Fixing our broken pensions - a transforming approach to pensions reform

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"*We will reform the pension system to progressively achieve universal coverage, with particular focus on lower-paid workers, to achieve better risk sharing, and to provide for greater flexibility for those who wish to retire on a phased basis.*" – Programme for Government, 2011 (page 55)

Introduction

Many people face the prospect of inadequate pensions. Aspects of present policy seem to be geared more to achieving necessary improvements in the public finances but the long-term sustainability of pensions also needs to be addressed.

Pension coverage in the working population is too low with too many people likely to be dependent, either totally or in part, on the State Pension.

Costs in the pension industry are too high. There is an unacceptable lack of transparency.

Radical change is necessary.

We set out a new model for pensions and savings provision in the future. Our model would apply to all individuals working in the economy and would not differentiate between different types of economic status such as self –employed, farmers, private or public sector employees.

We propose a two –tier approach to pension provision. The first tier would build on the current PRSI pension arrangements –essentially providing a floor against poverty. The arrangements for the second tier would involve so- called "soft mandatory" contributions by employees and employers and an income related SSIA –style Exchequer contribution (which would be capped at a certain level of income). The cost of the Exchequer contribution would be offset by the abolition of tax relief on pension contributions. An important feature is that each contributor would have an individual account in a central fund. The accumulated payments and contributions made by them and on their behalf would be available for funding post –retirement income – but there could be some opportunities for pre –retirement partial encashment.

The paper also reviews the investment performance and costs of the pensions "industry" and the existing rules and structures.

We signal approaches to transition mechanisms from the existing arrangements to the new structure. We also look at the implications of the proposed central fund for investments and savings at the level of the national economy and national debt management. The model also has the potential to facilitate new approaches to "retirement" – through part time employment arrangements where an individual might be both a beneficiary and contributor to the national fund. This will be a necessary and appropriate response to the projected increase in the proportion of older people in the population. We also highlight the need for robust governance arrangements arising from the need for assuring contributor investor protection and confidence.

[1] The views and proposals outlined in this paper are those of the authors alone. They should not be attributed to any of the organisations with which they are associated. Biographical notes are attached (Appendix1).

Why Change?

As a society our current pension arrangements are inefficient and socially divisive. They are not sustainable and are not fit for purpose.

Compelling reasons (all of which are known and well rehearsed) include

1. Pension "coverage" across the working population is inadequate and does not appear to be increasing.

2. Significant long term demographic changes will, on the basis of current definitions, increase the ratio of people at pensionable age to the numbers at work – creating major social policy and financing challenges.

3. The funding of many pension schemes is inadequate.

4. Some of the arrangements for purchasing pensions which are available to private sector employees and self employed people are structurally and operationally inefficient with high management charges which are not transparent and are at levels which significantly erode the future benefits to the scheme members.

5. Different pension arrangements applying to people working in the public sector and those in the private sector are a source of social tension and disquiet. There is also a popular view that the current arrangements in respect of tax relief are inequitable.

These issues are briefly discussed in the following paragraphs.

1. Inadequate pension coverage.

According to the National Pensions Board, only 54% of people in the work force have pension coverage. [2] Within the working population there are wide disparities. Public service coverage is over 90 percent while in some areas of the private sector coverage is very low. The National Pensions Framework published by the previous government in 2010 cites the examples of the hotel and restaurant sector (pension coverage of 23 percent) and the wholesale and retail trade (pension coverage of 36 percent)[3]. Independent consumer research carried out on behalf of The Pensions Board indicates that:

- Almost eight out of ten people, who do not contribute to a pension, say that the State Pension would not meet their needs in retirement
- Although employers are obliged by law to offer employees access to a pension, 43% of those interviewed had not been offered access, of those 93% had never asked an employer about access to a pension,
- Although awareness of the tax relief for pension contribution is relatively high at 73%, the majority of people didn't know or had incorrectly understood the amount of tax relief that applies to them.

[2] National Pensions Board; http://www.pensionsboard.ie/en/National_Pensions_Awareness_Campaign/Overview_of_the_NPAC/#para2

[3] National Pensions Framework; http://www.nationalpensionsframework.ie/downloads/NationalPensionsFramework.pdf

- According to the Pensions Board these figures demonstrate reluctance, by the general public and the key target audiences with low pension interaction, to properly plan and save for retirement[4].

2. Demographic changes

Life expectancy is increasing. According to David Malone of The Pensions Board, the average person retiring today aged 65 has a life expectancy of 20 - 23 years.[5] . The impact of this and other demographic changes is projected to result in very significant changes in the ratio between the numbers of people at work and those in receipt of pensions. The following table shows the projections cited by Malone[6].

	2006	2026	2056
Numbers at work	2.0m	2.26m	2.12m
Aged over 65	0.46m	0.84m	1.53m
Numbers at work per person over 65	4.3	2.7	1.4

Restrictions on people drawing their pensions if they continue to work after pension age should be removed. This would encourage individuals to phase in retirement and allow them to establish their own balance between paid work and leisure and unpaid work within the framework of sustainable incomes. This is an essential change to address funding sustainability as the proportion of older people in the population and workforce increases. The projected steep decline in the ratio of those at work to people over 65 shows that the existing model of "compulsory retirement" and the barriers to employment faced by some retirees (particularly with their current employers) are no longer appropriate[7]. There are also outdated provisions in the State Pensions system. Access to the State Pension (Transition) at age 65 requires retirement from work while after age 66 an individual in receipt of the State Pension can work. This prevents people from working or pushes them into the black economy at a critical time for them in managing the transition from full time work. This anomaly will be removed in 2014 when the state pension age is increased to 66. But, why wait until then?

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[4] The National Pensions Framework sets a target of maintaining social welfare pension rates (currently at €230.30 per week at 35% of average earnings.

[5] See presentation by David Malone, Head of Information, Pensions Board to the Michael Smurfit Business School, UCD The Irish Pensions Experience, 22 February 2011 available at http://www.pensionsboard.ie/en/Publications/Presentations/Presentation_to_UCD.html

[6] Malone, Pensions Board; http://www.pensionsboard.ie/en/Publications/Presentations/Presentation_to_UCD.html

[7] The compulsory retirement age was abolished for those who entered the public service after 1 April 2004 (Public Service Superannuation (Miscellaneous Provisions) Act, 2004. The recently (29 September 2011) published Public Service Pensions (Single Scheme) and Remuneration Bill 2011 proposes a maximum retirement age of 70 in the Public Service.

3. Inadequate funding of pension schemes

Pension provision in both private and public sectors faces enormous challenges.

Within the private sector, the Annual Report of the Pensions Board (2010) concludes that the Board *"estimates that as at 31 December 2010 some 75% of defined benefit schemes are in deficit and in many cases, the deficit is substantial".*[8]

Contributors to defined contribution schemes have experienced investment losses; many are not paying sufficient contributions to fund adequate pensions and too many are not making any contributions at all.

This, of course is linked to the poor performance on stock markets and the difficult economic circumstances since 2008. Irish pension fund performance has been poor. In the five years to December 2010, the average annual return was minus 0.6 percent and minus 4.1 percent in the most recent three year period.[9] These compare poorly with the returns achieved by the National Pensions Reserve Fund (NPRF).

Group Pension Managed Fund Returns to 31 December, 2010

	Q4 %	1 Year %	3 Years % pa	5 Years % pa
AIB Investment Managers	6.3	11.8	-6.5	-1.0
Aviva Investors	5.8	8.8	-7.2	-2.2
BIAM	5.8	10.6	-3.8	-1.9
Canada Life/Setanta	3.9	9.5	-1.8	0.3
Eagle Star/Zurich Life	6.0	10.9	-2.0	1.6
Friends First	6.5	12.2	-5.2	-1.3
Irish Life Investment Managers	3.8	9.0	-4.9	-1.2
Kleinwort Benson Investors	5.8	11.8	-6.1	-2.3
Merrion Investment Managers	5.9	10.2	-2.1	0.9
Standard Life Investments	7.4	16.6	-1.4	1.0
Average	5.7	11.1	-4.1	-0.6
NPRF	**5.4**	**11.7**	**-2.1**	**1.8**

Sources: Finfacts.ie and NPRF

NPRF returns are on Discretionary Portfolio excluding Directed Investments

[8] Annual Report of the Pensions Board 2010: http://www.pensionsboard.ie/en/Publications/Annual_Report/The_Pensions_Board_Annual_Report_and_Accounts_2010.pdf

[9] http://www.finfacts.ie/fincentre/irishpenfunds.htm and http://www.nprf.ie/Performance/selectYear.htm

As regards the public service the Comptroller & Auditor General has estimated the State's accrued liability in respect of pensions for serving staff, pensioners and preserved pensioners was €116 billion at 31 December 2009 (or 90% of the annual GNP for 2010)[10] .

This liability will of course arise over many years but addressing it will be more challenging due to the diversion of three quarters of the assets of the National Pension Reserve Fund (NPRF) to recapitalise the Irish banks.

4. High management charges

Some of the current models of pension purchase available to private sector employees and self employed people are structurally and operationally inefficient with high management charges which are not transparent and are at levels which significantly erode the future benefits to the scheme members.

Management charges levied by the pensions industry are too high. The UK Turner Report set a target of 0.3 percent for Annual Management Charges. Research by Mahon (2006)[11] found that the average cost of operating pension schemes in Ireland was on average to be 1.25 percent of assets, which is higher than international counterparts. The annual charges borne by the smallest schemes represented 3.64 percent of assets while the charges borne by the larger schemes represented 0.32 percent of assets. Mahon estimated that industry charges amounted to 26 percent of the total "pot" of retirement income over the lifetime of a pension in private sector schemes.

The Turner Report[12] found that in the UK reductions in yield arising from providers' charges can absorb 20-30 percent of an individual's pension saving, even though they have fallen to a level where provision to lower income groups is unprofitable.

The Turner Report identified high costs of distribution and administration as one of the inherent barriers to the success of a purely voluntary system of funded pension savings. Insurance companies and banks, whether selling directly or via financial advisers, cannot profitably serve substantial segments of the market except at annual management charges (AMCs) greater than 1 percent, and for some segments well above that rate. AMCs this high are a logical disincentive to voluntary saving, and substantially reduce income in retirement. The drivers of these high costs, compared with the levels of 0.1 percent to 0.3 percent attainable by large occupational schemes, include:

- The high cost per successful sale arising from the need for individual advice and persuasion, and from the low success rates achieved.
- The proliferation of separate contracts for the same individual, arising from the existence of separate employer schemes into which the individual must enrol to receive an employer contribution.
- The lack of economy of scale buying power in the purchase of fund management services.

Costs matter. For example a sum of €1m invested at a gross market rate of return of 10 percent per annum would increase to €10.8 million over 25 years. If annual costs are 2 percent the net return is €6.8 million—a €4 million penalty[13]. At a minimum there should be much greater transparency in relation to costs.

[10] (Comptroller and Auditor General, Annual Report 2010. http://audgen.gov.ie/documents/vfmreports/68_Central_Gov_Pensions.pdf

[11] "Irish Occupational Pensions: An Overview and Analysis of Scale Economies"; Aidan Mahon, Waterford Institute of Technology, 2006; see http://www.finfacts.ie/irishfinancenews/article_10006890.shtml

[12] "A New Pensions Settlement for the 21st Century" Turner Report 2005; http://www.pensionscommission.org.uk/publications/2005/annrep/annrep-index.asp

[13] http://www.vanguard.com/bogle_site/lib/sp19980521.html Speech by John C. Bogle, May 21, 1998

5. Different Public and Private Pension Arrangements

Different pension arrangements applying to people working in the public sector and those in the private sector are a source of social tension and disquiet. There is also a popular view sense that arrangements in respect of tax relief on pension contributions are inequitable.

Differences in pension arrangements and entitlements have become controversial and divisive. The different pension arrangements applying to public service and private sector workers have become an issue of resentment stimulated in part by the publicity given to the retirement arrangements applying to top level civil servants. The perception that wealthy individuals in the private sector could shelter wealth and income from tax by making sizeable pension contributions is also resented by middle and lower income groups. These reliefs have been tightened in recent years[14]. These social tensions are undesirable and particularly so during current times of serious social and economic challenge when the premium on social solidarity requires that the burden of economic and income adjustments be equitably shared – and be seen to be so.

The traditional arrangement in the public service (as distinct from public sector) was for "pay as you go" pension schemes - with pensions adjusted annually adjusted in line with the salaries of employees in the pensioners' retirement grades. Many of the pension schemes were non-contributory. These arrangements are due to be modified. Draft legislation published in late September[15] proposes the introduction of a new single pension scheme for all new entrants to the public service from 2011. This aim of this new scheme is to reduce the Exchequer cost of public service pensions in the longer-term. The main provisions of the proposed new scheme are;

- Raising the minimum pension age to 66 years initially and then linking it to the state pension age
- A maximum retirement age of 70 years;
- Career average earnings rather than final salary to be used to calculate pension (a pension amount to accrue each year and this to be up-rated each year by the CPI so as to maintain its purchasing power).

These provisions are in line with the commitments made in the EU/IMF Programme of Financial Support for Ireland.

Traditionally, most of the private sector employees with pension cover were members of defined benefit schemes. Newer employees with pension coverage (and many longer serving employees) are now mainly members of defined contribution schemes[16]. For defined contribution members the poor performance of pension funds has, as we noted earlier, reduced the value of their pension savings.

The tax reliefs on pension contributions have become the focus of much attention and disquiet – and have been misunderstood. Traditionally, the tax reliefs on pension contributions were intended as an encouragement to saving. The underlying thinking was that the Exchequer cost of the tax reliefs available at the time of making the contribution would have an offsetting counterpart (over time) from the income tax receipts on the pensions payments subsequently received by the pensioners. This trade off seems to have been lost sight of and public attention (and that of policy makers) focused on the immediate and expensive costs[17] of the income tax revenue foregone on

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[14] We discuss the possible impact of recent changes below and in Appendix 2.

[15] Public Service Pensions (Single Scheme) and Remuneration Bill, 2011

[16] According to the Pensions Board (Malone – see references above) there are 586,488 members in 1,307 DB schemes, 266,909 members in 82,939 defined contribution schemes and over 181,000 Personal Retirement Savings Accounts (PRSAs).

[17] €2072m in 2008; the larger constituents of this estimated cost were the costs on the relief on employees' and employers' contributions to approved superannuation schemes, the exemption of investment income and capital gains of approved superannuation funds, the exemption of employers' contributions to approved schemes from employee benefits in kind and the reliefs on retirement annuity premiums- see http://debates.oireachtas.ie/dail/2011/07/14/00073.asp

pension contributions. Because the tax reliefs were based on a proportion of income, the arrangements were also seen as regressive – though, of course, wealthier pensioners would also in time pay more income tax! The result has been a gradual tightening of the income tax reliefs both in terms of reductions in the rate at which the relief is applied and in reductions in the income cap. The Programme for Government contains a provision that will cap taxpayers' subsidies for all future pension schemes) that deliver income in retirement of more than €60,000. In addition the Government in May announced its intention to impose a 0.6% annual levy for four years on pension funds in order to finance its Jobs Initiative.

The various changes have not improved transparency and have in some respects led to outcomes which seem at very best to be unintended (See Appendix 2). For example, as a result of the recent changes a self employed individual availing of the maximum tax relief is unlikely to be able to fund the benefits available in the public sector.

Recent Policy Directions

These have been set out in the National Pensions Framework, published in March 2010 by the previous Government, the National Recovery Plan 2011- 2014 (also published by the previous Government), the EU/IMF Memorandum of Understanding and the Programme for Government which also contain a number of commitments in relation to public sector pensions[18]. Some of these measures, including auto –enrolment and the increase in the pension age, are positive and should improve pension coverage and the long-term sustainability of pensions. However many of the others, such as the recent pensions levy and the reductions in tax relief seem more geared to achieving short-term improvements in the public finances. The arbitrary nature of some measures such as the pensions levy increases uncertainty and will do little to improve pension coverage. The figures in Appendix 2 suggest that some of the tax relief policies being signalled may provide a disincentive for certain categories of people to invest in their pensions. At a minimum, present policy needs to be reviewed and much greater clarity and certainty provided in relation to pensions policy.

Our Proposed New Structure

Our proposals for change are influenced in part by the example of the Singapore Central Provident Fund (CPF). The CPF is a compulsory comprehensive social security savings plan which aims to provide working Singaporeans with a sense of security and confidence in their old age.

Proposal - a National Savings Fund (NSF)

A statutory fund would be established with two pillars. **An important feature of this scheme is that every individual who was in the labour force at any stage would have his or her own unique account with the Fund.** Information on contribution details, accumulated value and equivalent annualised income values would be regularly updated and available to the account holders. All contributions would be collected through the tax system.

Pillar 1

Compulsory contributions from employees, employers, self –employed and farmers, with a contribution scheme broadly similar to the current PRSI system while removing some of the complications and anomalies of the current arrangements. Funds in this tier, which may need to be supplemented by Exchequer contributions, would be used to fund a basic income for pensioners

[18] See Appendix 3 for details.

similar in concept to the current contributory State Pension. This income would be entitlement and contributions based. A means tested non-contributory pension scheme funded from taxation would remain in place as a safety net, anti-poverty measure. The coverage of this pillar would include everybody in the labour force as well as those people, not formally in the labour force, but undertaking socially valuable roles such as parents who have taken time out of the work force for child minding and carers of elderly and frail relatives.

Pillar 2

This in essence would be a single centrally managed defined contribution scheme with individual accounts funded by "soft" mandatory or auto-enrolment[19] contributions from employees and employers according to specified scales.[20]. Exchequer counterpart contributions (modelled on the SSIA and PRSA schemes) would be paid into the Fund at specified proportions of employee contributions and subject to an income cap. The existing income tax reliefs on pension contributions would be abolished. Parallel arrangements, operated through the annual system for income tax returns, and also based on a default contribution assumption would be put in place for farmers and the self employed. Because of the policy priority which in our view should apply to expanding pension coverage we propose that each year contributors opting out would be statutorily required to reaffirm their decision each year or otherwise the default" opt in" provisions would apply. An additional provision could be to allow contributors a choice of rate, lower than the default rate, at which they could make their contribution.

How the scheme would work

Pillar 1

Access to the funds in **Pillar 1** would only be available to account holders from a legislatively prescribed pension age and only in the form of a determined income determined by statute. This retains the essential characteristics of the PRSI Contributory Pension and would fill the same role as an important basic income.

However, in our view a number of changes are required.

1. For pension purposes a single contribution rate would apply to all contributors irrespective of employment status – whether employed or self employed (including farming). For employees the contribution (and rate) would be apportioned between the employer and the employee.
2. The application of an income ceiling to the employee contribution would be a matter for debate and decision by Government and the Oireachtas. If there were no ceiling then the contribution would be redistributive (better off people would pay more). In these circumstances the employee contribution could be merged with general income taxation and the employer contribution could be changed into a flat –rate payroll tax.
3. The entitlement rules would be changed to remove existing anomalies. The most unfair of these is the "average contributions" approach to entitlements whereby some people qualify for higher pension payments even though they may have fewer contributions (but a higher average) than others who do not qualify, or qualify for a lower pension, due to the average contributions test. We support the proposals in the National Pensions Framework for a "total

[19] By soft mandatory or auto-enrolment we mean that employee and employer contributions would be deemed to be made unless the employee decided to opt out. This concept is now being applied in New Zealand and in the UK. A parallel regime would apply to farmers and the self employed. This approach was also proposed in the National Pensions Framework document.

[20] Currently most occupational schemes are based on a 5% contribution from the employee and 10% from the employer. It is likely that these rates will need to be increased to ensure adequacy.

contributions" approach where the level of pension paid would be directly proportionate to the number of contributions made by and on behalf of a person over their working life.
4. As already proposed in the National Pensions Framework an option would be provided for people to defer their pension entitlement at the stated retirement age in return for a higher rate of pension which would be actuarially determined.

Pillar 2

The objective of **Pillar 2** is to increase pension provision by those with no or inadequate provision such as some contributors to defined contribution schemes. The objectives of this Pillar are to address the challenges of general inertia and the unwillingness of younger people in particular to tie up money for periods of up to 40 years (or more?) when they have other priorities and demands on their cash flow.

Our recommendation for auto-enrolment is designed to address the inertia problem. Research has shown that the contribution rate to pension schemes is much greater when people have to opt out rather than opting in [21]. Contributions could be made to a defined contribution scheme provided by the employer or through the tax system to the **National Savings Fund (NSF**). Where an employer provides a defined contribution scheme, the employee must have contributions deducted unless they specially opt out in writing. This would have to be done annually and employees could also for a limited number of years be given the option of making contributions at a lower percentage of income. Where an employer does not provide a pension scheme or the individual is self-employed, a default auto-enrolment mechanism can be set up by the **National Savings Fund** with contributions collected through the tax system.

To provide greater encouragement for younger people to make pension contributions a proportion of pension capital (savings plus capital growth) could be withdrawn for certain **specified** life events without tax penalty. One such event should be to allow first-time buyers to use pension savings for house purchase and for education of their children.

Account holders in **Pillar 2** would be free subject to actuarially based regulation to draw down their funds in part as capital payments (analogous to the current Approved Retirement Funds (ARFs) and as income annuities from a prescribed age (say 60 years+). If an account holder were to die the funds in the account would form part of his or her estate. On retirement the funds could be used to purchase an annuity or be invested in an approved retirement fund (ARF) under the existing rules.

Implications for individuals

1. Each individual contributor under Pillar 2 becomes an investor/account holder – with ready and continuing access to information about her or his savings.
2. Individuals would not be tied to the pension schemes established by their employers. Any technical difficulties surrounding portability and job change. The scheme would promote labour mobility and economic efficiency.
3. The account transparency, investor ownership and soft mandatory character of the contributions to Pillar 2 represents a middle way between trade union objectives to protect the post employment income of their members through having mandatory contributions and employer concerns about increasing the tax wedge. The Pillar 2 contributions in essence become a form of "soft" compulsory saving.

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[21] "The Power of Suggestion: Inertia in 401(K) Participation and Savings Behaviour", Brigitte C. Madrian and Dennis F. Shea, Quarterly Journal of Economics 116(4): 1149-87, 2001

4. The provision for early partial withdrawals regime is more relevant to the needs and time horizons of younger people than a "pure" pension scheme.
5. Account holders coming to retirement age would be able to make decisions on the desired balance between employment and pension income. The scheme would have a role to play in encouraging people to continue in the labour force doing work of their own choice. There would be no mandatory barriers to continuing to work after "retirement age" but employers should in our view be allowed to have the discretion to apply term limits or compulsory retirement ages for senior and top management positions – but employees and employers would be free to conclude new employment arrangements in the same organisation following "retirement".

Investment and fund management policies

The funds would be under the management of a statutory board of the National Savings Fund (NSF). Investors would be free to advise the NSF of the risk desired profile they wished to apply to their funds in **Pillar 2** and to change these profiles over time and in line with their own perspectives, requirements and assessment of market conditions. The NSF could competitively contract fund management to a portfolio of managers as well as managing funds directly.

The establishment of a National Savings Fund on the lines we propose clearly could result in the accumulation of significant resources.

The Revenue Income Distribution Statistics (latest year 2007) show that the pool of income available to those under 65 and earning more than €25,000 per annum was about €62 billion (This figure excludes income in excess of €115,000 which would not qualify for pension tax relief). About €16 billion of this relates to public sector pay excluding pensions leaving a net €46 billion to represent the pool of money out of which pension contributions might be paid.

While it is difficult to estimate the likely size of the National Savings Fund, tentative projections suggest that the Fund would be very substantial (of the order of €20b) within a 10 year period and would be significantly larger than the biggest occupational funds. An indication of the long-tem potential is that the assets of the Central Provident Fund in Singapore amount to over 60 percent of GDP.

This would create the opportunity for the government to raise funds at a domestic level by offering suitable long-term products such as indexed or GDP related bonds.

Our calculations suggest that using plausible assumptions that these arrangements, even with very conservative investment policies, could provide contributors with retirement incomes of the order of 50 percent of their pre-retirement pay.

Governance

Because of its scale and its importance to individual stakeholders careful attention would need to be given to the governance and management of the NSF.

In our view core principles should include:

1. Assuring the independence of those people entrusted with the governance responsibilities through appropriate legislative (or perhaps in time constitutional) protection. It would be important to avoid diversion of funds without popular debate by the Government of the day such as happened in the case of the Social Insurance Fund and the National Pensions Reserve Fund.
2. Probity of trustees and fitness and probity of managers

Possible Governance Structures

These could include a dual governance structure with a Board of Trustees (responsible for oversight) and a Management Board (charged with strategic governance). The trustees would be responsible for the appointment and oversight of the f Management Board with limited intervention rights in respect of Management Board decisions prescribed in legislation. To ensure their legitimacy and accountability the trustees would most appropriately be appointed by the Dáil (as the democratically elected chamber of the Houses of the Oireachtas) for one term only. The terms would be such as to be longer in duration than the term of a single Dáil. Appointment and election of the trustees should be on a basis which makes it evident that they are accountable to the Oireachtas and not to the Government[22] . Government or Oireachtas would not be able to interfere in the decisions of the trustees except through a very demanding "super majority" of Dáil deputies.

Implementation and Transition

Clearly a structural change of the magnitude we are proposing would take some time to implement fully and would encounter a range of implementation challenges. However, the potential benefits are very considerable.

Existing employees in the private sector, could opt to continue their present arrangements or switch their (and their employer's) contributions to the new National Savings Fund. If they opted to switch, their accrued pension entitlements would be preserved. A further option might be for people in existing pension schemes to transfer their investments to the new scheme. Similar options could be given to self-employed.

Our proposals imply a change in public sector pensions from pay as you go to pre-funding. Clearly such a change for existing employees would be very difficult to contemplate given the current state of the public finances. A more practical option would be to introduce the new arrangements for new employees.

Conclusion

We put forward the approach outlined here as a response to the challenges in the pensions arena including poor coverage, underfunding and impending demographic changes. Unless credible responses are produced to the upcoming crises there is a real risk of a potential intergenerational conflict arising between younger people concerned about issues such as tax burdens and the funding of child care and education services and costs and older people worried about income sustainability and health care costs. Such a social conflict would be very damaging. We believe that our proposals could play a role in reducing this risk through the creation of a national savings fund underpinned by transparency in regard to both total fund performance and individual holdings as features which will contribute to enhancing social solidarity and individual responsibility.

[22] The d'Hondt method of voting used for the election of the Executive in Northern Ireland may be an appropriate model.

Appendix 1

Dr Donal de Buitléir

Donal de Buitleir is Director of the newly established Irish Fiscal Policy Research Centre. Earlier in his career he worked in AIB Group and in the civil service. He was Secretary to the Commission on Taxation 1980-85 and is a former Board member of the Health Services Executive.

Dr Don Thornhill

A former top civil servant, Don Thornhill is a consultant and adviser on strategy and policy to a number of leading Irish organisations.

He chairs the National Competitiveness Council, the Irish Payments Services Organisation, the board of Hibernia College, the Ageing Well Network and the Inspire interuniversity nanoscience consortium. He is also Deputy Chairman of the Chartered Accountants Regulatory Board and is a member of the boards of Forfás, the Irish Hospice Foundation and the Foundation Board of the Royal Dublin Society.

Appendix 2

This Appendix compares the returns earned by an individual investing in a pension fund with those which might be earned if similar amounts were put aside outside the fund. It assumes that the tax treatment of pension fund investments will be as set out in the National Recovery Plan. To isolate the effect of differences in tax treatment, returns on both are assumed to be the same.

Example Showing Effect on Self-Employed Individual aged 60 Making Pension Contributions Assumptions

Income	€100,000
Pension Contributions	€40,000
Tax Relief	20%
Marginal Tax rate on Exit	41%
Rate of Return	3%
Interest on Deposit	3%
DIRT Rate	25%

If Money Put on Deposit (Outside Pension Fund)

	Savings	Cumulative	Return Post Tax
Year 1	40,000	40,000	
Year 2	40,000	80,000	1,000
Year 3	40,000	121,000	2,000
Year 4	40,000	163,000	3,025
Year 5	40,000	206,025	4,075
Total After 5 Years		216,125	10,100

If Money Invested in Pension Fund

	Savings	Cumulative	Return Post Tax	Tax Relief	Cumulative	Return on Tax Relief
Year 1	40,000	40,000		8,000	8,000	
Year 2	40,000	80,000	1,200	8,000	16,000	200
Year 3	40,000	121,000	2,400	8,000	24,000	400
Year 4	40,000	163,000	3,636	8,000	32,000	600
Year 5	40,000	207,236	4,908	8,000	40,000	800
Total After 5 Years		219,380	12,144	40,000	42,000	2,000

Max Tax Liability	219,380
Net	129,434
Add Tax Relief	42,000
Total After 5 Years	171,434
Worse Off By	44,691
Percentage	20.7%

Appendix 3

Recent decisions in relation to pension's policy include:

National Pensions Framework (March 2010)

- System of auto-enrolment proposed
- Replace tax relief with State contribution equal to 33% tax relief
- Increase State pension age to 66 in 2014, 67 in 2021 and 68 in 2028.

National Recovery Plan 2011-2014 (November 2010)

- Eliminate employee PRSI and Health Levy relief on pension contributions in 2011.
- Reduce the annual earnings cap for employee/personal pension contributions by almost 25% from €150,000 to €115,000 and to reducing the Standard Fund Threshold (The maximum allowable pension fund on retirement for tax purposes).
- Reduce tax relief on pension contributions from 41% to 34% in 2012, to 27% in 2013 and 20% in 2014.

EU/IMF Memorandum of Understanding (November 2010)

- Budget 2011 to reduce pension tax relief to yield €260 m in a full year
- Budget 2012 to further reduce pension tax reliefs

Budget 2011

- Employee pension contributions subjected to employee PRSI and the Universal Social Charge.
- The annual earnings limit for tax-relievable contributions for pension purposes reduced from €150,000 (2010) to €115,000 for 2011.
- The maximum allowable pension fund on retirement for tax purposes (known as the Standard Fund Threshold (SFT)), reduced to €2.3 million with effect from 7 December 2010.
- The annual imputed distribution which applies to the value of assets in an Approved Retirement Fund (ARF) at 31 December each year increased from 3% to 5% in respect of asset values at 31 December 2010 and future years.
- The overall life-time limit on the amount of tax-free retirement lump sums that an individual can draw down from pension arrangements reduced to €200,000. The excess of this amount to be taxed at the standard income tax rate (currently 20%) up to an amount equal to 25 percent of the new Standard Fund Threshold (up to €575,000). The excess of retirement lump sum payments over that amount to be taxed at the taxpayer's marginal rate of income tax.

Programme for Government (March 2011)

- Proposed to cap taxpayers' subsidies for all future pension schemes that deliver income in retirement of more than €60,000.

Jobs Initiative (May 2011)

- An annual levy of 0.6% on the market value of assets under management in pension funds and pension plans approved under Irish tax legislation was introduced for the years 2011-14.