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A roadmap for pension reform 2018-2023 in Ireland

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In a context of low pension replacement rate of average earnings, anomalies in the State pension and low public confidence in governance and regulation of supplementary pensions, Ireland has published a roadmap to reform the pension system and to auto-enrol workers in a savings scheme for retirement.

Description

The aggregate replacement pension rate amounts to 35% in Ireland versus 58% in EU-28. The objective of the State pension in Ireland is to prevent poverty by replacing one-third of average earnings and to sustain workers' desired standard of living when they retire with supplementary pensions increasing it to 50%. Workplace pensions are not achieving that objective because of low coverage, reduced contributions in the transition from Defined Benefit (DB) schemes to Defined Contribution (DC) schemes and non-transparent high fees by pension providers. The roadmap for pension reform 2018-2023 (2018: 21) launched by the government in February 2018 also refers to a "low public confidence" in governance and regulation of supplementary pensions.

There are six strands to the new roadmap. Strand 1 proposes to reform the State pension on the basis of three key objectives: adequacy, sustainability and equity. Adequacy will be addressed by the adoption of a formal benchmark that the State pension should be 34% of national average earnings to ensure the benefit is above the poverty line. Sustainability will be ensured through social insurance contribution rates that will be adjusted by an actuarial analysis to finance the State pension. For equity, the proposal is to replace the current "yearly average" system with a "Total Contribution Approach" to make the State pension proportionate to contributions over 40 years.

Strand 2 aims to build retirement readiness by addressing low coverage in supplementary pensions and low savings for retirement. These issues will be tackled by introducing a quasi-mandatory automatic enrolment savings mechanism for workers who satisfy some basic conditions albeit with an "opt-out" after a minimum period.

Strand 3 addresses low confidence in pension outcomes, the need for an enhanced regulatory framework and for tackling the high fees by pension providers.

Strand 4 is designed to support the sustainability of DB schemes by implementing legislation for new controls to funding DB schemes.

Strand 5 will consolidate reforms on public service pensions by linking the minimum pension age in the public service with increases in the State pension age. Compulsory retirement age will increase to age 70 and there will be an Additional Superannuation Contribution for public servants.

Strand 6 is oriented to enabling fuller working lives. To this end the roadmap is committed to challenging and altering perceptions around "normal" retirement age at 65 or earlier.

Outlook & commentary

The roadmap is an ambitious attempt to reform Ireland's pension system. The stated objectives to strengthen the system include the decision to consolidate the State pension at 34% of national earnings, to tie adequacy to sustainability of the Social Insurance Fund by actuarial analysis, to change the current "average system" to a "Total Contribution Approach", to reduce the enormous number of occupational schemes, to improve governance and regulatory framework of workplace pensions. It will be important to tackle high fees for DC schemes and to implement the EU Directive for Institutions for Occupational Retirement Provision II by 2019.

There are big challenges and some weaknesses in the roadmap. The government has made the choice to focus mainly on measures to encourage greater personal savings through auto-enrolment and not to extend the State pension to a notional DC earnings-related component (as Italy, Latvia, Poland and Sweden have done), or to a universal pension for all pensioners.

Auto-enrolment is not a pension scheme but a potential costly State-incentivised savings vehicle and the government will not give a guarantee on investment returns similar to "Riester pensions" in Germany. In the past, market-based pensions have failed to deliver on their promises for DB pensions as, for example, the Irish Congress of Trade Unions points out (2017). Since DC pensions replaced DB pensions the total contribution to schemes have nearly halved from 20.9% for DB schemes in 2002 (Irish Association of Pension Funds, 2002) to 11.1% for DC schemes in 2014 (Irish Association of Pension Funds, 2015). Commenting on this trend the Irish Association of Pension Funds (2015) said that "many workers in these [DC] pensions (even those with long service) may not achieve the comfortable retirement life they had planned".

A notable weakness in the roadmap is that there are no proposals to avoid "levelling down" where some employers reduce their contribution to existing pensions. The Office of National Statistics (2014) survey shows that when auto-enrolment was introduced in the UK employer contribution to DC schemes reduced from 6.6% in 2012 to 2.9% in 2014.

There is no evidence in the roadmap that pension tax reliefs have increased total savings in Ireland, rather than changing the composition of savings. After auto-enrolment was introduced in New Zealand The Treasury (2015, p.2) evaluation was that "KiwiSaver is a very costly voluntary savings scheme which has not substantially increased savings".

Collins and Hughes (2017) show that nearly 75% of pension tax reliefs accrue to 20% of high earners. Apart from a promise to review the cost and distribution of pension tax reliefs the roadmap has no proposal to make it fairer. The same promise was made in the National Pensions Framework (2010) so the roadmap has missed the opportunity to contain the cost and inequitable distribution of pension tax reliefs.

The roadmap adds to the framework published by the last government. Rapid consultations with trade unions, employers, pension providers, social justice organisations, academics, the public and opposition political parties will be needed to avoid slippage of the schedule.

Further reading

Collins, M. and Hughes. G. (2017). "Supporting Pension Contributions Through the Tax System: Outcomes, Cost and Examining Reform", Economic and Social Review, 48, 4.

Department of Social and Family Affairs (2010). National Pensions Framework. www.welfare.ie

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The Treasury (2015). Regulatory Impact Statement: Repeal of KiwiSaver Kick-Start Payment, http://www.treasury.govt.nz/publications/informationreleases/ris/pdfs/ris-tsy-rks-may15.pdf

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