REVIEW OF THE IRISH PENSION SYSTEM

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Outline of the presentation

- Terms of Reference for the Review and process;
- The way forward:
  - Options for reforms in the public scheme
  - Options for reforms in the private scheme
- Bottom line

The Review: Starting points

- The Review takes into account existing Government commitments in the pensions area and economic developments since the *Green Paper* and *National Pensions Framework*.
- It adopted an international perspective: lessons to be learned from comparator countries
- Focus of the review is the long-term impact of the planned changes in pensions in achieving the objectives of: financial sustainability; adequacy; modernity of pension systems; and equity.
- A first evaluation and assessment was presented to key stakeholder in September 2012;
- Policy recommendations to be presented today

Enhancing sustainability, adequacy, modernity and equity of the Irish pension system

- There is a long-term financial sustainability challenge as population ages but it is not insurmountable <u>if</u> economic growth resumes and the effective retirement age rises;
- But it may well be necessary to envisage further increases in the state pensionable age beyond 68 in 2028
  - Several ways to raise the pensionable age, e.g. link it to rising life expectancy

Enhancing sustainability, adequacy, modernity and equity of the Irish pension system (cont'd)

- The economic position of Irish retirees is relatively good on international standards, but maintaining this poses a serious challenge;
- A "retirement savings gap" is likely to emerge and would need to be filled to ensure retirees enjoy adequate incomes, especially for low and middle-income earners;
- Equity is a concern between different sectors (public/private), genders, different lengths of contribution periods, different generations;

Enhancing the public pension system's parameters to achieve a better balance between its different objectives

- Pensionable age (PA) is relatively high on international standard but its increase to 68 in 2028 may not be sufficient to maintain sustainability.
- But working longer should be adequately rewarded and flexibility in the transition into retirement improved. Some good news on this front: older worker employment rates are rising in many OECD countries
- Indexation and valorisation might benefit from changes. Different combinations possible to ensure that pensions would remain adequate and more financially sustainable.

The Case for Structural Reform of the State pension system

- Recent reforms will reduce the number of beneficiaries on full-rate SPC;
- But the link between contributions and benefits is very weak and non-transparent to contributors;
- A substantial overlap exists between the contributory and non-contributory State pensions;
- Household Benefits Package provides substantial resources to all pensioners over 70 and (through means-testing) to poor pensioners under 70; it should be integrated with the State pension

Possible Structural Reforms to the State pension system

- Options:
  - A universal basic pension scheme
  - A means-tested basic pension
- Design issues matter and costed alternatives should be thoroughly assessed (beyond the scope of this review)
- The articulation between the private and public components of the pension system should be reviewed carefully because it is key. For example, a modest universal basic pension scheme might provide more adequate retirement incomes if complemented by <u>mandatory</u> private arrangements

Achieving a better equity between different groups of workers and generations

- The reforms of public service pensions should be phased in more rapidly and changes in pension schemes in the private sector should be extended to public sector workers;
- There are different arguments against having separate pension schemes for public and private-sector workers. Equity and administrative efficiency are some of these;
- The Irish gender gap in employment has been narrowing substantially over time but large differences exist between the pension entitlements of men and women.
  - Narrowing the gender pensions gap should be a priority

Reforms to the Private Pillar: need to expand Coverage and Retirement Savings

- Current coverage of funded pensions is inadequate: it is below 50% and uneven across sectors and workers
- Existing tax deferral structure provides higher incentives to save for retirement to high-incomes
- Main policy goal: increase coverage of funded pensions, especially for mid-to-low incomes, to improve pension adequacy

Three Options to Increase Coverage

1. **Compulsion**: The less costly and most effective approach to increase coverage of private pensions
2. **Automatic enrolment**: Second-best option. Its success depends on how it is designed and on its interaction with incentives in the system. The cost of establishing and managing AE may also be higher
3. **Improving the existing financial incentives**: Flat subsidies and matching contributions could help increasing incentives to save for retirement for middle to low incomes

Improve the Design of Defined-Contribution (DC) Schemes

- The OECD Roadmap for the Good Design of DC Pension Plans provides relevant elements to improve the design and institutional set-up of DC pension plans
- Establish appropriate <u>default</u> investment strategies for those unable or unwilling to make investment choices
- Establish <u>life-cycle</u> investment strategies as a default option to protect those close to retirement against extreme negative outcomes
- Encourage partial annuitization as a protection against longevity risk

Address High Charges in some DC Schemes

- Current status: The Irish pension industry charges are not too costly compared with other countries' benchmarks for large DC occupational schemes
- But they are rather expensive for small occupational schemes and personal pension schemes
- Specialized private institutions (e.g. pension funds, asset managers) should manage the assets, even under compulsion or auto-enrolment. The establishment of an autonomous public option could be envisaged to provide competition, lower costs, and a default pension fund

Enhance Benefit Security in Defined-Benefit (DB) Schemes

- Large impact of the crisis on DB schemes: 80% are in deficit and assets are still below their 2007 level
- The guarantee schemes (IPS & PIPS) only provide a partial protection to DB plan members' benefits in case of sponsor insolvency
- The priority currently given to pensioners before other members if a scheme winds up creates large inequalities and should be eliminated
- Healthy plan sponsors should not be allowed to "walk away" from DB plans unless assets cover 90% of pension liabilities

Enhance Benefit Security in DB Schemes (cont'd)

- Offering strong incentive for pension funds to invest in Government bonds, in particular sovereign annuities, may create new risks for pensioners
- Consider introducing more flexible DB plans to allow some degree of risk-sharing between plan members and pensioners, as well as plan sponsors
- Establish a clear framework to facilitate domestic investment in infrastructure projects without distorting capital allocation

Bottom line

- Financial sustainability while not completely assured in the future, does not seem an insurmountable challenge
  - But the State pensionable age will probably have to rise above 68 post-2028;
- Adequacy of the pension promise is a big challenge
  - Dealing with it necessitates changes to the public and private
  - mandatory enrolment of workers in private pension schemes pensions would be preferable to auto-enrolment in order to raise coverage significantly;
- Equity requires greater alignment of the pensions of public and private sector workers