A UNIVERSAL PENSION FOR IRELAND

POLICY AND IMPLEMENTATION ISSUES BASED ON INTERNATIONAL BEST–PRACTICE

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THIS DOCUMENT WAS PREPARED FOR INSURANCE IRELAND BY TOR FINANCIAL CONSULTING

TOR Financial Consulting Limited

INSURANCE IRELAND

About this Report

The Government-commissioned OECD *Review of the Irish Pension System* recommended the establishment of a universal defined-contribution (DC) pension model that would eventually cover all, or nearly all, Irish workers in both the public and private sectors. In February this year, the Minister for Social Protection, Joan Burton, indicated that the preferred solution would be auto-enrollment of Irish workers into a supplementary scheme and that a roadmap and timeline for introduction would be developed. This is a highly technical area with many complex issues for policymakers and stakeholders to address. Insurance Ireland members can bring a great deal of knowledge and experience to the discussions by explaining the implementation issues of policy options under consideration. Insurance Ireland's primary role would be to ensure the policy option chosen by Government could be implemented effectively.

In response to the OECD report Insurance Ireland has:

1. established an academic advisory panel, comprising individuals within the academic and public-policy community who have demonstrated significant knowledge and leadership in pension and social security reform in their home countries;

2. signalled to Government that it will develop proposals to achieve the OECD objective of 90% pension coverage for the working population on an equitable basis;

3. reached out to key stakeholders in Irish society with a view to building a national consensus on what needs to be done so that an efficient, effective, equitable, sustainable and legitimate solution can be offered to all Irish people;

4. engaged Tor Financial, who assisted the OECD in preparing its *Review*, to assist in outlining the policy options and technical challenges as the basis for a dialogue, initially with other stakeholders and then with Government.

A Universal Pension for Ireland was distributed to stakeholders prior to our policy workshop on 11th February last. Following feedback from Members and Stakeholders we now present this as the finished report. The report does not necessarily reflect the views of Insurance Ireland or its Members.

Gerry Hassett
Chair – Insurance Ireland Pension Policy review group
September 2014

About Insurance Ireland – Insurance Ireland represents 95% of the domestic market and 70% of Ireland's international life insurance market. This business generates €25bn in premium income (domestic and overseas), employs 15,000 people – and thousands more in ancillary services – and contributes more than €1.1bn in tax to the Irish exchequer.

About Tor Financial – TOR is a UK-based consultancy with long-standing involvement with pensions in relation to public policy and industry trends. It has extensive knowledge of pensions systems and pension reform worldwide, and advises stakeholders on the impact of public policy, legislation and regulation and on competency and compliance issues.

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Executive Summary

1. Ireland has public debt of €192bn but even this becomes insignificant when account is taken of hidden state pension liabilities estimated at €440bn[1] – of which €116bn has been accrued in respect of occupational pensions payable to public servants[2] and €324bn to shortfalls in the Social Insurance Fund[3]. Resources required to fund state pensions increased by more than €190m in 2013 alone[4].

2. New figures estimate that one in three babies born in 2013 will reach the age of 100 and men who retired in recent years are likely to spend more than 21 years in retirement.[5] Increases in longevity are a great success but present huge problems for governments across the world. How will retirement and the consequences of old-age populations continue to be funded as the ratio of workers to pensioners widens?

3. According to the OECD[6] Ireland currently has the highest old-age support ratio[7] in the EU-27 but by 2050 people over 60 could account for 29% of the population (compared with 17% in 2013). The country has a slower ageing rate than some other European nations but this fact remains: **Ireland's ageing population will increasingly face pensioner poverty if urgent action is not taken to reduce the retirement savings gap and alleviate the pressure on the working population to fund lengthening retirement for parents, grandparents, great grandparents and possibly great, great grandparents**. Ensuring financial security for individuals in retirement is now a priority.

4. Successive Governments have considered this problem and made relatively small changes towards a solution – raising the state retirement age for instance – without implementing fundamental reforms that will make sufficient difference over the long term.

5. A Green Paper published in 2007 explored options around the state pension, public services pensions and automated enrolment into workplace pensions in the private sector; however in 2008 much of the reform package was sidelined because of the economic crisis. Nevertheless, the Coalition Government has implemented some reform and did commission the OECD's *Review of the Irish Pension System* (2013) which recommended compulsory saving into workplace pension schemes. The time is now right to fix a framework for future-proofing Ireland against the demographic time-bomb. Many other countries have made reforms to do this.

6. There are indications that the Defined Benefit (DB) model is broken in both the public and private sector because the cost is prohibitive and the promises being made are unsustainable. DB will continue to decline as trustees are forced to consider: closing DB to new entrants; closing future

[1] The Pensions Board
[2] The Comptroller and Auditor General
[3] *Actuarial Review of The Social Protection Fund*, KPMG, 31 December 2010
[4] *A Strategy for Growth – Medium Terms Economic Strategy 2014-2020*, December 2013
[5] UK Office of National Statistics, 2013
[6] Review of the Irish Pension System, 2013
[7] The number of people of working age (20-64) relative to the number of people of retirement age

accrual to existing DB members; scaling back benefits and withdrawing or restructuring to meet liabilities. At the same time voluntary retirement saving is diminishing. The inevitable consequence will be that sustainable and adequate income in retirement cannot be guaranteed.

7. Agreement must be reached on a system which ensures future retirees are more financially secure. A way must be found to assist workers to sacrifice income now for income at the end of their working life.

8. It is time to design a 21st century pension system for Ireland which deals head-on with the demographic shifts that threaten to expose so many people to an old age in poverty and Ireland to a welfare burden that will become increasingly unsustainable.

9. Insurance Ireland's objective in joining the debate is to support the Government by sharing the industry's knowledge and providing a forum for informed dialogue. It has assembled an advisory panels of experts from academia, consulted key stakeholders and commissioned a survey on international pension reform (see Appendix B). In addition a draft version of this report formed the basis for a workshop with stakeholders and international experts in February 2014.

10. Insurance Ireland is keen to build a consensus of opinion about the way forward for Ireland. There are many influences that could be brought into discussion for such an important change in public policy. Insurance Ireland believes it can play a vital role in providing technical support and guidance to policymakers on implementation issues.

11. The organisation's focus is that the outcome should be good for both Ireland and individuals and that **the fundamental guiding principles of a reformed retirement system should be fairness, practicality and affordability**.

12. A critical element of any solution is going to be personal ownership of pension savings by individuals. This will be necessary to create public confidence. Some of this confidence must be stimulated by system design and supervision and some must be achieved by helping workers to become more self-reliant savers - whilst avoiding the need for them to make complex investment decisions.

13. It is inevitable that Defined Contribution (DC) workplace retirement saving will be the model for the future and this is backed up by its almost universal adoption in other parts of Europe, the United States and Australia. Within that model there are variations of approach which can be debated in order to achieve the best system for Ireland and its own particular economic profile.

14. It is for policymakers to decide how DC coverage should be expanded and maintained, but it is noted that the OECD recommended a *mandatory* DC workplace pension system with employer and employee contributions (in addition to the state pension). Mandation would be a less expensive system for the state to implement but a consensus on the strategy for Ireland must be established.

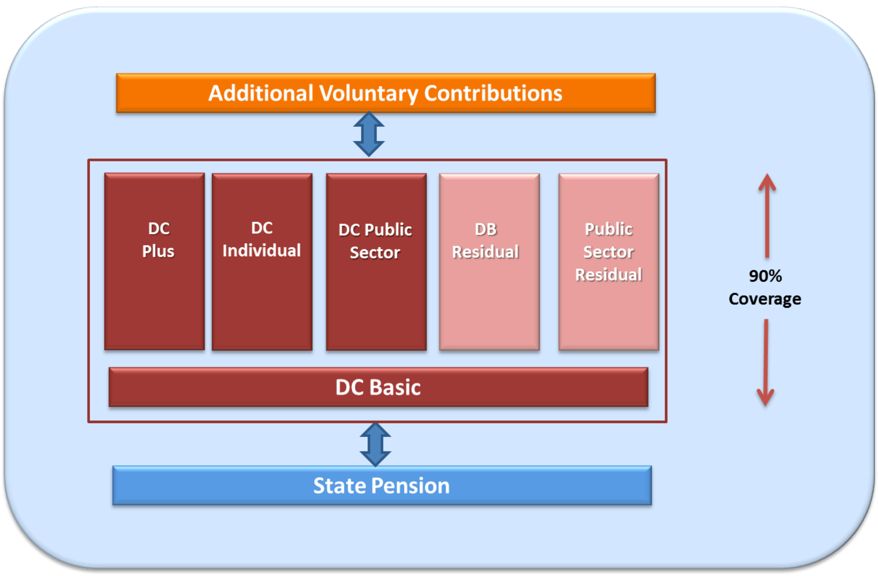
15. That said, an employer contribution, whether in a mandatory system or through auto-enrolment, will be necessary in order to ensure the accumulation of adequate pension assets for employees. This additional burden on employers should be affordable and take into account the exceptionally high proportion of small businesses in the Irish economy.

16. Employer contributions – for new members of workplace pension schemes – should be required in a way that is sensitive to the economic reality of Irish companies: small contributions initially which increase over time and have an ultimate cap for *mandated* contributions (see Policy Options).

17. Employers currently providing workplace DC schemes should continue to do so as long as employer and employee contributions meet legislated default contribution levels. Where contributions are above the default levels employers should be encouraged to continue to make additional voluntary 'top ups'. They should also be allowed to auto-enrol new members at the default levels.

18. From a practical point of view each element of the pension infrastructure should align with common design principles to allow individuals maximum flexibility as they move between employers. There is an opportunity here to remove complexity from the current system and make pensions more accessible and less costly.

19. The Irish pension system could eventually look like this:



The state pension to provide national insurance and a top up for private pensions for some years to come.

DC Basic/*MySaver*, as a new element to the system, could be an entry level to serious retirement saving and as such could be based on defaults: contribution levels, investment funds, member communication, charges etc. It would have mandated minimal (default) contribution rates from employees and employers and a tax rebate. The new vehicle would be individual-specific: each employee would have a single retirement account accepting contributions from multiple employers over the working life of the individual. This would be a means to *universal* pension coverage but not a universal pension *per se*: existing good schemes would continue.

DC Plus describes an existing occupational pension plan with higher employer and employee contributions than the legislated default contributions for DC Basic. The schemes would be covered by mandation or auto-enrolment – and new regulations would be applied to them – but DC Plus would enable employers to continue with good schemes and use them as a recruitment incentive.

DC Individual is the existing retail offering for self-employed individuals and company directors alongside PRSAs and RACs.

DC Public is the new DC plan required to fund public sector pensions into the future. In effect it would be the public sector version of DC plus mirroring both its shape and structure.

DB Residual describes the preserved benefits to members of existing DB schemes (and assumes all would be moving to DC for future contributions).

DB Public Residual describes the same process in the public sector and assumes that public sector employees would not qualify for future accruals at some stage in the future.

20. If mandation is not going to be the route taken to expanded pension coverage then suitably ambitious goals should be set for auto-enrolment (with voluntary opt-out) – there is little point in going through change unless it makes a difference.

21. Auto-enrolment can be considered a success if it achieves 90% coverage of the eligible workforce *contributing regularly to plans*; but if 70% cannot be achieved within five years of the introduction of a universal pension model then mandation should be re-considered. The system also needs to provide adequate pensions to take account of inflation; an overall gross replacement rate to aim for may be 54.1% (the average recorded by the OECD).

22. The auto-enrolment route will necessitate a workplace pension that is attractive to individuals. It will require the following incentives:

- an *affordable* employee contribution
- a *required* employer contribution
- a tax rebate for low earners on top of the existing tax reliefs
- low charges
- limited early access (10% every 10 years)

- a default investment fund that will make *reasonable*[8] returns, protect accumulated funds and be capable of achieving individual retirement aims
- disbursement protection (ensuring optimal income from funds)
- portability – a single retirement account with a growing balance will be more of an incentive to a saver than numerous small pots accumulated from a number of employers
- stability of public policy around pensions and public confidence building campaigns.

23. These incentives indicate the need for consensus on the way forward as co-ordinated co-operation is required from a number of sources.

24. An integrated solution should be a key objective. There must be consistency between what exists in Ireland and what additional elements or improvements are required. DB is broken, as already noted, but that does not mean it should be abandoned. An orderly move towards DC will be necessary for both private and public workforces.

25. A review of any new system should be conducted every three years by an independent advisory panel of domestic and international experts.

26. Ireland already enjoys a well-developed DC infrastructure and it does not make economic sense for the Government to go to the expense of building a new pension architecture. Insurance Ireland is aware of the need for low charges and competition is likely to be the best route to drive down fees. It should be open to all potential providers (whether insurance based or not) to enter the market.

27. Insurance Ireland's workshop on 11 February 2014 highlighted the importance of the following:

    - active fund selection of a simplified fund choice should be encouraged to engender ownership by individuals;
    - default design must be fit-for-purpose for those who do not make investment choices (great emphasis has been placed on this in the Australian *Super* system);
    - an informed debate is needed around charges – charging levels will need to reflect the realities of existing books of business;
    - any new system must tackle accumulation *and* decumulation: failure to include annuitisation in pension reforms is seen as a mistake in New Zealand, Australia and the US. (The UK is removing rules around annuitisation to allow individuals greater freedom about disbursement choices but it will remain a sensible choice for many retirees);
    - detailed consumer, economic and fiscal modelling is required before pension reforms are introduced – understanding how people make decisions about their finances and savings will be important;
    - complicated regulatory structures should be avoided and simplicity *of the whole pensions system* should be pursued;

[8] It should be possible to define 'reasonable'

- start small and phase in mandation or auto-enrolment: people must be given time to adjust to any new system.

Key Questions

Q1 Are the arguments against mandation sound?

Q2 Should *all* employers be compelled to make a contribution to workplace pensions?

Q3 Should all employees be auto-enrolled or should auto-enrolment only apply to *new* entrants to the workforce from one legislated date?

Q4 What are the priority reforms and in what timeline?

Existing Infrastructure

1. Average weekly earnings are €695.78 (Q2 2013)[9] but a significant proportion of Ireland's workforce are 'low-wage earners' whose hourly pay is less than two-thirds of the median national hourly wage. Eurostat gives the proportion as 20.7% (see Appendix A). According to the Nevin Economic Research Institute (NERI) Quarterly Economic Observer[10] 56% of households have a gross income of less than €50,000 and 50% of individuals have less than €18,000.

2. Small firms account for more than 60% of the Irish workforce. The CSO's report *Small Business in Ireland* (2007)[11] shows that in 2004 82% of **industrial** enterprises were small firms[12] and generated just under a quarter of the total industrial employment. In the **services** sector 98% (83,000) of enterprises were small and employing 400,000 people and the vast majority employed fewer than 10 people. The **construction** industry employed 227,400 people in 2004 but only 38,000 worked in larger companies and more than half of those employed were self-employed or in firms with fewer than 10 people.

3. OECD estimates[13] show that 41.3% of individuals aged 20-69 working in the private sector are covered by a voluntary private pension plan and 31% of these are covered by occupational schemes. The OECD estimates that 42.7% of members of occupational plans are in DB schemes but the number of active members is declining. It calculates that 43.4% of those in occupational plans are in DC schemes but the number registered with the Pension Board between December 2010 and April 2012 decreased to 65,770 (a loss of 9,413) and the number of active members also decreased. Average contribution rates to DC plans are between 5% and 10% of earnings with employers contributing about half each.[14]

4. Personal Retirement Savings Accounts (PRSAs) have grown to 198,038 since introduction in 2002 (an increase of 10,924 in 2011 alone according to The Pensions Board). There are two types – standard and non-standard – and charges for the standard version are capped at 5% of contributions and 1% of assets. Employers must offer access to at least one PRSA to any employee not eligible to join an occupational scheme and for additional voluntary contributions (AVCs) if these are not available in the occupational scheme. Contributions are made via the employer's payroll. Employers can chose to contribute Retirement Annuity Contracts (RAC) for employees who do not belong to an occupational scheme. There are approximately 200,000 RACs in play.

See also Appendix A

[9] CSO http://www.cso.ie/en/media/csoie/releasespublications/documents/earnings/2013/earnlabcosts_q22013.pdf

[10] http://www.nerinstitute.net/research/quarterly-economic-observer-january-2013/

[11] http://www.cso.ie/en/media/csoie/releasespublications/documents/otherreleases/smallbusiness.pdf

[12] Defined as employing fewer than 50 people

[13] Study by Antolin, Payet and Yermo (2012)

[14] OECD Review of the Irish Pension System, 2013

Policy Options

1. The options for expanding DC workplace pension coverage are:

   - mandatory contributions into workplace DC schemes from
     - employee only
     - employer only
     - both

   - auto-enrolment (with voluntary opt-out) with contributions from
     - employee only
     - employer only
     - both

   - hybrid – auto-enrolment leading to future mandation

   - voluntary saving with added incentives

   - making existing DC workplace schemes 'universal'

   - introducing a new DC Basic/*MySaver* scheme for workers who are not currently members of a workplace scheme or do not have access to one

2. **The primary aim of policymakers – and stakeholders – should be to increase private pension coverage and retirement income adequacy in Ireland in the most affordable way. The priority should be to establish a universal pension system designed for Ireland but which features some of the most successful aspects of models used in other countries.**

3. At the same time, the opportunity should be taken to make the legislative framework for DC plans (whether in the public and private sectors) as simple and consistent as possible to assist workers who move between employers. At present there is a great deal of unnecessary complexity around different types of pension schemes and this is often cited by individuals as the main reason for not engaging with pensions.

Mandation

> *"Compulsion, according to international experience, is the less costly and most effective approach to increase coverage of private pensions."* (*OECD Pensions Outlook,* 2012, Chapter 4)

4. The OECD believes mandation should be the preferred policy option and that this is likely to be the most manageable and most cost effective solution in terms of pension administration. The Australian experience has shown that compulsory pensions can be readily accepted by workers

and highly successful in improving retirement income adequacy. Nevertheless, it may be a challenge initially to convince workers that it is not an additional tax on income (even though the money is retained as savings) and that it is not a precursor to diminution of the basic state pension. Anything other than a very gradual flight path into mandation would present difficulties for those on low incomes and for small employers. An additional test for legislators and regulators will be to ensure that the saver's interest is primary in the market as workers are compelled to save and invest with third parties (unless the state wishes to provide the DC product in some form). If this route were taken some guarantees would be needed to constrain Government interference in setting future contribution levels.

Auto-Enrolment (with opt-out)

"Auto-enrolment requires monitoring, accurate record-keeping, fiscal incentives and careful design. Implementing a centralised institution to manage the system and provide default investment options would add to the costs" (OECD, Review of the Irish Pension System, 2013)

5. International studies indicate that auto-enrolment is a proven option for increasing pension coverage. The challenge would be to minimise opt-out and maintain regular saving -New Zealand's KiwiSaver has experienced a high opt-out rate and a large percentage of employees failing to make regular contributions. As we know, any element of choice runs the risk of individuals failing to make good economic decisions.

6. We believe that an auto-enrolled system can be designed to increase coverage and adequacy but it will need incentives such as:

    - an *affordable* employee contribution;
    - a *required* employer contribution;
    - a tax rebate for low earners on top of the existing tax reliefs;
    - low charges (as per the recent DSP report on pension charges);
    - limited early access (10% every 10 years);
    - a default investment fund that will make *reasonable*[15] returns, protect accumulated funds and be capable of achieving individual retirement aims;
    - disbursement protection (ensuring optimal income from funds);
    - portability – a single retirement account with a growing balance will be more of an incentive to a saver than numerous small pots accumulated from a number of employers;
    - stability of public policy around pensions and public confidence building campaigns.

7. In addition those who opt-out should be re-enrolled after two years (at the start of the fiscal year) and employers or trustees (if applicable) should be required to communicate the impact of opting-out and failing to make regular contributions (in terms of 'loss' and income adequacy etc).

[15] It should be possible to define 'reasonable'

8. Auto-enrolment would address one issue that would require resolution if mandation were chosen: the position of employees who already have PRSAs and RACs. Are they likely to continue with these if compelled to save in a workplace DC plan?

9. We believe that ambitious targets should be set for auto-enrolment and that it could be considered a success if it eventually achieves 90% coverage of the eligible workforce *contributing regularly to plans.*

Hybrid – mandation via auto-enrolment

10. Auto-enrolment could be used as a route to future mandation – when the economy is on a better footing for instance – and if 70% coverage of the eligible workforce cannot be achieved by auto-enrolment by 2020 then mandation should be re-considered anyway.

Existing DC private sector schemes

11. Is it feasible to make existing DC workplace schemes 'universal' and available to all workers? Probably not; smaller employers would find it financially too hard to fund contributions for 100% of the workforce at existing contribution levels and could decide to balance the books by cutting those levels – and benefits – for existing members. Employers who sponsor DC schemes are making the right choice for their employees and this position should not be undermined by mandation or auto-enrolment; good schemes should be supported and encouraged. For this reason any system for increasing coverage should enable existing DC schemes to thrive as long as:
    - employer and employee contributions meet minimum levels;
    - governance reaches a required standard;
    - a default investment fund is offered;
    - any legislated criteria for a universal DC offering are met.

12. Guiding principles should be that:
    - the financial status of existing DC workplace members is not compromised by changes; and
    - employers who choose to sponsor pensions above the required level set by legislators should be able to describe their schemes as 'DC Plus' to differentiate them from basic-level schemes.

DC Basic/*MySaver*

13. This would be a new scheme for workers who are not currently members of a workplace scheme or do not have access to one. It can be described as the entry level to serious retirement saving – a base level – to supplement the Basic State Pension and, potentially, savings in PRSAs and RACs.

14. *MySaver* would require very little decision making from members other than:

- whether to stay in the scheme;
- whether to voluntarily save more than the required minimum contribution;
- whether to voluntarily choose investment funds (from a limited risk-based set of options);
- choosing an annuity product.

15. The features of *MySaver* could be:

    - low cost (AMC of below 1%);
    - a default investment fund providing 'reasonable' annual returns;
    - a choice of funds based on 3 risk levels;
    - fund protection plus an element of life insurance;
    - spouse contributions;
    - limited early access for evidenced hardship;
    - commutation of small pots (less than €10,000);
    - standardised and regular communication (moving to entirely online communication within 5 years);
    - a recognised quality mark;
    - a single reference number for each member;
    - the ability to transfer in existing pension pots;
    - a realistic cap on voluntary saving into the scheme.

16. Industry funds should be encouraged, particularly for *MySaver*, to provide scale and efficiencies. These funds could be in a position to invest in Ireland's future infrastructure development and growth and this could become an important selling point for Irish workers.

17. The existing industry infrastructure can provide *MySaver* as a contract-based or trust-based offering at a low charging level.

Key questions

Q1 Considering affordability what would be realistic in terms of:
- a default (minimum) employee contribution for those who are auto-enrolled;
- an income floor for those who should be auto-enrolled;
- varying minimum contribution levels for different age or income cohorts;
- the flight path to an adequate contribution?

Q2 Considering affordability what is realistic in terms of:
- a small employer minimum contribution;
- a larger employer minimum contribution;
- the flight path to an adequate contribution for each size of employer?

Q3 Considering affordability what is realistic in terms of tax incentives such as:
- a one-off kick-start tax credit for everyone or just the lowest earners;

- additional (to existing tax relief) tax credit to match small employer contributions?

Q4 Should the self-employed be obliged to join *MySaver* if they are not contributing at least the default level of employee contributions to an individual pension?

Q5 What would be the legislated criteria for universal DC?

Q6 Should target date funds be a feature of *MySaver*?

Q7 Should a target be set for 'reasonable' annual returns or would this affect investment performance?

Q8 Should employers with existing DC schemes be allowed to run these in tandem with *MySaver* or should they be expected to auto-enrol their workforce into the existing scheme?

Replacement rate

18. We think an overall gross replacement rate of 54.1% (OECD average) could be a target rate for universal pension coverage.

Q9 Is this sufficiently ambitious?

Eligibility

19. In the UK every employer must automatically enrol workers into a workplace pension scheme if they are aged between 22 and State Pension age, earn more than £9,440 (€11,212.94) a year and work in the UK. As noted earlier, a significant proportion of Ireland's workforce are low-wage earners and as such may fall outside the affordability test for auto-enrolment but it would seem to be counter-productive to exclude low-wage earners from a pension scheme which includes an employer's contribution and tax relief (if applicable). In Ireland the equivalised disposable income (per individual) was €22,168 in 2010 and the at-risk-of-poverty threshold was €10,831[16]. At-risk-of- poverty rates for those in employment were 6% for men and 5% for women in 2002[17].

20. The age of 22 is a realistic age at which to start pension saving – and will exclude a proportion of low wage earners – and a similar qualifying earnings parameter to that used in the UK, eg minimum €6,732, should be used for auto-enrolment into *MySaver*.

UK Qualifying pay *"Includes all of the following, if an individual is in receipt of them: salary, wages, commission, bonuses, overtime, statutory sick pay, statutory maternity, paternity and adoption pay. Contributions are calculated on any of the above earnings that the member is in receipt of between £5,668 and £41,450 pa."*
The Pensions Regulator

Q10 Should auto-enrolment/mandation be applied to workers aged 22 and above only?

Q11 Should workers of 50+ be excluded from auto-enrolment in the first two years for reason of ability to build pension adequacy?

Q12 Should *MySaver* be available for voluntary contributions from those younger than 22 and older than 50?

Contributions

21. The UK has introduced auto-enrolment with minimum contributions of 0.8% of 'qualifying earnings' for employees (rising to 4% by 2018) and 1% for employers (rising to 3% by 2018) and 0.2% from the Government (rising to 1% by 2018). Similarly, Australia introduced compulsory contributions in 1987 by trading off half of a 6% centralised wage increase – 3% was placed into individual retirement accounts. In New Zealand employee contributions are deducted from pay at a default rate of 3%, 4% or 8% as the individual chooses. Employers contribute 2% of an employee's gross salary or wage into a complying fund. An increase to 3% was planned but not implemented.

22. An employer contribution is a necessary incentive to increase workplace pension adequacy but the rate at which the minimum is set should be sensitive to the economic realities of small businesses. Thought should be given to an initial low contribution rising gradually over a number of years or allowing very small enterprises to make contributions on a voluntary basis only. It would not be sensible to advocate a system which compromises economic recovery or has a negative impact on job creation.

23. In terms of affordability there may be an argument for varying minimum contribution levels according to age cohorts; younger workers have less disposable income and less interest in saving for retirement whilst those in their fifties have, generally, more disposable income and show a great deal more interest in pension saving.

Q13 Should very small employers be excluded from compulsory contributions?

Q14 Should minimum contribution levels be set for different age cohorts?

Tax treatment

24. Tax relief at the marginal rate is an important incentive for retirement saving – and for achieving adequacy – and it would not be sensible to change that. The question on tax should be whether it is possible to give additional tax relief to low earners or provide a one-off tax rebate to encourage workers to stay in a scheme. The Commission on Taxation report recommended that low-earners get relief at a rate higher than standard rate and a €1 rebate for every €1.60 invested. They also wanted a 'kick start' mechanism for low earners where they received a €1 rebate per €1 invested

for the first five years up to a cap. The Government should consider this as part of its auto-enrolment policy alongside allowing employer contributions to attract some relief from payroll taxes.

Orderly exit from Defined Benefit (DB) schemes

25. It is not for the State to rescue failing private sector DB schemes but there is an argument for the protection of the rights and monies of workers via a compensation scheme funded by a levy on DB pension funds. The levy on all funds, DB and DC, is not fair given that DB savers tend to be in a far better financial position at retirement than their DC counterparts. Similarly, it would not be fair to fund a compensation scheme for public sector DB schemes from private sector funds. Public confidence in pensions matters and inequity in compensation treatment is noted.

Public Sector DB

26. Much public comment has been made on the unsustainability of existing public sector pension arrangements. Excluding new entrants from existing DB schemes will not entirely fix the growing liability impacting on public resources. The Government should consider closing future accruals for existing members too.

Disbursement

Consideration should be given to improving confidence in annuitisation by designing annuities to provide more in the early years of retirement or requiring an annuity to be bought at age 85, as suggested by the OECD.

Q15 Should there be a legislated requirement to buy annuities unless adequate retirement can be met for 20 years via drawdown (capped extraction)?

Implementation

Timeline

1. Australia and New Zealand moved quickly to implement reforms when policy decisions had been taken. Over a two-year period in Australia parliamentary hearings, industry and employer consultations and public education campaigns allowed reforms to be 'bedded down' without any excessive deterioration in public confidence. The experience demonstrated that defining the timeline firmly and having political and regulatory leadership supporting its preservation was important to maintain employer and industry change requirements. Similarly, New Zealand's timeline for pension reform was around two years from initial parliamentary debates and budgetary discussions on KiwiSaver (2005 to its introduction in 2007). During this period major structural changes placed demands on the associated timelines. These included:

   - Inland Revenue New Zealand's need to make necessary IT system changes in order to collect and pass on KiwiSaver contributions to industry providers;

   - employers modifying existing payroll and accounting systems;

   - increasing employees' understanding of what they would be contributing to their future retirement provision.

2. Critical to the success of the timeline were cross-departmental co-operation and regular industry consultations which enabled pooling and resolution of any problems or obstacles.

Figure 1: Australia and New Zealand: Major Retirement Policy Developments

	1975	1985	1992	1997	2001	2002	2003	2005	2007	2008	2009	2010	2011	2012
Australia		3% employer super contribution via ACTU national wage case	Superannuation Guarantee (SG) starts at 3% gradually rising to 9% by 2002			SG reaches 9%	Govt. co-contribution for low earners	Employees allowed to choose their fund. Transition to retirement introduced	Super withdrawals tax-free for over 60s. Concessional contribution limits. Employer contributions permitted up to age 75 (from 70)		Cap on concessional contributions halved to $25k for under 50s and $50k for over 50s from 2012/3	New Govt. co-contribution for low earners to apply from 2012 up to $500pa	Stronger Super reforms- *MySuper*: a low cost default product	SG levy to rise from 9% to 12% over 7 years from July 2013. Cap on concessional contributions for over 50s reduced from $50k to $25k from 2013/4
							Reduction in 2003 and abolition in 2005 of 15% tax surcharge on contributions of high earners							
New Zealand	NZ Super Scheme launched			Referendum on compulsory super scheme defeated	NZ Super Fund to partly pre-fund NZ Super				KiwiSaver introduced Contribution rates of 4% (default) or 8% Employer contribution Of 1% rising to 4% by 2011	New default contribution rate of 2% (options of 4% and 8%) Employer rate set at 2% with no ramp up. Employer tax credit replaced by tax exemption for employer contributions up to 2%. Annual fee subsidy removed.			Default rate to increase to 2% from 2013. Employers' rate increased to 3% from 2013. Tax exempt status of employer contributions removed.	

Source: Guest R, Comparison of the New Zealand and Australian Retirement Income Systems, Griffith University, February 2013, Brisbane Australia, p.10

Name

3. KiwiSaver's name appealed to all major stakeholders. It conveyed a sense of national purpose to the pension reform initiated by Prime Minister Clarke's government. The same can be said of Australia's superannuation system which is now known as 'Super'. We suggest that something similar such as *MySaver* could emphasise the personal nature of the accounts.

Guidance to employers

4. It will be important to ensure that guidance is simplified and co-ordinated with and through stakeholder channels. Compliance is a challenge and it starts with good information easily obtained. We think guidance for SMEs should be the priority given Ireland's employer profile and based on what has worked in other countries. New Zealand, with a similar employer profile put heavy emphasis on education and information materials provided by the regulator, Retirement Commissioner's Office and Inland Revenue NZ. It was assumed that larger employers would have better access to legal and accounting resources but SMEs would have a tendency to gravitate towards free information or advice from employer associations.

5. Some thought should be given to incentives for compliance: Australia, for example, classes employer contributions as a levy that attracts related tax deductions but if payments do not happen or are late this levy crystallises into a charge, whereby the employer receives no tax relief.

Communication to employees

6. Much thought and application has gone into communication and education programmes for workplace pensions in the past ten years and especially where pension reform has taken place. Studies show, however, that most workers have not been persuaded to make decisions about their pensions. The majority remain in default investment funds and at levels of contribution that are unlikely to be adequate for the ambitions they have for retirement. US companies in particular have examined this issue and have come to the conclusion that regular and simple communication can be effective if delivered face to face and if investment decisions are limited to a few funds. We suggest that costs in *MySaver* could be kept low if communications were standardised and delivered at point of need via online portals.

7. The onus around effective communication for employees is that it has to lack bias, be informative and tailored towards individual needs. International experience suggests that Government, regulatory agencies or specific retirement bodies are best placed to devise standards and the industry is best placed to deliver information and guidance.

Collection and Tracking

8. Three distinct approaches should be considered for the collection and tracking of contributions from employers and employees:

- The Revenue Commissioners could add further fields to employer taxation returns whereby employer and employee contributions could be collected and directed towards retirement account providers. These payments would be tracked online via secure account log-ons offered to plan members by the Revenue Commissioners. Efficiencies and low costs generally follow this approach – as seen in both New Zealand and Sweden.

- Insurance Ireland could form a not-for-profit company to collect retirement account contributions via the existing administration infrastructure. This model would recycle and re-use existing industry technologies and related collection protocols. Web interfaces would be needed to allow retirement account holders to access their balances and check the receipt of contributions from employers.

- The current collection and tracking system organised by corporate pension providers could be extended and deepened to allow for greater data volumes to be processed.

Administration

9. The increased administrative burden of auto-enrolment may need to be met partly or fully by the Revenue Commissioners or a not-for-profit collection and administrative hub offered by the industry. Economies of scale would help to contain fees and charges without the need for a pricing cap. Advanced data matching and internet technologies would aid in the development of administrative points of excellence. Innovation in administration adopted by Australia, New Zealand and the United Kingdom should be considered to minimise the likelihood of expensive IT builds that do not generate efficiencies.

10. Ireland has a sophisticated DC infrastructure which can be deployed as part of the solution. An example is the ability of the system to permit free movement of individuals between schemes (if allowed) and the transfer of monies as required into individual accounts. The industry is well placed to build trust and long-term relationships with DC members and is committed to high standards of transparency, disclosure and to providing members with information that enables good decision making about funds.

Regulation

11. Regulation should be principles-based rather than prescriptive and should be developed in consultation with industry to ensure that compliance can work and is cost effective.

12. Development of an enforceable code of practice for industry behaviour regarding administration, complaints resolutions and charge levels (fair and reasonable) should be also be considered.

Appendix A – Existing Infrastructure

Population estimate 4.59m in April 2013

Population structure (2012)

Age	% of pop	male	female
0-14	21.3	512,854	491,801
15-24	12.2	290,532	283,344
25-54	44.7	1,060.471	1,048,695
55-64	10	238,339	236,110
65 and over	11	255,858	304,024

Source: CIA World FactBook http://www.indexmundi.com/ireland/#Demographics

Employment profile (000s)

Total in employment	1,869.9
Women at work	829
Total unemployed	300.7
Total Labour Force	2,170.7
Not in Labour force	1,415.6
Retired	404
Agriculture, Forestry & Fishing	103.4
Industry	238.4
Construction	102.7
Wholesale & Retail Trade including repair of motor vehicles	271.5
Transportation & storage	86
Accommodation & food service activities	129.6
Information & Communication	80.4
Financial, insurance & real estate	98.9
Professional, scientific & technical	108
Administrative & support	58
Public administration & defence + compulsory social security	95.1
Education	150.3
Human health & social work	244.6

Source of figures: CSO

Workforce profile 2013 (000s)

	Low-wage threshold (EUR)	Median gross hourly earnings (EUR)			Proportion of low-wage earners (%)		
	2/3 of the median	Total	Men	Women	Total	Men	Women
EU-27	-	11.9	12.8	11.0	17.0	13.3	21.2
EA-17	-	13.2	14.1	12.3	14.8	11.0	19.2
BE	10.9	16.4	16.8	15.7	6.4	3.3	10.3
BG	1.0	1.5	1.6	1.5	22.0	22.5	21.6
CZ	3.0	4.4	4.8	4.0	18.2	12.9	24.5
DK	16.6	25.0	26.7	23.8	7.7	5.4	9.8
DE	10.2	15.4	16.9	13.8	22.2	17.0	28.7
EE	2.7	4.1	4.8	3.6	23.8	15.5	30.1
IE	12.2	18.3	19.3	17.3	20.7	17.6	23.6
ES	6.3	9.4	10.3	8.4	14.7	9.2	21.0
FR	9.2	13.7	14.5	13.0	6.1	4.5	7.9
IT	7.9	11.9	12.1	11.5	12.4	10.3	15.1
CY	6.2	9.4	10.6	8.0	22.7	14.9	31.4
LV	1.9	2.9	3.1	2.7	27.8	26.7	28.7
LT	1.8	2.7	2.8	2.6	27.2	24.5	29.4
LU	11.9	17.8	17.8	18.0	13.1	9.3	20.2
HU	2.3	3.4	3.6	3.3	19.8	18.1	21.5
MT	5.0	7.5	7.6	7.4	18.3	15.6	22.4
NL	10.2	15.3	16.4	14.3	18.1	15.3	21.2
AT	8.6	13.0	14.2	11.1	15.0	8.2	24.8
PL	2.6	4.0	4.1	3.8	24.2	21.8	26.8
PT	3.4	5.1	5.5	4.6	16.1	10.2	22.1
RO	1.3	2.0	2.0	1.9	25.6	25.5	25.8
SI	4.8	7.2	7.1	7.3	17.1	15.3	19.3
SK	2.6	3.9	4.2	3.6	19.0	14.6	23.7
FI	10.6	16.0	18.0	14.6	5.9	3.3	8.0
SE	9.9	14.9	15.8	14.1	2.5	1.9	3.1
UK	8.4	12.6	14.1	11.2	22.1	16.7	27.6
IS	6.7	10.0	10.7	9.5	9.1	5.7	12.0
NO	16.6	25.0	26.3	23.8	7.3	6.0	8.6
CH	14.9	22.4	24.0	20.4	11.0	6.1	16.9
HR	3.2	4.8	4.8	4.7	18.2	15.7	20.7
MK	1.7	2.5	2.5	2.5	28.3	26.4	30.3
TR	1.4	2.1	2.1	2.1	0.2	0.2	0.2

Note: Data refer to enterprises with 10 employees or more and to NACE Rev.2 sections B to S excluding O

(-) not applicable

Source: Eurostat, SES (earn_ses_pub1) (earn_ses_pub2)

Household Income

Households	Gross income
33%	Less than €30,000
56%	Less than €50,000
62%	Below the average (mean) household income of €56,500
Top 30%	More than €70,000
Top 20%	More than €80,000
14%	Above €100,000 per annum
2%	Above €200,000 per annum
The average household disposable income	Just under €46,000
Individuals	
Almost 300,000 aged 17 and upwards (9% of adult population)	No income
50%	less than €18,000
40%	Between €10,000 and €30,000 per annum
77%	Below €50,000 per annum

Source: Nevin Economic Research Institute (NERI) Quarterly Economic Observer

Retirement saving profile

Type	Members
DB schemes	197,177 (2012) active
DC occupational schemes	239,150 (2012) active
PRSAs	198,038
RACs	200,000
Total	834,365
Total in employment	1,869,900

A Pensions Plan for Ireland

International Experiences

Prepared for Insurance Ireland

TOR Financial Consulting Ltd

October 2013

Overview

In the past 25 years governments across the world have accepted that a major challenge to their national economic sustainability is the cost of welfare, and more specifically the care of burgeoning aged populations. There has been general agreement that the problem cannot be solved by increasing public spending on first pillar (state-provided) pensions; instead, workers must be persuaded to provide an 'income for life' for themselves. This 'persuasion' has taken a number of forms but has a core of:

- encouraging saving for retirement across the spectrum of workers and improving the 'income for life' prospects of women and low-to-medium earners in particular;
- mandating or auto-enrolling workers into workplace pensions;
- setting a minimum employee contribution level into funds;
- providing tax relief to help build funds and act as an incentive to save;
- compelling employers to make at least minimum contributions;
- increasing the state pension age (to reduce benefit liability and encourage self-responsibility);
- removing barriers to working past traditional retirement age.

Each of the countries reviewed here has undertaken pension reform at different speeds and in different ways – some aspects of the approaches have been highly successful and others less so – but we can draw some conclusions from their experiences:

- mandation and auto-enrolment increase a government's responsibility for safeguarding the financial wellbeing of consumers of privately-sourced pension products (competitive markets will not meet this need);
- realistic contributions have to be made to ensure that funds will provide long-term adequacy;
- employee contributions have to be regular and sustained over the long-term;
- plans must ensure pension adequacy (through a combination of returns and reasonable charges);
- pension administration systems (whether public or private) must be fit for purpose and able to interact with all of the players involved in mass transfer of monies and information;
- relying on individuals to make sensible choices about pensions is not realistic (this is not an argument for defaults but for more proactive assistance to safeguard financial wellbeing in both growth and disbursement phases);
- default fund structures matter – the majority of savers will be in default investment funds and these need to be fit for purpose;
- public policy is needed for pension growth *and* disbursement: there seems little point in promoting fund growth if at the point of retirement annuity products fail to produce income adequacy;
- early access to funds may be necessary in very limited circumstances;
- Governments, in particular, should build trust in retirement saving by their own actions and by regulating the actions of others.

The Pensions Commission (a non-departmental public body) or the Turner Review as it became known, published its second report in 2005 and a final statement in 2006. The Commission suggested a National Pensions Savings Scheme into which people would be automatically enrolled but could opt out. This morphed into the National Employment Savings Trust (Nest) which now provides low cost, workplace pensions for low-medium earners alongside private sector schemes which 'qualify' by meeting legally prescribed criteria. The UK introduced auto-enrolment (AE) in 2012 for larger employers and rolling adoption over 4 years for the rest.

An employer's 'staging date' depends on the size of company. At that date they must:

- assess all workers on their payroll and decide who is eligible;
- enrol eligible workers aged between 22 and the state pension age – contributions are payable on qualifying earnings which include: salary, wages, commission, bonuses, overtime, statutory sick pay, statutory maternity, paternity and adoption pay. The threshold for qualifying earnings would be reviewed annually (for 2013/14 the lower threshold was £9,440 (€11,252);
- re-enrol every 3 years those who opted out and accept 'opt outs' back into scheme once in every 12 months.

The law says a minimum percentage of 'qualifying earnings' must be paid into a workplace pension: 0.8% rising to 4% by 2018 by the employee and 1% rising to 3% by 2018 by the employer. The Government pays 0.2% of earnings rising to 1% by 2018. Workers can pay less than the legal minimum if their employer makes up the shortfall. These contribution levels are regarded as too low to provide a worthwhile retirement income and 1.7m UK employees are still below the minimum threshold for AE (predominately part-time workers). Consultancy Lane Clark Peacock (LCP)[18] has warned that the success of auto-enrolment depends on a significant rise in pension contributions and not the number deciding to contribute. The opt-out rate in 2013 was lower than expected at an average of 10% but only large employers had been compelled to introduce AE at that time.

Rather late in the day the Government considered how charges would impact on pension funds and consulted on whether a charge cap was necessary. The state-sponsored Nest scheme has an annual member charge (AMC) of 0.3% (of the total value of the member's fund each year) and a 1.8% charge deducted from contributions (and tax relief) before they are invested – somewhat higher than a potential 1% cap being debated in the UK.

The UK is one of the few places in Europe where it is mandatory for schemes using AE to provide a default option and an estimated 80% of members end up in default compared with 35% in Sweden and 8% in Netherlands. Default design is a live issue and there are some innovations: the Pearson Group, for example, replaced its default with 3 lifecycle options to improve returns.

[18] LCP's 20th annual 'Accounting for Pensions' report

Workers in the UK pay income tax to the government via PAYE and the government adds money to the pension in the form of tax relief. Employers deduct pension contributions before income tax so that tax is not paid on contributions (but National Insurance is). There has not been a change to tax relief on pensions despite occasional suggestions that those on the top rate of tax (40%) should get relief only at the basic rate (20%) or tax relief in entirety should be removed – no political party has the appetite for this. It remains the case that 25% of a pension pot can be taken as a tax free lump sum and small pots can be taken in full tax free.

The Coalition Government has made further changes to the system by:

- increasing state pension provision in line with national prosperity and restoring the link between the state pension and earnings – the Coalition introduced the Triple Guarantee to uprate the basic state pension by earnings, prices or 2.5% (whichever was higher). In future the state pension will be a flat-rate universal retirement payment of £140 (€167) a week instead of the current basic pension and means tested 'top ups';
- improving women's pensions by cutting the qualifying years to 30 for a state pension, scrapping qualifying conditions and introducing weekly credits (70% will now get the full pension in 2010 and 90% by 2025);
- abolishing the default retirement age to enable people to work longer;
- increasing the state pension age for both genders from 65 to 66 between December 2018 and October 2020 – women's state pension age will rise faster than originally planned from April 2016 and will equalise with men's at 65 by November 2018;
- pegging the state pension age to longevity gains.

The Coalition Government has proposed reforms to the four largest public service pension schemes which will link benefit to a member's average salary, increase member contributions and increase the Normal Pension Age in line with the increased State Pension Age. An analysis of the impact is here http://www.nuffieldfoundation.org/sites/default/files/files/20130517_PPI_Report_Implications_of_Coalition_Government's_reforms_to_public_sector_pensions_FINAL.pdf

Life companies have introduced AE software solutions but there is a view that the industry will be unable to cope with demand for AE solutions for smaller organisations.

We think Nest has had a positive effect on provision in terms of providing a relatively painless way for small-medium sized businesses to introduce auto-enrolment and improving competition in the low-cost market. But the long-term sustainability of Nest has still to be proven. It has to repay a large loan with interest to the government and this has had an impact on its charges. Nest has not penetrated the market to full expectation largely because of the restrictions placed upon it (a cap on annual contributions and ban on incoming transfers) but these are being reviewed.

Despite the consensus about reform there are party-political differences in how the retirement system should develop:

- The OECD and a House of Lords report say DC plans are not fit for purpose http://www.parliament.uk/business/committees/committees-a-z/lords-select/public-services-committee/report-ready-for-ageing/. The Pensions Regulator (TPR) says the 3000 pension schemes in the market for 12 - 1000 members are struggling with poor trustee knowledge and understanding of scheme rules. Its decision to publish a guide advising small employers to avoid trust-based DC schemes has been attacked by the industry.

- The Labour Opposition has suggested it would impose mergers on small pension schemes that have under delivered and argues that pension funds should finance huge housing and infrastructure projects to deliver national benefits.
- Labour wants all qualifying workplace schemes to be overseen by trustees.
- The National Association of Pension Funds (NAPF) is suggesting there should be a mechanism to enable individuals to receive AE contributions into a scheme of their choice (to solve the problem of numerous funds)
- An Office of Fair Trading Report (OFT) market study concluded:
    - employers may fail to get value for money when choosing a pension scheme;
    - around £30bn of savings in old and/or high charging contract and bundled-trust schemes may not be value for money;
    - around £10bn of savings in smaller trust-based schemes are at risk of delivering poor value for money due to low levels of trustee engagement and capability;
    - there is a lack of independent scrutiny of contract based schemes;
    - transparency and comparability of information about charges needs to be improved to scheme choice easier;
    - the Government should consult on preventing schemes being used for auto-enrolment that contain in-built adviser commissions or penalise members with higher charges when they stop contributing.

NEW ZEALAND

A Labour-led Government introduced the idea of auto-enrolment and KiwiSaver. Both major political parties accepted it as a DC scheme with capped public subsidies but discussions continue on whether the system should become mandatory.

The first pillar (the NZS) is a generous, flat-rate pension based on a residency test. The second pillar comprises KiwiSaver (introduced in 2007) and other qualifying workplace schemes all of which use auto-enrolment but without the automatic re-enrolment seen in the UK. Workplace schemes are promoted as voluntary savings and employee contributions are deducted from pay at a default rate of 3%, 4% or 8% as the individual so chooses. Employers contribute 2% of an employee's gross salary or wage into a complying fund. An increase to 3% was planned but not implemented.

Once auto-enrolled a worker can opt out of a scheme via an online a request to their employer or the Inland Revenue. This must occur between the second and eighth week of starting a new job. The IR refunds the employee and employer contributions in this event. From a membership of 1.88m workers the opt-out rate was 34% in 2009 and 28% in 2011 and it has been estimated that nearly half of members fail to make regular contributions. At 31 March 2012, the average balance across all

KiwiSaver accounts was $6,668 (€4,088) and the average balance in a default fund was marginally lower at $6,530 (€4,010).

Employees are given a choice of KiwiSaver provider but if they do not make a decision their employer makes the choice. If neither makes a choice the Inland Revenue facilitates this by using a computerised system that makes a random selection from five default providers. KiwiSaver has more than 30 providers – including banks, insurance companies, investment managers and specialist managers – who have the primary relationship with members. The majority of NZ stakeholders interviewed by TOR Financial Consulting agree that rationalisation of providers will be needed to contain charges and generate efficiencies in the KiwiSaver system.

Total average fees are 1.4% (excluding the cost of the Inland Revenue administration hub). All providers charge for investment, management and administration. The Government negotiates fees for default schemes. If an employer has chosen a scheme or an employee has applied to a provider directly, the fees will be set by the scheme although the KiwiSaver Act prevents charging of unreasonable fees. 'Reasonability' is determined by the Financial Markets Authority which also monitors fees in general. From July 2013, the *KiwiSaver Periodic Reporting Regulations* requires fund managers to report their performance and returns, fees and costs, assets and portfolio holdings, liquidity and liabilities, key personnel and any conflicts of interest, in a standardised format on their websites.

The system is administered by the Inland Revenue and collection is monthly with mainly through the PAYE tax system. The IR:

- provides employers with information to pass on to employees;
- receives contributions;
- transfers them to the right scheme;
- allocates people who don't make choice to default schemes;
- administers requests for opt outs and contribution holidays;
- provides information to the public and helps build awareness.

An incentive of $1000 was offered by the NZ government to any worker joining KiwiSaver for the first time plus an annual member tax credit of up to $521.43. Taxation relief for employer contributions was abandoned on the basis of fiscal austerity by the Keys Government and this reduced the contributions being paid into funds. Contributions are calculated on before-tax pay but tax is paid on the full amount earned. Investment earnings are taxed and this is deducted by the provider who then pays it to the IR.

Access to a retirement fund is restricted to age 65 when all savings can be withdrawn as a lump sum. Withdrawals from the KiwiSaver account are tax free. Early access may be allowed for the first home, emigrating, financial hardship or serious illness.

KiwiSaver has grown quickly to become a large retirement programme but it has faced some issues:

- the initial $1000 (€614) 'sweetener' to join KiwiSaver scheme was open to abuse;
- the opt-out rate was persistently high at around 30%;

- at 31 March 2012 there were 1,910,211 in a KiwiSaver scheme but only half were making regular contributions;
- access to retirement funds for housing deposits has subverted the intended outcome of AE;
- the replacement rate was comparatively low compared with Australia or Switzerland;
- charges remained comparatively high, especially around passive funds;
- no one specific government department is responsible for overall retirement policy;
- default funds are relatively conservative and lack international innovations;
- disbursement solutions are either very limited or non-existent;
- levelling down of long established, occupational schemes took place in order to foster the KiwiSaver reforms.

AUSTRALIA

In the 1980s a reforming Labor Government saw the opportunity to introduce a compulsory second pillar system during a booming economy and through a centralised wage fixing system. The Insurance & Superannuation Commission (ISC) was established as an offshoot of the Commonwealth Treasury to drive the policy. In 1987 a 6% wage increase was traded off and 3% was placed into individual retirement accounts.

The government ran a public education campaign – '*Money for Trees*' which highlighted the positives of '*your superannuation*' and how it would provide better retirement outcomes in the future. The second pillar is now called the *Superannuation Guarantee* and it covers 91% of the Australian workforce. Assets under management of $1.4trillion are projected to reach $6.7trillion by 2035.

The default is now known as the 'employer contribution' and it has been steadily rising since introduction.

Actual and proposed employer contribution rates

1992-93	3% and 4% (higher rate for employers whose annual national payroll for the base year exceeds $1m
1993-94	3% and 5% (see above)
1994-95	4% and 5% (see above)
1995-96	5% and 6% (see above)
1996-97	6%
1997-98	6%
1998-99	7%
1999-2000	7%
2000-01	8%
2001-02	8%
2002-13	9%

2013/14	9.25%
2014/15	9.5% (note the increase from 9.5% has now been deferred)
2017-18	10% (deferred until 2021)
2018-19	10.5%
2019-20	11%
2020-21	11.5%
2021-22 and subsequent years	12%

Extra can be contributed via salary sacrifice, spouse contribution or a voluntary contribution (dollar for dollar government matching is capped and means tested). The Government makes a *Super co-contribution* to match a worker's personal contribution up to a maximum amount. It also offers a *low income super contribution* and allows a rebate to be claimed for Super contributions made for a spouse. The self-employed get a tax deduction for Super contributions but contributions above $25000 can incur extra tax. Tax savings are also allowed for people over 55 setting up a transition-to-retirement account and there are tax incentives for voluntary contributions and self-managed superannuation funds. A high level of compliance is achieved because employer contributions are seen as a levy that is tax deductible. If compliance does not occur this levy becomes a charge.

Employers send funds to each provider and advise the Australian Tax Office which administers all the accounts but does not receive funds. The ATO runs the *Super Seeker* site which tracks down lost accounts and picks up enquiries if an employer fails to pay. The Small Business Superannuation Clearing House is a free online super payments service that helps business with fewer than 19 employees meet their Super Guarantee obligations.

There are minimum and maximum withdrawals from the fund when preservation age is reached, the worker retires or turns 65. Preservation age will increase from 55 to 60 between 2015 and 2025. Those continuing to work can also receive a pension income. Early access is possible for specific medical conditions and severe financial hardship.

The Australian system is generally regarded as highly successful for improving coverage, removing inequities and boosting the economy but there have been weaknesses such as:

- failure to develop disbursement products such as annuities;
- insufficient investment in administration and IT which affected cost and the transfer of contributions to individual accounts - the initial lack of transfer protocols between funds caused chaos but from this year the Australian Tax Office will allow funds to use the universal tax file number system;
- numerous (7.3m in 2011) lost accounts (deemed to be small pots without a contribution for 2 years and returned member statements) because members fail to consolidate pots when they change employer;
- contributions to many thousands of funds (in a workforce of 11m there are just over 30m member accounts);
- high charges - total average fees are 1.25% which has led to major debate and reform.

Major reforms have been implemented since the introduction of compulsion. In 2009 the government commissioned the Cooper Review to provide it with recommendations on how to make superannuation simpler, safer and more efficient. The most recent reforms:

- empower APRA (the regulator) to require a strategic plan from each fund and to publish fund returns as well as detailed fund costs, fees and charges;
- create a new simple, low cost default super product called *MySuper*;
- make processing of everyday transactions easier, cheaper and faster through the *SuperStream* package;
- strengthen governance, integrity and regulatory settings of the Super system including in relation to self-managed super funds.

The MySuper and Superstream initiatives are expected to lower fees by 40 per cent and make it easier to consolidate multiple accounts, compare different funds and pay superannuation for employees. The Cooper Review's final report is here:
http://www.supersystemreview.gov.au/content/content.aspx?doc=html/final_report.htm

The Government announced in April 2013 that it would establish a Council of Superannuation Custodians to ensure future changes to superannuation are consistent with an agreed Charter of Superannuation Adequacy and Sustainability. The Charter will clearly outline the core objects, values and principles of the Australian superannuation system[19].

Mandation led to the creation of new multi-employer industry funds with trustee governance and private sector fund investment and administration. The trend is to embrace master trust structures and the outgoing Labor Government has provided taxation incentives for superannuation funds to merge. The growth in assets has promoted a flourishing financial services industry.

SWITZERLAND

Switzerland's state pension is small and funded by compulsory contributions of 6.15% of total earnings from workers over 20 and from employers. In 1985 the Federal Law on Occupational Retirement, Survivors' and Disability Pension Plans (BVG) introduced minimum requirements for occupational pensions and introduced guaranteed minimum benefits that became mandatory for all employees.

The country has good pension coverage, a high percentage of people working longer than the default retirement age and high pension asset levels which have helped to stimulate the economy. The system also has a degree of self-selection in the third pillar which allows individuals to decide where to invest their money. The OECD has described the Swiss system as the 'triumph of common sense'. It has two main advantages: risks are spread across three pillars and pre-funding creates large pots of investment capital.

[19] Commonwealth Treasury: http://www.treasury.gov.au/PolicyTopics/SuperannuationAndRetirement/supercharter, p.1

Employees whose annual earnings exceed CHF 19,350 (€15,622) with the same employer must join the compulsory system although it is voluntary for the self-employed. The system stipulates that as a minimum an employer must provide a cash-balance plan and a minimum level of benefits. Employer contributions must at least match those of the employee and often plans offer terms in excess of the minimum to attract qualified workers. A sponsoring organisation may choose to establish its own pension fund or join a collective pension fund.

Occupational pensions are calculated on the basis of the contributions accumulated during working life and built around a system of retirement credits. Contributions are determined according to a percentage of pensionable earnings and depend on a person's age:

Age range	25-34	35-44	45-54	55-65 (women 64)
Contributions	7%	10%	15%	18%

The occupational scheme requires minimum pension benefits based on a guaranteed interest rate of 2.75%. Any shortfalls in achieving this guaranteed rate of return must be met from pension fund reserves. Not surprisingly, therefore, pension schemes and trustees adopt highly cautious investment arrangements. Taxation also encourages investment in the domestic market and the system has strict investment limits regarding percentages in foreign assets and individual asset classes.
The Swiss Employers' Federation believes that demographics and low investment returns now make reform of the second pillar inevitable. The Swiss Federal Office of Social Insurance has calculated that the average pension fund had a 2% funding deficit at the end of 2011 and there is said to be a multi-billion shortfall in the civil servants' fund BVK. Nevertheless, in 2010 a nationwide referendum rejected a plan to cut the conversion rate – on which future pension promises are calculated – from 7% to 6.4%.
Criticisms of the Swiss system are for:

- conservative investment strategies - Swiss workers are exposed to risk linked with investments because of regulations which indirectly encourage conservative investments and a bias towards the domestic market;
- poor transparency;
- high fees and charges - there has been public controversy around this issue particularly on asset management costs which are not completely shown in pension funds' operating statements (a survey by the c-alm consultancy found that overall asset management fees varied from 0.15% to 1.86% amongst the 73 pension funds surveyed).

The government has outlined plans for reform and formal proposals will be put before parliament by the end of 2014. It will also have to be put to public vote. The proposals include:

- retirement age for women will match men at 65 and it will be introduced in stages;
- early retirement will not be possible before 62;
- the conversion rate will be lowered to 6% - highly controversial and it is estimated it will cut pensions by 12%.

UNITED STATES

The United States has a PAYG, first pillar social security programme which is being closely evaluated for reform and how it works with second pillar, 401(k) DC plans (the name comes from the Internal Revenue Code). 401(k)s provide the bulk of US pension assets and second pillar coverage. They now hold $2.8 trillion in assets on behalf of more than 50m active participants and millions of former employees and retirees.

The Pension Protection Act 2006 encouraged the development of automatic enrolment and a study by Vanguard found that participation rates in plans that adopted automatic enrolment boosted participation rates for all racial and ethnic groups, with many plans experiencing rates of 90% or more[20]. Further support for automatic enrolment came from the US Treasury Department which "…*noted the potential positive impact of automatic enrolment on 401(k) participation rates. The first Treasury Department opinion on this subject, issued in 1998, sanctioned the use of automatic enrollment for new hired employees*"[21].

The popularity of 401(k) plans remains paramount but challenges still exist over:

- coverage levels;
- the use of 401(k)s for lifestyle needs via loans;
- the level of contribution rates;
- returns;
- charges.

Savings rolled over from 401(k) and other employer plans also account for most of the $4.2 trillion held in individual retirement accounts. This sounds impressive but around 40% of employees do not have access to a 401(k) plan, and many workers with this option choose not to participate or contribute negligible amounts. Smaller employers remain stubbornly indifferent to offering retirement plans. This may be offset by automatic enrolment into Individual Retirement Accounts (IRAs) that are being promoted by leading think tanks in Washington DC.

Loans from 401(k) plans have aided stickability and early access helps to support university expenses. Forbes Magazine recently made the following observations about charges: "*Looking at the total plan expenses, including administrative and record-keeping fees, the 401(k) Averages Book found that the average total expense for a small plan in 2012 was 1.46%, with a range between a low of 0.38% and a high of 1.97%. Investment fees continued their downward trend. Small plan average investment expenses declined from 1.38% in 2011 to 1.37% in 2012, and large plan average investment expenses declined from 1.05% to 1.00%.' In summary, 401(k) solutions could not be considered a cheap proposition, based on the weightings of charges linked with administration and investment*"[22].

[20] http://www.retirementmadesimpler.org/Automatic 401(k) Basics - What you Need to Know, p.1.

[21] Choi JJ, Laibson D, Madrian BC and Metrick M. (2004). *For Better or for Worse: Default Effects and 401(k) Savings Behavior*, Perspectives on the Economics of Aging, National Bureau of Economic Research, Boston, United States, p.82.

[22] http://www.forbes.com/sites/ashleaebeling/2013/03/11/401k-fees-still-widely-misunderstood, 11 March 2013

Since 2008, the investment features found in second pillar plans have very much focused on the default design. Heavy losses by plan members encountered over the past two recessions have seen many revert to target dates funds. These funds automate asset allocations for an employee over their lifetime and as they approach retirement and are now estimated to have $3.2 trillion in assets. They are popular because they can be easily explained to employees.

Some broad observations regarding the United States second pillar structures are worth noting:

- regulatory and compliance trade-offs have been used to maximise contributions and proposition design;
- opt-out rates are significant;
- target-date funds dominate the design of default funds;
- advanced financial education and intuitive front-end portals are allowing better connectivity with members;
- leading 401(k) providers such as T. Rowe Price and The Principal Financial Group indicate reluctance to engage with providing record keeping services if the 401(k) solution was designed from 'the ground up again' – litigation risk and the need for bespoke IT interfaces have seen many plan vendors embracing a concept of having a possible clearing house for employer and employee contributions run by industry;
- doubts exist about automatic enrolment: *"While automatic enrolment has, by all accounts, increased 401(k) participation, this 'success' has come at some cost. The employer must choose a default contribution rate and a default fund in which to invest employee contributions. Madrian and Shea (2001) show that, at least in the short term, only a small fraction of automatically enrolled 401(k) participants elect a contribution rate or asset allocation that differs from the company-specified default. Therefore, low default savings rates and conservative default funds may lower employee wealth accumulation in the long run. A recent Profit Sharing/401(k) Council of America (2001) survey reports that 76 percent of automatic enrollment companies have either a 2 percent or 3 percent default savings rate and that 66 percent of automatic enrollment companies have a stable value or money market default fund"*[23].

CHILE

Chile has a basic solidarity pension (PBS) payable from age 65 but Chilean workers are also required to have mandatory individual retirement accounts with an AFP (pension fund manager) of their choice. Workers must contribute 10% of their monthly earnings into the accounts up to a set maximum (indexed to average earnings). Employers are not required to contribute. AFPs collect the contributions and invest them according to regulations set by the government.

At the normal retirement age – 65 for men and 60 for women – workers can use their pension pots to buy an immediate annuity, set up a programme of withdrawals, buy a deferred annuity or buy an immediate annuity and make withdrawals. Early retirement is allowed and excess funds can be

[23] Choi JJ, Laibson D, Madrian BC and Metrick M. (2004). *For Better or for Worse: Default Effects and 401(k) Savings Behavior*, Perspectives on the Economics of Aging, National Bureau of Economic Research, Boston, United States

withdrawn from an account for any reason if the remaining balance will be worth 80% of the maximum welfare pension and on condition that a certain replacement rate is reached, relative to earnings, in the 10 years before drawing a pension.

When the retirement account system was introduced investments had to be in low-risk instruments and investment in foreign securities was banned. This rule has gradually been relaxed to allow AFPs to diversify their portfolios and reduce reliance on domestic instruments. At the same time pension fund choices have increased. Now each AFP is required to offer four funds (called B, C, D, and E) with different degrees of risk. They can also offer a Fund 'A' with up to 80% of assets in equities. Account holders allocate their contributions between two different funds in the proportion they choose. In 2011 the Type C fund held around 41% of all AFP funds. Every fund managed by an AFP must make a minimum and a maximum rate of return, calculated according to the average performance of each fund category among all AFPs over a 3-year period. If any fund underperforms it must make up the difference from its reserve fund. In 2011, as reported by the regulator SAFP, the three riskiest of the five types of funds saw negative returns.

AFPs have been able to charge two administrative fees every time a worker makes a contribution to their account: a percentage of earnings and a fixed fee. These charges have been high by international standards and, because they are based on contributions, have cross-subsidised those not making any or irregular contributions. Most fixed fees are no longer levied.

Although lauded as a success in terms of boosting retirement saving the Chilean system developed two significant problems: insufficient contribution levels and poor benefit levels. The changing nature of work towards fixed contracts and temporary jobs meant that despite mandation a large proportion of the workforce was failing to make contributions or doing so irregularly. The large self-employed workforce was not required to have retirement accounts.

Reforms in 2008 were intended to increase adequacy and protect the poorest families. The Government introduced a supplement for those whose DC pension failed to meet the maximum welfare pension threshold and obliged the self-employed to hold retirement accounts. Investment rules were liberalised and gender equality was improved. The Government now provides vouchers for women reaching 65 which are equivalent to 10% of 18 month' minimum wages (at the time of birth) for each child plus the average net rate of return on pension plans. Commentators suggest that the supplement has helped poorer households but at the expense of Government intervention and cost to the Chilean economy.

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