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The Roadmap for Pensions Reform: Actuarial and other Issues

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Road Map on Pension Reform

- An Automatic Enrolment pension system has been proposed as part of the solution to the long run sustainability of the Irish pension system. The Government published a Roadmap on pension reform in February this year.
- Some of the key issues identified:-
- Poor coverage and low incomes in retirement.
- Low contributions to second tier pension
- Unsustainability of Social Welfare Pensions

Pension Coverage

Four sectors have consistently low pension coverage

- accommodation and food;
- Other NACE activities;
- Admin and support services;
- wholesale and retail;
- Pension coverage by women fell slightly over the period to 46.2 % of those in employment, just below that for men at 47.2%.

- These four sectors also have the lowest level of pay of 13 sectors;

- Above average rates of job churn

- Part time employees have low rates of pension coverage as do non-nationals
- The biggest change in pension coverage was by those described as self employed – a fall of nearly 50%.
- Self employment in construction sector increased from 25 % of those at work to over 40% in 2010 where it has remained
- In future years self-employment may become more important has been described as 'collaborative economy' using internet platforms, Uber., etc.
- Considerable implications for pension provision

Occupational pension coverage in Ireland 2005-2015

Sector	Q12005	Q42005	Q12007	Q12008	Q42009	Q42015
All sectors	51.9	55.9	55.4	56.3	51.2	46.7
Accommodation and food	20.8	23.7	19.9	22.7	17.3	13.1
Other NACE activities	34.2	34.2	29.0	30.2	27.0	23.3
Admin and support services	30.2	37.2	35.8	37.9	29.1	24.9
Wholesale and retail	35.1	39.3	38.9	36.2	29.6	26.5
Part time	26.5	29.9	28.2	31.7	23.7	22.3
Non-nationals	27.5	32.1	26.1	53.6	28.1	29.2
Self employed	44.8	48.4	45.7	45.8	36.4	22.9

Over dependence on the State Social Welfare Pension

Income Category	Average %	Average Amount €
Employee Income	1.9%	359.67
Self-employment income	4.9%	941.41
Private pension income	4.4%	847.75
Occupational pension	27.9%	5,373.82
State old-age related payments	53.1%	10,222.32
Rent income	1.8%	355.71
Investment income	2.0%	385.67
Other direct income	0.0%	0 .72
Housing allowances	2.3%	445.89
Other social transfers	1.7%	323.02
Gross income	100.0%	19,256.97

Source: Collins and Hughes (2017), using SILC 2014

Expected Main Source of Retirement Income for 2009 and 2015.

The State Social welfare pension is expected to increase in importance comparing 2009 and 2015.
This is especially so for non-Irish nationals and part time employees

Income Source all	Q4 2009	Q4 2015
Occupational	40.8	41.6
Social welfare	25.8	36.2
Non Irish Nationals		
Occupational	22.8	28.6
Social welfare	18	38.6
Full time Employees		
Occupational	48.0	49.5
Social welfare	20.7	30.4
Part Time Employees		
Occupational	17.1	18.2
Social welfare	42.3	53.5

Proposed Reforms

- Proposed reforms reflect different motives.
- “The system is facing a number of challenges in relation to population changes, income adequacy in retirement and ensuring the sustainability of the Government finances”
- “create a new and necessary culture of personal retirement saving in Ireland”
- In summary stated objectives of pension reform are:
- To ensure income adequacy in retirement;
- Ensure the sustainability of public finances;
- Increase personal saving for retirement.

Omitted issues

- No acknowledgement that a major factor in “income inadequacy” is the collapse in private sector pension provision.
- The demise of DB schemes with employer contributions rate of 18-20 % with DC schemes with employer contribution rates of 7%.
- Coupled with rules relating to late entry to a company pension scheme, and
- Rules relating to vesting which means that employment periods of under two years often do not result in any employer contribution to a pension scheme.
- The net result is that those with continuous employment but with mutiple employers will have difficulty in accruing sufficient funds in a pensions scheme.

The Central Role of Actuarial Reviews

- The sustainability of the state pension is a key issue. This currently determined by a five year actuarial review. But in future actuarial reviews will become more important.

- The Roadmap states (p. 9):-
- "In order to bring greater certainty to the funding of the State pension the Government proposes to move to a system whereby social insurance contribution rates and contribution classes are actuarially reviewed on an annual basis to determine what changes would be required to fund benchmarked increases in payment rates or expansion of benefits cover"

Actuarial Forecasts and Reform

- The recent actuarial review states:-
- “it is only possible to draw conclusions about the sustainability of a social security scheme by comparing pension and indeed other social security obligations with the respective assets.
- The resulting residual amount of obligations and assets represents the sustainability or fiscal gap.
- It represents the stock which has to be set aside today to sustain the present social insurance expenditure system (in its legal status quo) into the long term”.
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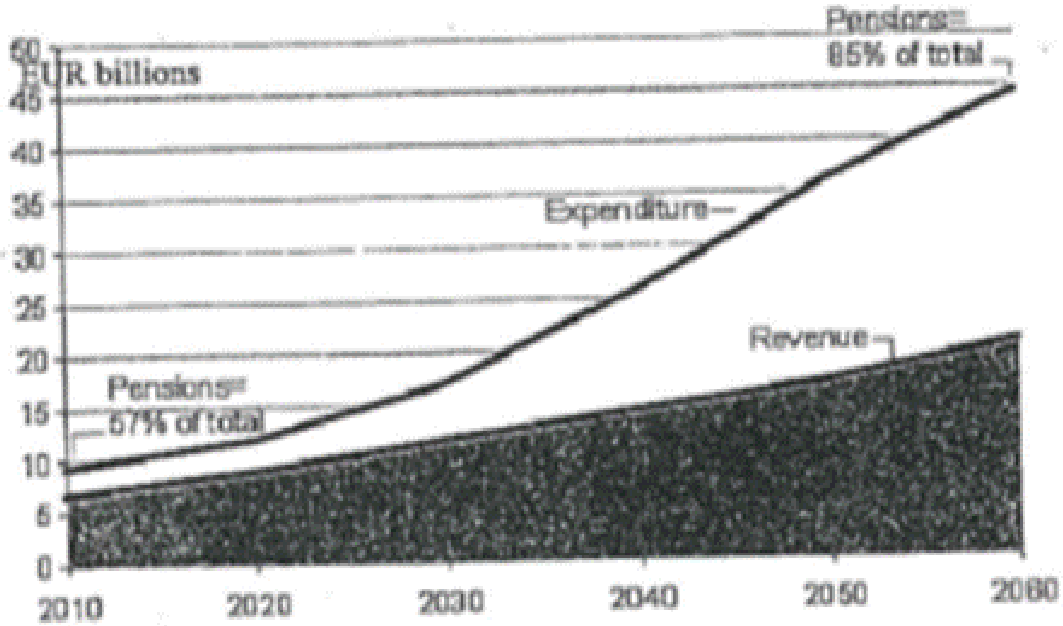
- Forecast deficits in the Social Security Fund are one of the factors used to drive policy options for pension reform.
- For example the OECD (p. 108, Par 4.4) stated:-
- “Given the many years that pension reform has already been discussed in Ireland without some fundamental choices being made about the way ahead, the time is ripe now to take some fundamental decisions on the future of Irish pensions”.

- One important reason the OECD consider the State pension system is ‘insolvevent’ is that Actuarial estimates for 2066 show receipts at €23.542 billion and expenditure €49.3 billion, resulting in a deficit of €25.7 billion or 5.7% of GNP.
- Views about the non-viability of the State pension system are widely held. For example an editorial in the Irish Times (Jan. 4th 2016) states:-
- “.. .. given the unsustainability of the State pension – decisive action is required.”
- The OECD illustrate their argument in a graph.

OECD (2013) Forecasts

Long-term projections of expenditures and revenues of the Social Insurance Fund for 2010 to 2060



Source: KMPG (2012) on behalf of the Department of Social Protection.

Actuarial Forecasts have turned out to be inaccurate

- Rather than a forecast deficit of €2.2 billion in the Social Insurance Fund in 2016, there was a surplus of €452 million.

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Pension Payments[1]	3546	4055	4527	4845	5007	5198	5320	5498	5641	5916	6018
SIF receipts[1]	8362	9347	9714	9226	8926	7864	7080	7632	8231	8439	8883
SIF receipts as % of GDP[2]	4.7	4.9	5.2	5.4	5.4	4.5	4.05	4.25	4.7	3.9	3.9
Surplus or Deficit[1]	649	583	-255	-2487	-2751	-1460	-2084	-1314	-542	-119	452
Actuarial review forecast (2012)[3]						-1485	-1828	-2024	-2008	-2039	-2230

Actuarial Forecast 2015 (published in Sept. 2017

As for Table (4), projected surplus for recent years are lower that the actual surplus for 2017 and the projected surplus for 2018.

Year	Deficit/surplus 2010 est.	Deficit/surplus 2017 est.[1]	Actual deficit/surplus from estimates
2015	-2.0	-0.1	-0.12
2016		0.4	0.45
2017		0.5	0.61
2018		0.2	1.01
2020	-3.2	-0.2	
2025		-1.7	
2030	-5.6	-3.3	
2055		-17.3	

Estimated current value of projected deficits

- The Actuarial Review 2015 (2017) also shows the net present value of projected future shortfalls using different discount rates as shown below.
- The actuarial review states that the discounted value of shortfalls while it is a hypothetical figure is "a useful measure of the magnitude of the shortfalls expected to build up in the Fund" (Social Welfare Fund).

'Real' Discount Rate	1%	1.5%	2.0%	3%
30 years to 2001-45	-104.0	-93.4	-83.9	-68.1
2015-2017	-404.2	-335.4	-279.6	-196.9

How Useful is an Actuarial Review ?

- The size of the deficit depends on assumptions, for example the discount rate.
- A fraction of the entire sum is due in any one year, not the entire amount.
- Another issue is why such a calculation deemed useful in relation to pensions but not in other areas of Government expenditure likely to last over the same period, for example health expenditures, expenditures on security, prisons, etc.
- Perhaps of greater importance is the implicit assumption that SWP are equivalent to private sector pensions and can be analysed in a similar way.
- An alternative view is that they are part of a social contract.
- This social contract could be across generations or intragenerational, as in transfers from those with greater wealth to those with reduced wealth.

PAYG versus Funded Pensions

- PAYG pensions are similar to funded pensions in that future expenditure by retired persons must come from future output.
- This can be funded via a PAYG pensions system, or a funded pension system in which future resources are purchased by income and capital assets of a fund.
- Required resources in both cases depend on future productivity.
- Income and assets of both systems are impacted by financial crises and shown in the recent financial crisis in Ireland

Automatic Enrollment: A Brief History

- Auto-enrolment was first discussed as a policy option in Ireland in a Green Paper in 2007.
- In 2010, the Government proposed an automatic enrolment (AE) pension scheme with the stated intention of ensuring increased "coverage and adequacy".
- To overcome "inertia";
- Increase transparency;
- Reduce inequities in pension provision;
- Increase affordability by allowing breaks in contributions and withdrawals for a house deposit.
- Employee would contribute 4%,
- Employers 2%
- The State 2%.
- AE would only apply to a band of earnings between €352 and €995 per week.

Current Proposal

- The citizens assembly voted that a ‘mandatory pension scheme should be introduced to supplement the State pension scheme and did not comment on the merits of PAYG versus fund;
- the proposed scheme is not mandatory and is funded;
- Important details such as contribution rates and targeted employees will be decided on the basis of a “public consultation process” (p. 17).
- Suggested parameters are :
- Employeees must earn more than €20,000;
- Be aged 23 or over;
- Employees may opt out after 9 months and will receive employee contributions only;
- Suggested contribution will be made by employers (maximum limit of 6%) , employees and the State.
- It is also suggested that any contributions made by the State would “replace rtaher than augment existing tax reliefs”

The Current Proposal

- Proposed employer contributions are lower than those made into current DC schemes.
- In the UK AE sytem, employee and employer contributions were phased so that after a number of year the max contribution) rate was achieved.
- Employee contributions were set at 2% to April, 2018, 5% to April 2019 and 8% from April 2019 on,.
- Employer contributions at 1, 2 and 3% respectively.

- Retirement benefits will be payable at the same age as the state pension.

- More controversially the Roadmap states :-
- "Workers with pre-existing personal or occupational pension arrangements will be able to retain those arrangements".
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- Multiple sources of retirement income is costly in terms of administration and hence fee income. It is also likely to result in lower returns as costs as a % of assets, vary inversely with the size of pension fund.

What About Self-Employed

- The proposed AE scheme is aimed at employees;
- Self- employed have low rates of pension coverage.
- Self employment in Ireland is higher than in the UK and some other countries
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Year	Ireland	UK	Germany	Denmark	New Zealand
2015	17.6	14.9	10.8	8.7	14.8
2014	17.4	15.4	11.0	8.9	15.3
2013	17.1	14.5	11.2	9.0	15.4
2012	16.7	14.6	11.6	9.1	16.6
2011	16.6	13.9	11.7	9.1	16.7
2010	17.1	13.9	11.6	9.1	16.2
2005	17.7	12.9	12.4	8.9	16.4
2000	18.8	12.3	11.0	9.1	18.5

The New Zealand Experience

- The AE scheme in NewZealand has been described “the world’s first national auto-enrolment national saving scheme”
- It has widespread coverage after 10 years, not confined to those at work, and low cost.
- In addition to tax reliefs further State subsidies take place via Revenue using the existing PAYE system both to collect employer and employee amounts allocate funds to manager and engage in extensive record keeping, thus avoiding many of the issues of lost accounts.

Some Issues: Differential pay

- With voluntary occupational savings schemes is that those who join receive higher remuneraton that those who do not.
- New Zealand employment law allows this to be taken into account when setting pay.
- If the employer has a ‘total remuneration’ policy, those who join KiwiSaver can see an adjustment to direct, taxable pay that reflects the requirement that the employer must contribute to KiwiSaver “
- The net effect is that AE schemes may result in employers offering higher benefits to those who do not join a pension scheme.
- This has led to many calls from industry to make the New Zealand AE scheme compulsory

Membership and churn

- The Table (over) shows a subsantial growth in members, but also a high proportion of those defined as ‘non-contributing’.
- The other feature is the high proportion of churn, that is those entering and leaving Kiwisavings schemes and switching schemes.
- While average assets are low at NZ$ 15,000 (€8,800

Membership and Churn

	Members million	Not contributing%[3]	Member entries[1]	Temporary and permanent exits[2]
March 2017	2.72	42.2	521735	443273
March 2016	2.61	42.7	519239	454382
March 2015	2.5	42.6	725995	574038
March 2014	2.29	44.5	997923	846015
March 2013	2.09	46.0	474895	401206
March 2012	1.91	45.0	625630	504059
March 2011	1.67	44.5	587227	477105
March 2010	1.37	44.3	560685	505618

Some Conclusions

- There is a vital need:
- For a supplementary second tier pension.
- To increase contributions by those currently in DC schemes.
- The issue is:
- is an automatic enrolment scheme the best solution and what should be the main features ?
- We would argue that a second tier pension should be mandatory for those without coverage, must be able to cope with 'contribution breaks', changes in employer, changes in address, and cross border movements.
- A universal mandatory pension scheme is likely to be lower cost, more equitable and less risky if organised as a PAYG, or notional funded scheme.
- The level and complex requirements data requirements means the burden (and cost) of administration will fall on the State.
- It is unlikely that private sector providers could meet these criteria.