Insurance Ireland response to Pensions Commission Consultation Paper
"Have your say on sustainable state pensions into the future"

March 2021

Introduction

Ireland is a thriving global hub for insurance, reinsurance and Insurtech. Ireland's insurance market is the fifth largest in the EU, and our reinsurance market is the second largest. Our members represent around 95% of the companies operating in the Irish market, making Insurance Ireland a strong leadership voice for the sector.

Insurance Ireland members are progressive, innovative and inclusive, providing competitive and sustainable products and services to customers and businesses across the Life and Pensions, General, Health, Reinsurance sectors in Ireland and across the globe. In Ireland, our members pay more than €13bn in claims annually and safeguard the financial future of customers through €112.3bn of life and pensions savings. Our members contribute €1.6bn annually to the Irish Exchequer and the sector employs 28,000 people in high skilled careers.

The role of Insurance Ireland is to advocate on behalf of our members with policymakers and regulators in Ireland, Europe and Internationally; to promote the value that our members create for individuals, the economy and society; and to help customers understand insurance products and services so that they can make informed choices. Insurance Ireland advocates for 135 member firms serving 25m customers in Ireland and globally across 110 countries (incl. 24 EU Member States), delivering peace of mind to individuals, households and businesses, and providing a firm foundation to the economic life of the country.

Insurance Ireland welcomes the establishment of the Pensions Commission and is strongly supportive of the commission's work to "examine and make recommendations for the sustainability of State Pensions and the Social Insurance Fund"[1].

In framing our response to this consultation, Insurance Ireland has focused on the policies that could be deployed to increase the sustainability of the State Pension. In framing our comments we have accepted the importance of the "social contract" implicit in such a system and in our recommendations have sought to maintain the contributory and solidarity principles.

Pay as You Go Pensions

The Irish State Contributory Pension (SPC) is an unfunded pay as you go scheme. In these systems current pensioners are funded by contributions paid by current workers. The key element is the relationship between the number of workers and the number of pensioners in the scheme.

In assessing the potential threats to the State Pension we are guided by a paper authored by the European Systemic Risk Board, published in July 2020 and the Actuarial Review of the Social

[1] https://www.gov.ie/pdf/?file=https://assets.gov.ie/118474/fdacc8e1-8f8e-49a7-aaa0-d8cf978d5484.pdf#page=null, accessed 23/02/2021.

Insurance Fund conducted in 2015 and published in 2017. The challenges to the sustainability faced in Ireland is in many ways similar to those in several schemes throughout the world.

The first vulnerability is "demographic factors" and is best summarised as "life expectancy in Europe has been steadily growing, while birth rates have decreased, result in an ageing population"[2]. This vulnerability is particularly relevant to pay as you go schemes such as the Irish state pension as they are particularly reliant on intergenerational transfer and the risk is that the "solidarity among generations may become strained over the long term if younger generations are overburdened with pension commitments towards the elderly"[3]. There is some positive news for Ireland in this respect; when the change in the working age population between 2016 – 2025 is plotted the EU average is in decline (-1% of working population in 2016) while Ireland has the third highest in the EU (5% of the working population in 2016)[4].

While this is positive it does not mean that demographic change is not a risk to the Irish state pension, it merely means that it will take a little longer to make its presence felt in Ireland than it will in other European countries. This vulnerability is brought into sharp focus by the most recently available actuarial review of the Social Insurance fund, conducted in 2015 and published in 2017. The review found that shortfalls in the fund would begin to emerge in 2020 and would gather pace over time, by 2030 the shortfall would be €3.3 billion increasing to over €22 billion by 2071[5]. The demographic pressures are illustrated by the finding that "long term pension related expenditure is projected to continue to be the predominant component of the Fund expenditure rising from 70% in 2016 to circa 80% in 2071"[6].

The second source of vulnerability is closely linked to demographics and it is referred to by the ESRB as "sponsor risk". This is the idea that pension expenditure already represents a significant proportion of Government spending. Many EU countries are already heavily indebted and increases in pay as you go spending on pensions via state subventions could result in less funds for other aspects of social expenditure or an inability to effectively manage a public deficit and consequently countries not being able to access international markets. In all likelihood it was this sponsorship risk that Minister for Social Protection Regina Doherty had in mind when, in 2017 on publication of the actuarial review, she wrote "It is clear that action needs to be taken over the short to medium term to put the long-term funding of social insurance on a more sustainable financial footing"[7].

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2 https://www.esrb.europa.eu/pub/pdf/occasional/esrb.op17~554f755910.en.pdf?10dfe231b7d1a4160e1b5b5cf0e88349 , accessed 23/02/2021.

3 https://www.esrb.europa.eu/pub/pdf/occasional/esrb.op17~554f755910.en.pdf?10dfe231b7d1a4160e1b5b5cf0e88349 , accessed 23/02/2021.

4 https://www.esrb.europa.eu/pub/pdf/occasional/esrb.op17~554f755910.en.pdf?10dfe231b7d1a4160e1b5b5cf0e88349 , accessed 23/02/2021.

5 https://www.gov.ie/en/press-release/bc2427-minister-doherty-welcomes-publication-of-the-actuarial-review-of-the/ , accessed 23/02/2021. A new actuarial review was scheduled to be undertaken in 2020, early publication of this review would be extremely useful in assess the effectiveness of policy options.

6 https://assets.gov.ie/37220/99a896910d574b7daa0b65fbb00900e5.pdf , accessed 23/02/2021.

7 https://www.gov.ie/en/press-release/bc2427-minister-doherty-welcomes-publication-of-the-actuarial-review-of-the/ , accessed 23/02/2021.

Potential Policy Options

In this section Insurance Ireland will discuss three policy proposals we believe could address the sustainability challenges faced by the Irish state pension. In making these recommendations we believe that it is vital to protect the "social contract" as the bed rock of the state pension. In framing our policy options we are going to argue that the sustainability of the state pension be treated partially as if it were a funded pension scheme. We will attempt to achieve this through applying the OECD six core principles of private pension regulation[8]. We are advocating this approach as we believe that the rigour contained in these principles, when fully adopted, goes a long way to build trust in the ability of any pension scheme, including the Irish state pension, to deliver the desired outcome for the scheme members. A brief summary of the OECD Core Principles of Private Pension Regulation are outlined in appendix 1, for more detail please consult OECD.org.

Gender Pension Gap

Cognisance must also be taken of the tangible pension pay gap for women in Ireland. The state pension relies on a contributory basis and a means-tested top-up, putting women at a disadvantage in retirement. Credits for time out of the workforce do not cover all the caregiving situations women experience and paid work contributions are still required[9]. The average membership of occupational pensions in Ireland is just 24 people per scheme (excluding single member schemes) and is in sharp contrast to international practice where schemes routinely achieve economies of scale with hundreds of thousands, and even millions, of members[10].

Pension policies should be reformed to be more women-friendly, thereby raising the profile for the other needed reforms such as the cost of childcare, discrimination, unequal sharing of the caregiving role, access to affordable housing, costs of long-term care.

The 2020 rates of state pension vary according to contributions records[11]. Rates of payment can also be influenced by a "dependant" adult, defined as a spouse, a civil partner or de facto. The inequity is introduced as the principal applicants income or property is not taken into account in the assessment. For the partner their income is reckonable as is any property, we would strongly recommend that there should be equity of treatment for both partners. Insurance Ireland in co-operation with our members are currently evaluating international best practice on principles which could reduce in a reduction of the gap in retirement income between men and women and we look forward to engaging with the Commission and the Department of Social Protection on these proposals over the coming months. It is our firm belief that working in co-operation across both public and private pension providers is the best way to ensure that Irish workers can enjoy a more gender equitable retirement.

Furthermore, we are recommending the introduction of auto-enrolment as it is line with recommendations from the OECD and the European Commission. A modest additional pension will allow both women and men who are retired to enjoy a more secure existence.

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[8] https://www.oecd.org/finance/principles-private-pension-regulation.htm

[9], [14,,15] Women and Retirement in a post COVID-19 world, Dr M.Claire Dale, Research Fellow, and Associate Professor Susan St John, Director, Retirement Policy and Research Centre (RPRC),, Sept 2020;

[11] gov.ie - Current rates of payment for social welfare payments (SW19) (www.gov.ie)

1. **Reform the Pay as You Go nature of the state pension by introducing an element of pre-funding and generating investment income.**

This policy reform would seek to boost the assets and the value of contributions through pre-funding future liabilities and utilising investment returns to offset these liabilities. In essence it would require the state pension to function in part like a private pension.

We are recommending this course of action. Ireland had legislation in place to do this with the Passage of The National Pension Reserve Fund Act 2000[12]. This Act facilitated the government in setting aside 1% of Gross Domestic Product to meet future pension liabilities. As a result of the dramatic deterioration of the country's finances, the government passed the National Pension Reserve Fund and Miscellaneous Provisions Act 2009 and subsequently the National Treasury Management Authority (Amendment) Act 2014. Both of these pieces of legislation changed the focus of the National Pension Reserve Fund. In order to ringfence exchequer contributions to meet future pensions liabilities we believe potentially putting constitutional protections in place could be useful at times of future economic crises (i.e. exchequer contributions couldn't be suspended or funds utilised for another purpose without a referendum). Such a measure would go a long way to protect trust in the state pension.

2. **Raise the retirement age and make it more attractive for those who wish to continue working.**

As life expectancy improves the appropriateness of an arbitrary retirement trigger age should be reviewed. In 1991 an Irish man who retired at 65 would have a life expectancy of 72, for an Irish woman it would be 78. By 2016 this has risen to 80 and 83 respectively. In 2014, 10 of the EU 27 countries had revised the age at which their state pensions could be drawn down. In order to further support these choices, the possibility of combining partial pension payments with income from work and tax incentives promoting later retirement should be examined[13].

We are recommending this action as currently there is too much of a separation between the working and retirement, the two are mutually exclusive. Some form of blending could go a considerable way to support longer continuation (possibly on a part time basis) in the workforce.

3. **Complement and underpin state pensions with broad and well designed supplementary pension schemes. Introduce Auto Enrolment as soon as possible.**

As we know the Irish state pension is designed to alleviate poverty in retirement and has an estimated replacement rate of 35% of annual industrial earnings. We do need to build on our coverage rates as currently only 50% of those in employment have access to a pension and when this is viewed as the private sector the coverage figure falls to 36%. Ireland is the only OECD country without an Auto Enrolment (AE) system in place[14]. The experience of the UK shows us that AE schemes can be very effective at building coverage. In 2012 prior to the introduction of AE, 47% of UK employees were members of a workplace pension scheme (similar to Ireland). Six years later, at the end of 2018, that figure had risen to 76% of employees[15].

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[12] http://www.irishstatutebook.ie/eli/2000/act/33/enacted/en/html , accessed 23/02/2021.
[13] https://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=8084&furtherPubs=yes , accessed 23/02/2021.
[14] https://www.oecd-ilibrary.org/docserver/67ede41b-en.pdf?expires=1613995875&id=id&accname=165670&checksum=B970576D4F8CD0BCEEE8FB77DD550015 , accessed 23/02/2021.
[15] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/workplacepensions , accessed 23/02/201.

Conclusion

In the above we are making pragmatic and internally tested recommendations and we are also discounting recommendations which do not sit well with the established principles of the state pension. We have included reference to the OECD principles for the regulation of private pensions because as a trade body this is the context in which our members operate and we believe partially treating the Irish state pension as a funded pension and some of the requirements of same opens opportunity to bring about reforms.

Ireland passed legislation in 2011 to raise the age of entitlement to the State pension in 2021 and again in 2028[16].

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[16] http://www.irishstatutebook.ie/eli/2011/act/9/enacted/en/html , accessed 03 March 2021.

Appendix 1 – OECD Core principles private pension regulation

- Core Principle 1. Conditions for effective regulation.

Private pension systems should have clear and well-defined objectives regarding coverage, adequacy, security, efficiency and sustainability. The achievement of these objectives should be regularly monitored. An effective legal framework, a robust institutional and financial market infrastructure, and a sound regulatory and supervisory system for pensions should be in place to support these objectives.

- Core Principle 2. Establishment of pension plans, pension funds and pension entities.

Pension plans, pension funds, and pension entities, jointly or separately, should be subject to an adequate, transparent and coherent set of legal, accounting, technical, financial, managerial and governance requirements, without imposing an excessive administrative burden. Pension fund assets should be legally separate from the assets of any other legal entity, including those involved in managing the pension plan assets. In the case of occupational pension plans, the pension fund or pension entity should be legally separate from the sponsor (or at least such separation should be irrevocably guaranteed through appropriate mechanisms). The ownership of any financial institution or other entity managing pension plans or plan assets should be clear and transparent.

- Core Principle 3. Governance

Regulations on private pension governance should be guided by the overriding purpose of serving the best interests of plan members and beneficiaries and ensuring the soundness of pension plans, pension funds and pension entities. The governance structure of pension funds and pension entities should ensure an appropriate division of operational and oversight responsibilities, and the accountability and suitability of those with such responsibilities. Pension funds and pension entities should have appropriate control, communication and structures that encourage good decision making, proper and timely execution, transparency, and regular review and assessment. The governing body of a pension fund or pension entity should ensure that the investment strategy follows a prudent approach and, where applicable, takes into account the profile and duration of its liabilities.

- Core Principle 4. Investment and risk Management

Investment by pension funds and pension entities should be adequately regulated. Investments should be aligned with the specific attributes and liabilities of the pension plan and the institutional and market environment in which it operates. Investment regulations should take into consideration principles related to risk diversification and dispersion and asset-liability management. Pension funds and pension entities should be required to act in line with the investment horizon and risk-return objectives of the plan, and take into account the long-term nature of saving for retirement and of eventual liabilities.

- Core Principle 5. Plan design, pension benefits, disclosure and redress.

Proper design of private pension plans should be promoted, especially when these schemes play a public role, through substitution of or substantial complementarity to public schemes, when they are mandatory, and when members face choices between plans or within the pension plan (for instance, the level of the contribution rate or the choice of investment option). Factors to be taken into consideration include member choice, degree of risk sharing, protection of the value of benefits, entitlements, accruals, contributions, coverage, and financial and market risks. Overall benefit adequacy should be evaluated taking into account the various sources of retirement income (tax-and-transfer systems, advance-funded systems, private savings and earnings)

- Core Principle 6.

Private pension supervision should promote the stability, security and good governance of pension funds, pension entities and/or pension plans with the aim of protecting the interests of plan members and beneficiaries. Effective supervision of pension funds and plans must be set up and focus on legal compliance, financial control, actuarial examination and supervision of those with the responsibility of operating or managing the plan. Appropriate supervisory bodies, properly staffed and funded, should be established in order to conduct when relevant off and on site supervision, in particular when problems are reported or identified. Supervisory bodies should be endowed with appropriate regulatory and supervisory powers over private pension plans, pension funds and pension entities, including powers over the functions that are outsourced.

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