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SPOTLIGHT

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National Pensions Review

On 17 January 2006, the Minister for Social and Family Affairs, Seamus Brennan, launched the Pensions Board's report on the National Pensions Review. The report, which with Appendices runs to 378 pages, is available on www.pensionsboard.ie .

Background to the Review

The Review was brought forward by the Minister because of his concerns that action needed to be taken sooner rather than later to increase supplementary pension coverage, given the apparent lack of progress towards the goals established following the previous "NPPI" report which was published in 1998. These were

- A target replacement income of 50% of pre retirement income
- Minimum income of 34% of Gross Average Industrial Earnings (GAIE)
- Supplementary pension coverage for 70% of the workforce over age 30.

The Board agreed that these targets were still appropriate, and noted that the State old age contributory pension (OACP) in 2005 of €179.30 per week was 32% of 2005 GAIE. [The increase in the OACP announced in the recent Budget increases the percentage to 33% of estimated 2006 GAIE.] However, the majority of Board members felt that the coverage targets would not be reached unless there were some changes in the current framework.

The report contains a detailed analysis of the current position, and projections of the future cost of State pensions. This disclosed that there would be significant increases in the cost of the existing level of OACP, which was projected to rise from the current 3% of GNP to 4.9% in 20 years' time, and 10.1% of GNP by 2056. There are two primary reasons for these increases

- An increase in the adult dependency ratio: at present there are over 4 workers for every pensioner, whereas in 50 years' time this will have reduced to 1.4
- Projected increases in life expectancy over the 50 year period of about 6 years for both men and women

The report noted that this cost can only be addressed by one or more of
- Increasing retirement age
- Increasing taxation or PRSI
- Increasing the Exchequer contribution to the National Pensions Reserve Fund
- Cutting back on benefits

The Board does not consider a reduction in benefits to be an appropriate response.

A number of models for possible alternative systems were considered, including enhancements to the current voluntary system, and mandatory systems whereby the employer and the employee would be required to make contributions to a supplementary pension arrangement.

The report makes a number of recommendations for immediate action, and lists issues which it considers should be considered further. These are outlined overleaf.

Recommendations for Immediate Action

- The way in which tax relief is granted on PRSAs should be changed to reflect the SSIA approach i.e. contributions are made from net income and the Government makes an additional contribution to the PRSA. The recommended amount is €1 Government contribution for each €1 paid by the individual, up to a prescribed maximum amount.
- Tax relief on contributions to other supplementary pension schemes should be at the higher rate for all taxpayers.
- PRSA holders should be permitted to access part of their accumulated fund before age 45. The suggested approach is to allow the withdrawal of up to 30% of the fund on a tax free basis before age 45, and to restrict the amount which can subsequently be taken tax free at retirement at age 60 or later to 20% of the residual fund.
- There should be a relaxation of the regulatory requirements in relation to taking out a Standard PRSA i.e. the need for an individual fact find should be removed.
- Current SSIA savers should be incentivised to transfer their savings on maturity to a pension arrangement by providing a one-off increase in the maximum pension contribution limits for those who had not paid maximum contributions in the recent past, and exempting the SSIA proceeds from exit tax on transfer to pensions where tax relief is not available on the amount being transferred.
- Those who wish to work beyond State pension age should be permitted to defer their OACP, which would be increased to reflect the period of deferral when they eventually draw it.

Issues for further consideration

The report identifies a number of areas for further consideration including

- Review the progress towards targets in 2008
- Research into reasons for the low level of pension coverage for women
- Mandatory systems including automatic enrolment/opt out system as proposed in the UK, or the Kiwisaver in New Zealand
- Pensions awareness campaigns
- Further changes to the funding standard
- Further consideration of a pensions protection fund
- Further consideration of State Retirement Support

The Minister's response

The Minister welcomed the report, and particularly the creative ideas to make PRSAs more attractive. However, he warned that all of these issue would need to be costed and discussed with Cabinet colleagues (notably the Minister for Finance, whom he indicated was supportive of the thrust of the report) and hence it would be some time before any changes would be made. He also indicated that his Department would be looking into the option to defer OACP, although he reiterated that the Government did not intend to increase the State pension age and force people to work longer. He indicated that he was pleased that the Board intended to look further at the mandatory and automatic enrolment approaches. He supported the Pensions Board's plans to review the funding standard, and said:

"I will be asking the incoming Board to review the situation again as a matter of urgency and to build on their earlier work. The present funding standard under the Pensions Act is based on a wind up on discontinuance basis. While I know that there are strong arguments to support a standard set on an ongoing basis, it is questionable if this would be in everybody's interest".

He intends to hold a national forum of interested parties in the next few weeks to debate the issues. Hewitt will consider the proposals and the Government response to them and will issue a more detailed bulletin on the key issues for our clients.

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