planned introduction of auto-enrolment in coming years will be an important additional lever in encouraging higher levels of private pension savings. This in turn will allow further consideration of policies (such as increasing the State pension age) to support the objectives of the SPC and potentially reduce the financial burden to the State.

(b) Phased State pension age increase: We believe it is inevitable that the State pension age will need to increase to ensure the future sustainability of the SPC. Policy in this area needs to be formulated for the long term and detached from short-term political objectives. Appropriate adjustments should also be made to employment law, as outlined above.

(c) The use of flexible retirement ages, whereby individuals have full freedom around when and how they wish to stop working, is more reflective of modern working practices. Individuals can opt to work for longer, in exchange for a larger State pension entitlement; retire early, in exchange for a reduced State pension entitlement; or phase out of work and into retirement while using their State pension entitlement to facilitate that financially.

(d) To facilitate employers who require flexibility in how they manage their workforce, we think the ability of employers to enforce a contractual retirement age should remain (subject to the existing objective justification condition) but this should not lead to a gap between the retirement of the individual and the age from which their State pension commences. To address this, we would propose that a pension bridging gap payment could be introduced, whereby employers (perhaps excluding those employers who will have already contributed in respect of their employees to a material extent) pay the equivalent of the minimum State pension up to chosen mandatory retirement age, where this is part of the employer's strategy. We see this measure as enabling an important balance between employers' needs to manage their workforce and individuals' needs to access retirement income at the right time in circumstances where obtaining suitable alternative employment may difficult (or even impossible). Employees who are affected by the gap could also be accommodated further by availing of more flexible benefit drawdown arrangements.

We remain available to discuss these and any other matters relating to pension policy should it be of interest to the Pensions Commission or to other government parties.

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