Three Necessary Actions Prior to Launch of Ireland's Auto-Enrolment Retirement Saving Plan

12th May 2023
Shane Whelan & Maeve Hally,
UCD School of Mathematics & Statistics
Contact: shane.whelan@ucd.ie

Abstract

The proposed Automatic Enrolment Retirement Saving (AE) Plan will fail to make a significant impact on pensions in Ireland unless three actions precede its introduction. First, we show that the existing tax reliefs for other pension arrangements are considerably more valuable than the 33% subsidy to contributions to the AE Plan for higher rate taxpayers. To create a level playing field for the new AE Plan, we recommend qualifying contribution levels be equalised and that tax relief on contributions to other pension arrangements be abolished, replaced with the common 33% subsidy. Second, a key selling point of the AE Plan is its low charges, considerably lower than individual private plans. However, low charges are not a particularly strong force shaping the pension landscape, even though such efficiencies accumulate to deliver materially higher pensions over the long term of pension savings. We recommend that selling practices of pensions are better aligned to the interests of the pension saver. This can be achieved by banning commission on pension products and by requiring illustrations of the size of the pension fund at retirement to be explicitly compared with that expected from the AE Plan. Third, the new AE Plan has the potential to solve the legacy issues that the run-off of defined benefit schemes poses to the State and to sponsoring employers. We propose that the AE Plan be open to transfers from such schemes, to help manage the contingent liability of the State and to help build a partnership in pensions with employers. Indeed, the AE Plan should be open to transfers from any existing pension arrangement, if it is in the best interest of the individual.

While these three reforms will assist in preventing the failure of the AE Plan, alone they may not be sufficient to ensure its success. The introduction of the AE Plan is obviously good for pension savers but it also has the potential for disruptive change in the pension industry, which to date has been successful in resisting reform.

JEL CODES: D18, H23, I38, J32, J78
Keywords: pension system, tax relief, fiscal welfare, regulation, Ireland

Introduction

The Government plans to reform the pension system in Ireland. It set out its intention with the publication entitled "The Roadmap for Pensions Reform 2018-2023" (Department of Social Protection (2019)) and followed that up in March 2022 with details of a plan for the introduction of an auto enrolment savings plan in Ireland (Department of Social Protection (2022a)). This proposal envisages an auto-enrolment plan (AE Plan) with the enrolment of approximately 750,000 workers into the scheme. It was originally planned to be ready to take on its first enrolments in

early 2024, but this may prove a challenging deadline as the tender process for the procurement of pension administration services was only initiated by the Department in March 2023.

The AE Plan for Ireland has no doubt been influenced by the similar National Employment Savings Trust (NEST), introduced more than a decade ago in the UK. The latest annual report of NEST notes that about one-in-three workers in the UK have a saving account (11.1 million in total but the majority dormant), with Stg£477 million contribution inflow each month and Stg£24.4 billion in accumulated assets (NEST (2022)). This works out at just under Stg£2,200 per worker after a decade of saving, with a monthly increase of Stg£43. Therefore, the average NEST account might fund a pleasant holiday after retirement but must be regarded as failing to make a significant impact on pension provision in the UK.

The proposed AE Plan in Ireland will compete in an already crowded marketplace for pension schemes and products where, as the original briefing acknowledges, "Ireland is home to about 50% of all pension schemes in the EU" (p. 14 of Department of Social Protection (2019)). At the most recent count, there are 671 defined benefit schemes in Ireland and 85,964 defined contribution schemes with active members (Pension Authority (2022b)). There also are many individual pension savings products available such as Personal Retirement Savings Accounts (PRSAs), Executive Pension Plans, Retirement Annuity Contracts (RACs), and Buy-Out Bonds (BOBs).

One of the key selling points of the proposed AE Plan is its very low charges. However, that selling point alone is unlikely to effect much consolidation in the industry as it is clear that efficiencies from economies of scale are not a particularly strong force shaping the pension landscape in Ireland. A casual appraisal of the Government's proposed AE Plan would suggest that, similar to the NEST equivalent in the UK, it may achieve a much greater level of pension coverage but deliver a relatively insignificant augmentation to the individual's pension. We contend in this paper that the proposed AE Plan has the potential to reform the complex and inefficient private pension sector in Ireland dramatically but, to achieve its potential, the Government must first create a level playing field for it. We identify three actions that must be taken before the launch of the AE Plan and argue each is necessary to prevent its failure.

The first action point is to make the incentives to save for a pension more equal between the AE Plan and existing pension arrangements. We show in section 1 of the paper that current State supports through tax reliefs materially favours those on the higher rate tax band to save through existing pension arrangements and not the AE Plan. We consider two ways that the incentives can be more aligned, including a discussion of the knock-on impact on public sector schemes. We recommend the abolition of tax relief on contributions be replaced with the 33% State subsidy adopted for the AE Plan on all private pension arrangements with immediate effect.

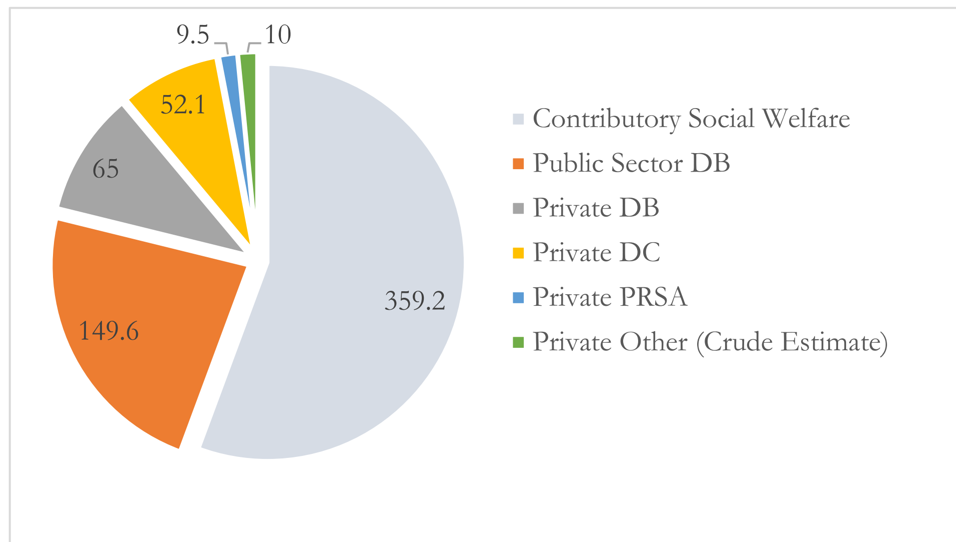
The AE Plan is designed to have transparent and low charges. The combined impact of the significantly lower charges of the AE Plan, compounding over the long term of pension saving, ensures that the projected pension is always greater under the AE Plan and, as we show in section 2, materially so. We compare projected pension sizes when pension saving is through the AE plan to projected pension sizes from existing pension arrangements on individual and group schemes with up to 50 members and report that the former can be more than double the latter in some cases. This is clearly an important consideration for the pension saver in making an informed choice. We recommend that that selling practices of private pensions be reformed, requiring disclosure at the point of sale of private pensions, or any alteration to an existing pension policy, of the projected fund size at retirement compared to that under the AE Plan. We also suggest that commission on pension products be banned, replaced by an explicit fee as it has been in the UK for many years.

The third section highlights the insecurity of pension promises to current active and deferred members of defined benefit plans and shows how this insecurity increases with time as such schemes mature. The State has a contingent liability to redress a shortfall in such pension entitlements due to the inadequate regulation of such schemes, as determined by the precedent set in the Waterford Crystal case. The State's contingent liability can be mitigated, if not extinguished, by allowing transfers from such schemes into the AE Plan. We recommend that the AE Plan should be open to accept transfer of the value of pension entitlements from funded defined benefit plans. Indeed, the AE Plan takes advantage of its economies of scale to offer a product that is more efficient than the vast majority of private pension saving vehicles in Ireland. Therefore it should be open to any pension saver, whether they have an existing pension or are a member of an existing scheme. These pension savers should be able to transfer funds from existing pension arrangements to the AE Plan if they believe it is in their best interests.

These three action points will ensure that the AE Plan enters the pension scene in Ireland without unnecessary handicaps. The AE Plan has the potential for disruptive change in the industry, so it can be expected to counter considerable resistance. We briefly discuss the influence the pension industry has exercised to prevent pension reform in Ireland so, unlike all other countries in the OECD, Ireland's system is structurally the same as it was over a hundred years ago. Two incidences are used illustrate the power of vested interests. The three actions identified here are necessary conditions to prevent the failure of the AE Plan but may not be sufficient conditions to ensure its success.

In the sequel, it will be helpful to bear in mind the current structure of pension provision in Ireland. Statistics on pensions in Ireland are not collected by a central source, so it is difficult to get an overview of the relative significance of each component of the pension system. Figure 1 sets out the relative size of each segment using either the size of the assets or the magnitude of the liability using the most recent figures available. The key point is that the State has by far the largest commitments to future pensions, representing about 79% of the total, with the State contributory pension system representing roughly 56% of commitments and another 23% from liabilities to public sector pensions. The private pension market represents less than one-quarter of the total, made of Defined Benefit (10%), defined contribution (8%) and other (3%). Of course, the State also financially supports all private and occupational pension savings through tax reliefs (see section 1).

Figure 1: Approximate Size (€ billion) of the Different Components in Ireland's Pension System (by Current Assets or Liabilities)



Sources:
For Contributory Social Welfare figure see Department of Social Protection (2020). This is the value of the State's Accrued-to-Date Liability in respect of current and former contributors to the Social Insurance Fund, and current pensioners, was estimated as €359.2 billion as at 31st December 2018.
For Public Sector DB figure see Department of Public Expenditure and Reform (2020) The value of the State's Accrued to date liabilities in respect of public service occupational pension schemes was estimated to be €149.6bn at the end 2018.
For Private DB assets, see Pensions Authority (2022a) Defined benefit schemes - Review of 2021 statistics.
For PRSAs, see Pensions Authority, The (2022b).
For Private DC, see Central Bank of Ireland (2022).
For Private Other, this is a crude estimate. There is is no register of their number or amount in personal pension arrangements outside of PRSAs (see Department of Social Protection (2012), p. 25) so this is a crude estimate.

Section 1: Incentivisation for Private Sector Pensions compared with new AE Proposal

Pension arrangements require savings to be locked away until retirement, or earlier invalidity, or death and then there are further rules governing the manner of drawdown. A saver would not opt for such restrictive access to their funds unless adequately compensated through incentives. Private pension provision in Ireland is incentivised using the Exempt, Exempt, Taxed (EET) model. Individuals receive tax relief at their marginal rate on their private pension contributions subject to certain limits, including a €115,000 limit on qualifying earnings. Investment income and gains are accrued tax free on pension savings and then, after an allowable portion of the individual's retirement income is received tax free, the balance is subject to taxation as earned income at the individual's marginal rate. However, the proposed new AE Plan comes with a different incentive: for every €1 saved in the AE Plan (after taxes and other deductions) the State will add 33c. So, effectively, the tax relief on contributions available for existing pension arrangements does not apply to the AE Plan but is replaced by an explicit top-up on net contributions. Details on the AE Plan is scant, so we assume it will benefit from gross roll-up of funds (i.e., no tax on investment income or gains) and drawdown options such as tax-free lump sums will be the same as existing pension arrangements.

It is necessary to compare the value of incentives under the AE Plan to existing pension arrangements to make an appraisal of the relative merits of each. However, it is non-trivial to estimate the value of the tax relief on private pension savings as it requires comparing the present value of outcomes under the TTE system applied to ordinary savings to the EET system applied to pension savings. This requires modelling the pattern of saving, investment return achieved, length of saving period, length of drawdown period, and contingent benefits for dependents as well as an individual's taxation position over their lifetime, which, in turn, depends on many factors such as the individual's level of income, marital status and income of spouse. It also requires economic and investment assumptions, such a future rate of salary increase, future rates and thresholds of taxation, and rate of return achieved before and after retirement.

Whelan & Hally (2018) provides such an analysis of the tax incentives for private pension saving, including a sensitive analysis to all the key assumptions. Their analysis estimates the 'net effective tax relief', which is the subsidy granted by the State on each €1 invested in a private pension, as compared to other savings. So net effective tax relief of 50% means that State contributes via tax reliefs 50c of every €1 invested or, equivalently, for every €1 invested after tax and other deduction the State contributed another €1. Table 1 sets out the results of the modelling exercise in Whelan & Hally (2018). It highlights that the value of the net effective relief an individual receives on their pension savings is crucially dependent on their level of income.

Table 1: Net Effective Rate of Tax Relief, estimated assuming individual saves 10% of salary over the 25 years prior to retirement, takes 25% of total fund at retirement as a lump sum and drawdowns the remainder evenly over 20 years. Tax on investment income assumed to be either 0% (for income levels below the income tax threshold), 20% or 30%.

Salary p.a. (€)	Married Person, one income household Tax on Investment Income assumed at			Single Person Tax on Investment Income assumed at		
	0%	20%	30%	0%	20%	30%
5,000	**-5%**	-	-	**-1%**	-	-
10,000	**-1%**	-	-	**1%**	-	-
20,000	**-3%**	-	-	-	**25%**	30%

30,000	-	**26%**	30%	-	**26%**	30%
40,000	-	**26%**	31%	-	44%	**49%**
50,000	-	46%	**51%**	-	38%	**42%**
60,000	-	46%	**51%**	-	33%	**38%**
70,000	-	46%	**51%**	-	32%	**37%**
80,000	-	46%	**51%**	-	32%	**36%**

Source: Extract of Table 2 (p. 332) in Whelan & Hally (2018). Figures in bold represent best estimates. The model assumes that future inflation is 1½% per annum and wage growth is 2½% per annum (so wage growth is assumed to be, on average, 1% per annum real). Investment returns before retirement are assumed to average 4½% per annum after investment charges. At retirement and after taking the tax-fee lump sum, the retirement fund is assumed to be invested in less risky investments, providing a net real return of ½% per annum.

Table 1 shows that the current system of pension incentivisation offers low-income workers on less than €20,000 per annum a disincentive to save (as tax relief is of no benefit but they must pay deductions such as Universal Social Charge on the pension). For standard rate taxpayers, the net effective tax relief received is in the region of 25-30%. However, for higher rate taxpayers, the net effective tax relief is between 31-51%. These conclusions are not particularly sensitive to the modelling assumptions, as detailed in Whelan & Hally (2018). The Report on the Commission on Taxation and Welfare (2022) notes the inadequacy of data on these "costly expenditures" and "recommends an urgent review" on "the cost and distribution of pension tax expenditures" (2022, p. 168). However, we do know that, unsurprisingly, a greater proportion of those with the higher incentive are found to save: Collins & Hughes (2017, Table 5, p. 503) estimate that 70.6% of pension savers were in the higher rate tax bracket in 2014.

The new auto-enrolment pension plan is proposing to offer a pension subsidy by the State equivalent to 33% of the worker's contribution up to salary level of €80,000, where the worker's contribution is after tax and other deductions (such as PRSI and Universal Social Charge). The 33% subsidy cannot be directly compared with the figures in Table 1 for two reasons. First, the way of presenting the figures differ in that a net effective tax relief of x% is equivalent to a subsidy of $x/(1-x/100)$% on a unit invested. So, for instance, net effective tax relief of 25% means that the State pays 25% of every €1 invested or, equivalently, the State subsidizes every €1 invested by the worker by 33% (that is 25%/(1-0.25)). Second, the explicit subsidy by the State is only part of the incentive to save via the AE Plan as we assume that the AE Plan will benefit from gross roll-up of funds (i.e., no tax on investment income or gains) and drawdown options such as tax-free lump sums will be the same as existing pension arrangements. So, to compare like-with-like, we must be mindful of how the subsidy is expressed and we must also put a value on the tax incentives available to investors in the AE Plan.

It is straightforward to estimate the value of the tax incentives available to investors in the AE Plan given the figures in Table 1. We can decompose the net effective tax relief into that arising from the tax relief on the initial contribution, which is just the saver's marginal rate of tax, and the net value of all the other tax reliefs. The only difference between savers in the AE Plan and other pension savers is the tax relief on the contributions as the value of the other tax reliefs are the same. Table 2 sets out the value of these other tax reliefs under the same modelling assumptions as Table 1.

Table 2: Best Estimate of Net Effective Rate of Tax Relief, decomposed into the tax relief on initial contribution and other tax reliefs.

Salary p.a. (€)	Married Person, one income household Present Value of Tax Reliefs on			Single Person Present Value of Tax Reliefs on		
	Initial Contribution	Other Tax Reliefs	Total	Initial Contribution	Other Tax Reliefs	Total
5,000	**0%**	-5%	**-5%**	**0%**	-1%	**-1%**
10,000	**0%**	-1%	**-1%**	**0%**	1%	**1%**
20,000	**0%**	-3%	**-3%**	20%	**5%**	**25%**
30,000	20%	**6%**	**26%**	20%	**6%**	**26%**
40,000	20%	**6%**	**26%**	40%	9%	**49%**
50,000	40%	11%	**51%**	40%	2%	**42%**
60,000	40%	11%	**51%**	40%	-2%	**38%**
70,000	40%	11%	**51%**	40%	-3%	**37%**
80,000	40%	11%	**51%**	40%	-4%	**36%**

Source: Authors' computations based on the best estimates figures in Table 1.

We can now make a direct comparison between the effective subsidy of pension savings through the proposed AE Plan and existing pension arrangements. The effective subsidy per €1 invested in the AE Plan comprises the 33% subsidy at the time the initial contribution is made (up to a salary threshold of €80,000) plus the present value of the other tax reliefs. The effective State subsidy on existing pension arrangements is derived from the net effective rate of tax relief (see also Table 4, p. 345 in Whelan & Hally (2018)). Table 3 sets out the effective State subsidy on the AE Plan compared to existing pension arrangements.

Table 3: Effective State Subsidy per €1 Invested by Saver, in AE Plan or Existing Pension Arrangements, by income and marital status

Salary p.a. (€)	Married Person, one income household		Single Person	
	Saver in AE Plan	Saver in Other Pension Plan	Saver in AE Plan	Saver in Other Pension Plan
5,000	€ 0.28	-€ 0.05	€ 0.32	-€ 0.01
10,000	€ 0.32	-€ 0.01	€ 0.34	€ 0.01
20,000	€ 0.30	-€ 0.03	€ 0.40	€ 0.33
30,000	€ 0.41	€ 0.35	€ 0.41	€ 0.35
40,000	€ 0.41	€ 0.35	€ 0.51	€ 0.96
50,000	€ 0.55	€ 1.04	€ 0.36	€ 0.72
60,000	€ 0.55	€ 1.04	€ 0.30	€ 0.61
70,000	€ 0.55	€ 1.04	€ 0.28	€ 0.59
80,000	€ 0.55	€ 1.04	€ 0.27	€ 0.56

Source: Authors' computations.

So, for every €1 a single individual earning €30,000 contributes to their pension via the AE Plan is increased to €1.41 with the addition of 41c from the State. This is made up of a 33c top-up of their initial contribution and 8c as the net present value of future tax reliefs (on tax-free investment income and gains and tax-free lump sum). If the same individual were to save for a pension via an existing approved pension arrangement, then the total value of the subsidy would be €0.35 in contrast to the €0.41 through the AE Plan. Such an individual is therefore more incentivised to use the AE Plan to provide for a pension, other things being equal.

There is a clear pattern in Table 3. Lower earners are more incentivised to use the AE Plan to provide for a pension. However, there is a very marked increase in the incentive to save through existing pension arrangements as individuals enter the higher rate tax band at earnings levels. In short, higher rate taxpayers are given considerably more support through tax reliefs than the supports for the AE saver. In fact, for a married couple with a single income over €50,000, the State will pay almost twice the subsidy to save through an existing pension arrangement than through their own AE Plan. It appears that the AE Plan is, be design, limiting itself to the poorer workers who are not, and do not expect to become, higher rate taxpayers.

The current structure of State supports materially favours those on the higher rate of tax to save through an existing pension vehicle. By lop-siding the incentives so much the State undermines its own AE Plan. Arguably, it is not logical to pay a higher incentive to those providing for their pension through a less efficient vehicle. In fact, as we treat in the next section, the higher subsidy to save through a higher charging provider may not increase the size of the eventual pension at the end of the day as the extra subsidy is consumed by the extra charges. In this case, the State's extra subsidy given to higher earners in private pension arrangements can simply be seen as indirect support to the less efficient pension industry.

The first issue is that the State currently proposes incentives to save in the AE Plan only up to certain limits on contributions and up to a qualifying salary limit of €80,000. In contrast, savings via other pension contracts is allowed up to much higher limits on contributions and up to a qualifying salary limit of €115,000. The thresholds on contribution levels and qualifying salary must be aligned. We suggest the current limits that apply to existing pension arrangements be adopted for the AE Plan. This would mean setting the higher qualifying salary limit of €115,000 for both and also adopting the same age-related maximum percentage qualifying contribution as currently allowed for private pension arrangements. The issue now is to equalise the State's incentives between the two system, given that the quantum of qualifying contributions is the same.

There are two distinct ways to equalise the incentives and so create a levelling of the playing field for the AE Plan. This will enable the potential pension saver to choose the better option based on its own merits rather than the incentives on offer. The first way is for the State's subsidy to AE savers to approximately equal the value of taxation reliefs on existing pension arrangements. This would mean that the subsidy would be regressive, with a higher percentage subsidy going to those with higher incomes (see Tables 1 and 3). This might be difficult to defend politically. Arguably, it is also rather mistargeted on economic grounds as it is the lower earners that require the greater incentive to save.

The alternative is to abolish tax relief on contributions, replacing it with the 33% top-up to the saver's contribution as proposed for the new AE Plan. The latter approach was advocated by, amongst others, Doorley et al. (2017), Collins & Hughes (2017), and Whelan & Hally (2018), on the grounds of equity, transparency, and efficient use of State resources to encourage pension savings. The value of incentivisation through tax reliefs is not fully understood even by pension

experts, so the explicit subsidy is preferrable. This is evident through the earlier success in encouraging SSIA savings through an explicit subsidy. The direct subsidy approach at the 33% level would entail a considerable reduction in the effective subsidy to higher rate taxpayers, which might cause a reduction in aggregate pension provision by this group. Many public servants paying the higher rate of tax would also be adversely impacted by the change (as they pay pension contributions). Therefore, it can be anticipated that such an equalisation of pension incentives amongst all workers regardless of earnings level could result in demands by public servants for either a compensatory pay rise or a reduction or abolition of the Additional Superannuation Contribution.

We recommend the abolition of tax relief on pension contributions, replaced by the explicit 33% State subsidy on contributions. This will result in a greater equality between the State's incentives to save through the AE Plan and existing pension arrangements. A consequence of this is that the State resources currently used to incentivise higher earners would be switched to providing incentives for new and lower-earning workers, which is where the current pension deficit is located. There will also be a knock-on effect to the tax relief available to higher earners in the public sector which might be mitigated by a straightforward reduction in the rate of the Additional Superannuation Contribution.

Section 2: Pension Charges

There is no shortage of pension schemes in Ireland, as noted in the Introduction. The defined benefit (DB) scheme is no longer favoured outside of the public sector, so now there are just 526 continuing private sector DB schemes (Pensions Authority (2022b)). In contrast, there has been remarkable growth in the number of defined contribution type schemes. Currently there are 85,964 DC schemes with 437,196 active members (so an average of 5 active members per scheme as over 90% of schemes have only active member) (Pension Authority (2022b)). If we add to this number, the number of pension products such as the 330,151 Personal Retirement Savings Accounts (PRSA) and their €9.5 billion in assets then it is clear that the future pensions in Ireland are being provided for by DC type arrangements made up of individual saving accounts, where the contributions plus investment return less charges will determine the ultimate pension.

The proposed AE Plan will enter this landscape also offering an individual savings account linked to a choice of investment fund but, using its economies of scale, guaranteeing that "it will ensure management fees are minimised by specifying a maximum permitted annual administration and investment management charge of up to a maximum of 0.5% of assets under management" (Department of Social Protection (2022a), p. 23). This, as we develop below, is a very considerable reduction to the charges levied on existing individual retirement accounts, whether in a defined contribution arrangement or as a stand-alone personal account. The reduction in charges, through the action of compounding over the long period of pension saving, increases the eventual pension markedly.

The Department of Social Protection published a *Report on Pension Charges in Ireland* in 2012 that ran to 290 pages in length and highlights the complexity and lack of transparency in relation to pension charges in Ireland. They surveyed all of the existing pension plans and the varying types and levels of charges associated with them (such as policy fees, allocation rates, bid/offer spreads, annual management charges, exit charges). Given such a wide variety of charges, it can be difficult to accurately quantify the impact of these charges over the long term of a pension. The Department of Social Protection (2012) models their impact expressed as a reduction 'reduction in yield' (RIY), which allows direct comparison with the maximum 0.5% per annum charges under the AE Plan. The RIY is calculated as a single percentage figure expressed as an adjustment to investment returns that captures the effect of the total disclosed charges in each pension arrangement. In order

to estimate the RIY, the model assumes that the pension arrangement would persist unaltered for a period of 30 years until retirement. The model also assumes a high average regular contribution size (as individual savers in such arrangements have typically higher incomes). Table 4 summarises the key findings of this report.

Table 4: Disclosed Pension Charges, on various types of private pension arrangement in Ireland expressed as Reductions in Yields (RIY)

Pension Type	Average RIY	High RIY	Low RIY
DC Insured with 0-50 members	0.91%	1.71%	0.53%
Executive Pension Plan Max Commission	1.97%	3.08%	1.08%
Executive Pension Plan Nil Commission	1.23%	1.77%	0.89%
Retirement Annuity Contract Max Commission	1.97%	3.08%	1.08%
Retirement Annuity Contract Nil Commission	1.17%	1.73%	0.89%
Standard PRSA Max Commission	1.57%	-	-
Standard PRSA Nil Commission	1.27%	-	-

Source: Extract from Table 8.24 in Department of Social Protection (2012), p. 144.

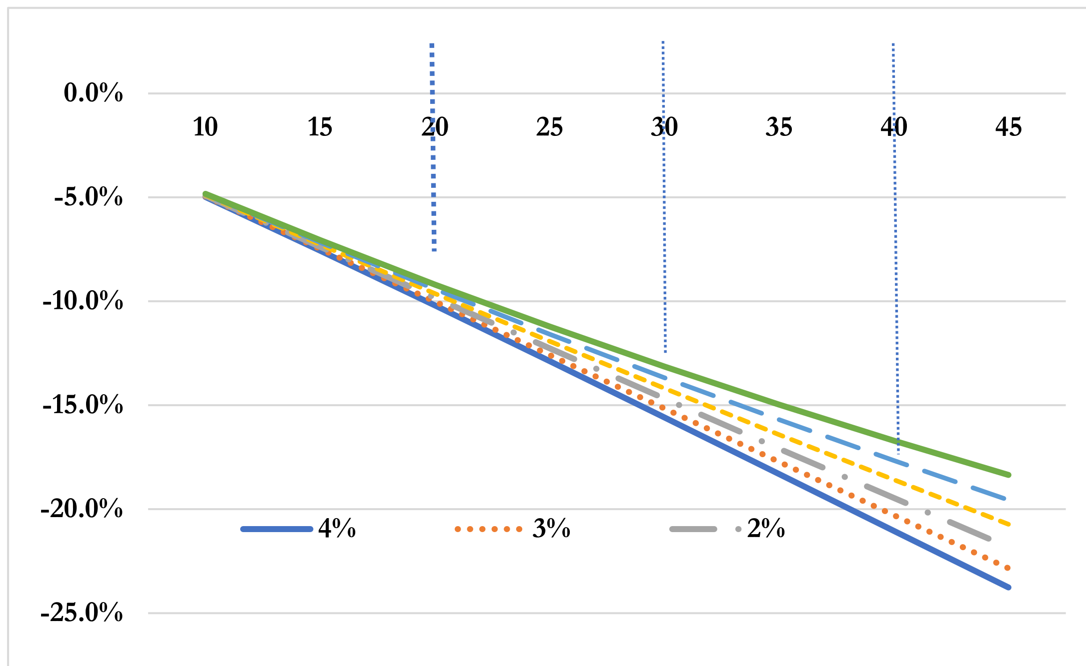
The above RIY figures must be regarded as conservative, as they are based on a long saving period and high average premium and reducing either would increase the RIY. The conclusion of the OECD Report (2014) in their review of the Irish system was that "pension charges by the Irish pension industry…are expensive for small occupational schemes and personal pension schemes" (p. 11).

Charges vary by provider, by type of arrangement or product and by the level of commission paid. There is considerable variation in the impact of charges by provider, with some policy types charging effectively three times as much as others – a particular source of concern as charges are not transparent and the individual saver will typically not know the charges applying or, for that matter, what is normal.

Let us suppose that the charge is at the maximum envisaged at 0.5% per annum on the AE Plan (so an RIY of 0.5%) and compare this the disclosed charges in existing pension arrangements above[1]. Figure 2 sets out the accumulated impact on the final fund value of a 1% RIY for a pension saver making regular contributions over saving periods of 10 to 45 years at various rates of return.

[1] We assume that implicit costs (i.e., undisclosed costs) such as the underlying costs of investment management - the costs of custodianship of the assets or the transaction costs (including stamp duty) where assets are being bought or sold – are the same for the AE Plan and private pension arrangements.

Figure 2: Reduction in Value of Fund at Retirement due to Impact of a 1% RIY, over future periods (years) and at various gross investment returns for regular pension saver



A good rule of thumb evident from Figure 2 is that a RIY of 1% reduces the pension pot come retirement (and therefore the pension) by about 15% over a term of 30 years and 20% over a term of 40 years. Private pension arrangements average charges are between 0.4% and 1.5% higher than the AE Plan so the cumulative impact is that the size of the pension from these arrangements will be between 10% to 30% lower than the AE Plan on average after 40 years. For some existing pension arrangements offered by certain providers, the pension will be 50% lower than from the AE Plan (or, equivalently, the AE Plan will provide double the pension for the same level of contributions).

The efficiency of the AE Plan will lead to considerably higher pensions than those that accrue under other private pension arrangements, for the same level of contributions on the modelling assumptions above. The AE Plan also allows considerable flexibility, to take contribution holidays, or stop or alter contributions, which are often costly options in private pension arrangements. Many passages in Department of Social Protection (2012) report noted the relative short average length of current in-force individual pension policies, with the majority seemingly initiated in the 5 years prior to the report. Indeed, few private pension policies will remain unchanged for more than 30 years and exit charges will further increase the RIY. The Report recognised this, pointing out

> "A key finding is that scheme re-brokering is significant in the case of occupational pension schemes and is also relatively common in individual pension arrangements. However, detailed consideration of the range and extent of the re-brokering being undertaken and its impact on all policy holders did not form a central part of the research. Anecdotal evidence would suggest that pension advisers are frequently the drivers behind the re-brokering of schemes… The high level of re-brokering in the marketplace raises some concerns, in particular, data was not available to provide assurances that re-brokering benefits the scheme member or individual policy holder. This is an area which merits further research."
>
> Department of Social Protection (2012), pp. 211-12.

It cannot be expected that pension advisers will promote the AE Plan, even if it is the most efficient savings vehicle. The high charges for alternative pension products and the variability of these charges by provider, as detailed earlier, show that efficiency is not a major selling point from the adviser's point of view. However, the final value of the pension is clearly material for the pension saver's perspective. Therefore, it is essential that pension advisers do not misrepresent the AE Plan, or minimise the impact of pension charges to pension savers given they are so material in determining the ultimate size of the pension.

In short, there must be some reform in pension selling practices prior to the introduction of the AE Plan. We make three suggestions in this regard. First, we propose that illustrations are required to be provided to any pension saver, showing the size of the future pension pot accrued via the recommended pension saving product versus the AE Plan, allowing for all disclosed charges. This will help the pension saver make an informed decision. Second, we suggest that payment of commission is banned on any pension products, as it has been in the UK for a decade now. A renumeration practice that allows the insurance or investment company, to pay the pension adviser introducing the business, can hardly be viewed to be in the best interests of the pension saver – by its nature, it introduces an unnecessary conflict of interest. Third, we recommend that pension selling practices be monitored to ensure compliance.

Section 3: Security of Private Pension Provision

To encourage people to save for their retirement, people must be confident that the system through which these savings are made is secure.

The main risks inherent in individual savings accounts or DC schemes relate to, adequacy of contributions, investment risk, charges incurred and longevity risk. Education helps mitigate some of these risks, especially on contribution levels, and set realistic expectations on the eventual size of the pension. Investment risk remains significant as, by the design of these arrangements, the pension saver is responsible for all investment decisions relating to their pension. In practice, the vast majority of DC pension savers opt for the default investment fund in practice, so allowing an expert decide the investment strategy (for instance, nearly 99% of savers in the Nest scheme in the UK opted for the default NEST Retirement Date series). Investment risk persists but it is actively managed by experts. Longevity risk can be managed by purchase of an annuity at retirement. Risks relating to investment charges can be addressed by appropriate regulation as discussed in Section 2.

Considerations are quite different for DB schemes. Pension entitlements are secured by a guarantee from the State in unfunded public sector DB arrangements. Pension entitlements in the private sector DB pension plans are not a debt on the employer (unlike the UK and US) and so are only secured by the assets of the plan. The Pensions Act (1990) and subsequent extensions, amendments and regulations established a Minimum Funding Standard (MFS), although the MFS does not actually require a minimum level of assets to be held by the plan. If the scheme does not meet the funding standard, the MFS only requires the scheme to submit a proposal to make good the deficit in the future, and this can be over a period greater than 10 years under certain circumstances.

A DB pension plan may be wound up if the employer stops or gives notice of its intention to stop contributing to the plan. The assets of the DB plan in a wind-up are distributed in strict priority as follows: AVC's and transfers-in first, followed by the benefits accrued to members who have

reached retirement age (excluding future pension increases), and then the remaining assets are then distributed between pre-retirement members, i.e. active plan members and deferred plan members. The impact of this distribution order can result in a significantly disproportionately negative impact on the assets remaining, to be divided between the active and deferred members. Nearly 10% of DB pension plans in 2020 did not meet the MFS requirements (Pensions Authority (2021)). As the Pension Authority itself states in relation to DB pension plans.

> "risk is not borne equally by all scheme members: it is mostly concentrated on members who have not yet retired. This group is getting smaller over time and, as a result, the risks are becoming more and more concentrated."
>
> Pensions Authority (2021), Defined Benefit Schemes Review of 2020 Statistics, p.1.

The pension insecurity of DB Plans in Ireland was considered in detail in Moloney & Whelan (2009), which highlighted the case of Waterford Crystal and "suggests that we might unfortunately witness a corporate event that might prompt revision of the current regulation of defined benefit pension funds sooner rather than later" (p. 94). In fact, later in 2009, Waterford Crystal, the company sponsoring the scheme, became insolvent. It subsequently emerged that the pension scheme would only be able to cover between 18-28% of active and deferred members pensions. The active and deferred pension scheme members sued the State for not protecting their rights and won in 2013 when the European Court mandated that the state had to compensate the pension scheme members. In 2015 agreement was finally reached and the state had to compensate 1,774 pension scheme members for loss of pension benefits2. This event did not change the weak regulation of defined benefit schemes but it does show that the State can be held liable and sued for pension loss.

It is not necessary for a DB pension scheme to go into wind-up for the inherent lack of security and protections of defined benefit pension promises to be evident. Section 50 of the Pensions Act allows the Pensions Board to direct the trustees of an underfunded scheme to reduce active and deferred members' benefits and post-retirement pension increases to such an extent that the assets of the scheme would be sufficient to meet the reduced liabilities. In addition, Section 50A of the Pensions Act allows trustees, with the consent of the Pensions Board, to make such amendments to the terms of their scheme where they are ensuring that the wind-up of the scheme will not be required by reason of the scheme having insufficient funds. In the period from 2010 to May 2021 the Pensions Board granted 136 Section 50 orders (Parliamentary Questions (20th May 2021)). There is a total of 553 schemes funded DB Schemes in Ireland so that is to 1 in every 4 schemes (Pension Authority, Annual Report and Accounts 2021, p. 38). The existence and prevalent use of such orders again illustrates the lack of protection for pension entitlements in DB schemes.

Funded DB pension plans can be regarded as a legacy issue, as their number and membership continue to decline. There were some 2,500 DB schemes in Ireland in the early 1990's (IAPF (2018)) but only 560 such plans remain at the end of March 2021. The liabilities of these remaining schemes are largely to current pensioners, with a liability of €38.5 bn in respect of 106,177 individuals (averaging €363,000 each), €10.9 billion in respect of 68,265 actives (averaging €160,000 each) and €12.2 billion in respect of 127,982 deferred members (averaging €95,000 each). However, this legacy issue has the potential to create a significant liability to the State due to its inadequate regulation given the precedent in the Waterford Crystal case.

The trustees of DB schemes have the power to transfer out the value of the liability in respect of a deferred pensioner into a retirement bond or other vehicle, with or without the individual's consent. Deferred pensioners can sometimes have very small entitlements and maintaining contact

with former employees can pose administrative difficulties and expense for the company scheme. The State could consider allowing the trustees to transfer the value of such liabilities into the AE Plan for the deferred member. In so doing, the State extinguishes any contingency liability, it gives the individual a start in building their own pension pot, and it accelerates the wind-up of the scheme and the demise of this potentially problematic sector. Of course, such transfers would not be increased by the 33% addition for new contributions as they already benefited from tax relief.

We recommend that the AE Plan should be open to accept transfer of the value of pension entitlements from funded defined benefit plans. In fact, given that the AE Plan is so more efficient than the vast majority of DC-type private pension saving vehicles in Ireland, as developed in the previous section, it should be open to any saver, whether they have an existing pension arrangement or are a member of an existing scheme. Accordingly, funds from any existing pension arrangements should be allowed to transfer to the AE Plan if in their best interests of the saver (without, of course, attracting the 33% subsidy).

The integration of the AE Plan into the pension landscape by allowing transfers in from other pension vehicles is obviously a good idea. It will assist the State to manage its contingent liability due to inadequate regulation. It also provides a solution to employers who have voluntarily run pension schemes and now wish to exit such provisions while still ensuring the employees' or former employees' pension needs are met in a cost-effective manner. "Final salary pensions have been uniquely horrible for UK plc" according to a recent headline in the Financial Times (28th March 2023) and managing such schemes consume "incalculable amounts of management time". The situation is little different in Ireland. A requirement for the success of the AE Plan is that it has influential supporters and offering the AE mechanism as a solution to the common problem associated with legacy DB liabilities will make allies of employers. The AE Plan will need supporters to help counterbalance its influential detractors, as discussed in the next section.

Section 4: Opposition to the Auto-Enrolment Plan

> "It is difficult to get a man to understand something when his salary depends upon his not understanding it."
>
> Upton Sinclair

Ireland is currently the only OECD country to have no mandatory or soft mandatory earnings-related scheme to save for retirement (Department of Social Protection (2022b)). The proposed AE Plan will be the most efficient of all the different types of individual retirement accounts in Ireland, in the sense that a contribution to the AE Plan will lead to a greater pension, as developed in section 2. Its introduction has the potential for disruptive change in the industry as it displaces all high-charge pension vehicles and could potentially address the issue of pension insecurity for deferred pensioners of defined benefit schemes. The introduction of auto-enrolment in Ireland arguably will be the most fundamental change to the pensions landscape in Ireland since the introduction of the Old Age Pension over a century ago.

The striking feature of the Irish pension system is that it has not evolved with time: the current system is structurally identical to the one inherited with independence in 1921 from the UK– a flat rate state scheme topped up by tax incentivised voluntary occupational and private pension provi-

sion. Accordingly, one puzzle that must be addressed in any study of the Irish system in an international context: how is it that the original system, originating in the UK survived intact in Ireland but required significant structural change in the UK and elsewhere in the OECD? We need to understand the forces at work maintaining the current system.

In the future, if existing or potential pension savers are attracted to the AE Plan then it will result in a loss to the private pension industry - every reduction of €1 in charges made by the industry is a reduction of €1 in the income or profit from a person or firm in the pension industry. It is, of course, to be expected that people will fight for their livelihood when change suits others not them. However, there is evidence that pension policy over the last century in Ireland has perhaps deferred too much to the private pensions industry.

Many countries reformed their social welfare systems shortly after the Second World War and Ireland also considered the matter. A White Paper, *Social Security*, was published in 1949. It was better known as the 'Norton Bill' as it was sponsored by William Norton, the leader of the Labour Party and the Minister in charge of the newly formed Department of Social Welfare. This bill was "the first major review of welfare legislation in independent Ireland" (Kelly (1995), p. 15) and advocated a Beveridge-type extension of social insurance in Ireland, including the introduction of a contributory state pension. The pension reform aspect was dropped from the Bill when eventually enacted by another government in 1952, a move that William Norton considered as "revealing the countervailing power of insurance companies. In fact, he saw the situation as one in which the insurance companies had won and the workers of the country had lost" (McCashin (2004), p. 51 quoting Cook (1990), pp. 100-101).

Maher's forensic study, *The Politics of Pensions in Ireland (*Maher (2016)), treats the developments in pension policy in Ireland over the last half-century enlivened with frank interviews from key players (see especially pp. 143-235). It is a story of the industry's increasing influence on policy. The industry drafted the legislation that prescribes its own regulation (Pension Act 1990) and that set up the statutory regulator, the board of which had a majority representation from within the industry (First Schedule, Section 8 of the Act). A senior public servant was later to reflect: "We kind of sleepwalked into it. We got them [the industry] to set up the Pensions Board. Gave them responsibility for it" (quoted in Maher (2016), p. 175). The Pension Act 1990 also provided the industry with statutory authority to provide on-going advice on pension matters to the Minister for Social Protection, whether invited or not (Part II, 10(1)(b) of the Act). This privileged position in all aspects of pension policy continued until March 2014, ending only after a formal review recommended a separate body to undertake such an advisory role to "obviate any perception of 'regulatory capture' by the industry" (Government of Ireland (2013), p. 47). Regulation by the industry might account for Ireland's particularly weak protection of pension rights treated earlier, considerably weaker than the UK and US. In particular, Maher (2016) considers how repeated calls for a reform of the tax incentivisation of pension savings were side-stepped over the years, including the State's commitment to the Troika of the IMF, European Commission, and ECB to raise tax revenues "by reducing various pension-related tax reliefs" (European Commission, ECB and IMF (2010), paragraph 23, p.8 of the Memorandum of Economic and Financial Policies) (see also Whelan & Hally (2018)).

It is quite clear from these episodes that the pension industry has exercised considerable influence over pension policy and has resisted change in the past, especially when it comes to the State's incentivisation of pension savings. The State's subsidy makes pension savings viable, and its amount and distribution must be a central policy issue. Such tax expenditures are expenditures by the State and must be subject to similar scrutiny as to whether it most efficiently meets the intended objective.

Conclusion

The introduction of a Automatic Enrolment Retirement Saving Plan is obviously beneficial to workers in Ireland, allowing them to provide a top-up to the State pension in a cost-efficient manner. However, the AE Plan cannot be expected make a significant impact on future pension provision in Ireland unless three actions are taken.

The first action is that the State must reform its tax incentivisation of private pension savings, to make it consistent with the explicit State subsidy on the individual's pension contribution in the AE Plan. As it stands, higher rate taxpayers are given considerably more support through tax reliefs than the supports for the AE saver in both level of pension savings incentivised and the level of the incentive. It is essential that there is a levelling of the playing field before the AE Plan is operational. We recommend that qualifying contributions and salary level thresholds be aligned. To facilitate this alignment the qualifying salary for saving in the AE Plan needs to be equal to the qualifying salary for saving in other pension arrangements. In addition, the abolition of tax relief on pension contributions is recommended, to be replaced by the explicit 33% State subsidy on contributions. This will ensure greater equality between the State's incentives to save through the AE Plan and existing pension arrangements. A consequence is that the incentive to save for a pension is reduced for higher earners, which will help meet the cost of the subsidy for new pension savers. There will also be a knock-on effect to the tax relief available for higher earners in the public sector but this can be mitigated by a straightforward reduction in the rate of the Additional Superannuation Contribution.

One of the unique selling points of the AE Plan is its low charges, considerably lower than existing individual private plans. Even through such efficiencies accumulate to deliver materially higher pensions over the long term of pension saving, this is not well appreciated by savers and so has not been a particularly strong force shaping the pension landscape to date. We recommend that selling practices of pensions be more aligned to the interests of the pension saver, by banning commission on pension products and by requiring illustrations of the size of the pension fund at retirement to be explicitly compared with that expected from the AE Plan for the same level of contribution.

The third action is to make the AE Plan open to all and open to transfers from any existing pension arrangement. The AE Plan takes advantage of its economies of scale to offer a product that is more efficient than the vast majority of private pension saving vehicles in Ireland. It should be open to any saver, whether they have an existing pension or are a member of an existing scheme, and they should be able to transfer funds from existing pension arrangements if they believe it is in their best interests.

These three actions alone will not ensure the success of the AE Plan. The AE Plan is a disruptive innovation in the private pension marketplace that can reasonably be anticipated to be opposed by many incumbents. In the past, the pension industry in Ireland has been successful in heading off reform. However, pension savings, in whatever form taken, require considerable State subsidy. In any reform of its financial incentives and the associated regulation, the State must do a much better job of weighing the public interest against the interests of the industry.

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