Irish Association of Pension Funds

Pre Budget Submission

November 2004

1. Executive Summary

The Irish Association of Pension Funds (IAPF) has prepared this submission with a view to making constructive observations and recommendations which the IAPF believe will be useful to the Minister and his officials in framing the forthcoming budget as well as in the Government's general deliberations on pension policy matters in Ireland.

We would very much welcome the opportunity to discuss the contents of this submission with the Minister for Finance and members of the Department.

In summary, the IAPF suggests:

- **that a positive message should be conveyed in this Budget as to the possible usage of SSIA funds for pension savings purposes. IAPF recognise that there are a number of alternative approaches which could be adopted and would welcome the opportunity of discussing same with the Department prior to the production of the Finance Bill.**

- **IAPF believes that pension funds should not be subject to any taxation on the accumulation or management of its assets.**

- **IAPF recommend that the ARF (Approved Retirement Fund) and AMRF (Approved Minimum Retirement Fund) retirement options be extended to Defined Contribution (DC) schemes**.

- **IAPF request that, where an individual is in receipt of the State Retirement Pension or Old Age (Contributory) Pension and entitled to an additional payment in respect of a qualified adult dependant, that the additional payment should be treated as income of the spouse under the tax individualisation rules**

- **IAPF believe that the existing ceiling amount on earnings which qualify for tax relief on employee pension contributions of €254,000 for individuals should be adjusted for inflation to €300,000 and linked to inflation for the future**

2. Avoiding the inflationary impact of maturing SSIAs

Studies carried out by the ESRI, the Pensions Board and the IAPF in recent years have highlighted two issues in relation to pension coverage amongst Irish employees:

1. that the percentage of Irish employees with any level of pension provision needs to be increased; and

2. that the current level of retirement savings for many Irish employees may not lead to an adequate level of income in retirement.

The IAPF welcomed the establishment of the National Pensions Reserve Fund and we continue to support the prudent management of the nations long term pension liabilities. The IAPF supports the continued prudent management of the assets within the National Pensions Reserve Fund to ensure the maximum level of investment return relative to inflation – having regard to the liabilities the fund is intended to match.

Given the projected increase in the numbers of retirees in the future, the IAPF believes that BOTH of these factors need to be addressed by the Government if it wishes to reduce the burden on future State resources from the retired population. To date the focus of the Pensions Board and other representative bodies have been on the level of “pension coverage” and not on the quality of coverage.

The IAPF believe that there is a need to increase the quality and level of pension coverage within the population at large and recognise that differing mechanisms and levels of incentives may be required in different segments of the working and non working populations.

The IAPF believes that an opportunity will present itself over the next two years to potentially partially address the quality of coverage for part of the population as a result of the maturing values of Special Savings Investment Accounts.

Given the likely maturity dates of these contracts, the IAPF believes that a positive message should be conveyed in this Budget as to the possible usage of SSIA funds for pension savings purposes. This is required to provide savers with adequate advance notice to avoid maturing SSIA accounts being “earmarked” for other purposes and hence increasing the inflationary impact on asset prices within the economy at a time when this is not desirable.

At the time of their inception, SSIAs were utilised as a mechanism to reduce the level of disposable cash within the Irish economy. The IAPF believe that a reasonable proportion of the workforce have become familiar with the concept of setting aside savings from disposable income for potential future use and that this “habit” could be converted, with some appropriate incentive, to setting aside savings for retirement needs.

At present, individuals who wish to increase the level of their pension contributions may do so under existing legislation, where employee contributions are based on the member's age, increasing from 15% of earnings to 30% of earnings for individuals over age 50. Therefore there will exist a mechanism for employees to utilise their SSIA funds to make up pension contributions in the year of maturity. However, IAPF would expect that, without some form of incentive, these monies may well be directed towards other, more short term expenditure, hence not assisting the Government's long term objective of reducing the dependency of the Irish working population on the State for pension purposes with the potential side effect of an an unwanted inflationary spike in the months around the maturity of SSIAs.

IAPF recognise that there are a number of alternative approaches which could be adopted, including:

- permitting (all or part of) SSIA maturity values to be transferred into pension schemes or PRSAs and allowing the value to be treated for income tax purposes as a special pension contribution (or AVC) in the year of payment (without reducing the individuals capacity to make ordinary pension contributions in that year);

- permitting (all or part of) SSIA maturity values to be transferred into pension schemes or PRSAs without crystallising the exit tax originally envisaged;

The above options could be seen to target those on middling incomes by providing tax relief at the individual's marginal rate of income tax subject to a minimum rate of, say, 30%. The tax treatment could be deferred or perhaps linked to the continuation of contributions to a pension scheme or PRSA. **As there are various options and alternatives available in this area, the IAPF would welcome the opportunity of discussing these with the Minister prior to Budget day.**

As the ultimate proceeds of pension schemes are, by and large, taxable, the granting of additional relief to the transfer of SSIA proceeds reflects somewhat a deferral of collection of income tax.

3. Providing an income in retirement

Background

IAPF aims to encourage a position where:

- Pensioners have an adequate income in retirement and in order to protect an individual's standard of living this needs to relate to pre retirement income;

- Pensioners have an income for all of their retired years of an amount sufficient to meet a specified minimum standard of living;

- Pensioners have a mechanism whereby their pensions can be increased whilst in retirement. Given increased longevity IAPF believes that it is important that the value of a pensioner's income is not eroded over time. The mechanism for providing such increases can either be:

  a) Provided as part of the pension scheme's basic benefits (e.g. guaranteed pension increases under an occupational pension scheme – generally a defined benefit type arrangement);

b) Selected (and paid for) by the member at the time of retirement (e.g. through the purchase of an annuity with provision for annual increases – generally the option available via defined contribution pension arrangements);

c) Available to the member and under his/her control during retirement (e.g. through setting aside capital via an ARF).

The IAPF also wishes to encourage a position whereby individuals may make provision to cover the cost of long term care where such need arises. Given the expected reduction in the provision of informal care and the significant increase in the cost of care, this will be a key issue for many pensioners into the future.

IAPF believe that these aims can best be met by encouraging individuals to set aside part of their income during their working lifetime to provide income in retirement. This is the principal aim of the current regime for the provision of retirement benefits in Ireland.

IAPF believes that the Government should continue its commitment to a stable taxation system for pension provision and that pension savings should continue to be afforded the greatest tax incentives because the savings set aside are locked away for a considerably longer period than other tax incentivised savings schemes and the ultimate capital accumulated will be used to provide an income in retirement.

IAPF believes that pension funds should not be subject to any taxation on the accumulation or management of its assets. In this regard, taxes such as stamp duty on the sale of properties is increasing costs for pension funds that are significant investors in the Irish property market. Stamp duty at it its current levels acts as a deterrent to domestic schemes investing in Irish property. **IAPF recommends that pension funds be exempt from stamp duty on property purchases.**

In addition, purchases of shares listed on the Irish Stock Exchange attract a stamp duty of one percentage point on the value of the purchase. This is out of line with the majority of stock exchanges around the world and more importantly places an additional cost burden on schemes who wish to invest in domestically quoted companies as part of the asset base for the provision of retirement benefits for scheme members. Given the increasing opportunities for pension schemes to invest beyond these shores without the additional cost of such a level of stamp duty, **IAPF recommends the elimination of the application of stamp duty to purchases of Irish listed companies by exempt pension schemes.**

IAPF believe that the existing ceiling amount on earnings which qualify for tax relief on employee pension contributions of €254,000 for individuals should be adjusted for inflation to €300,000 and linked to inflation for the future.

Approved Retirement Funds (ARFs) and Approved Minimum Retirement Funds (AMRFs)

IAPF has supported the view that additional flexibility and choice has been needed from the pension scheme member's point of view in relation to the method of securing an income in retirement.

IAPF recommend that the new ARF (Approved Retirement Fund) and AMRF (Approved Minimum Retirement Fund) retirement options be extended to Defined Contribution (DC) schemes. This would assist the attractiveness of pension funding in such schemes and complement the wider agenda of increasing pension coverage for all.

IAPF believe that the on-going education of current pension scheme members who, before retiring, may have been familiar and reliant upon fixed salaries and wages as to the investment risks associated with ARFs will be highly important to ensure that the availability of ARFs (or extension thereof) does not expose pensioners to excessive risk of an inadequate income in retirement. IAPF will continue to assist in this education process.

IAPF recognises the value of the Minister's objective in providing for the establishment of an AMRF where an individual does not have a minimum guaranteed retirement income of €12,700 per annum. However, the IAPF believes that the minimum income requirement of €12,700 per annum is pitched at a very low level and makes no allowance for the increase in earnings or the cost of living since its introduction in 1999. Inflation since 1999 was 20% so on this basis the minimum retirement income should have increased by now to €15,240. **The IAPF recommends that this figure should be increased to €17,500 and linked to inflation thereafter.**

It is also of considerable concern to the IAPF that the alternative to the minimum income requirement is a minimum capital requirement of €63,500 (which is again not linked to inflation). Such a capital amount is wholly inadequate to meet the minimum income objective of the Minister for any individual aged less than 65 years without an immediate entitlement to a State pension. If this amount had been increased by inflation it would now be €76,200. **IAPF recommends that the minimum capital requirement be increased to €85,000 and linked to inflation thereafter.**

IAPF recommends that if an ARF and AMRF is set up and the holder subsequently meets the guaranteed minimum retirement income hurdle due (for example, due to a pension coming into payment), it should be possible for the holder to immediately change the status of the AMRF to an ARF.

4. Individualisation of Tax Bands

The individualisation of tax bands was introduced by recent Finance Acts to encourage the participation of particular segments of the population in the workforce. It is noted that retired married couples are not in a position to take advantage of the individualised tax bands. Any further moves towards individualisation would increase the proportion of married pensioners subject to the higher rate of income tax as compared to the proportion of those still in the work force. A particular anomaly arises when an individual who is receiving the State Retirement Pension or Old Age (Contributory) Pension is in receipt of additional payment in respect of a qualified adult dependant. Under the current regime, no allowance is made in tax bands for this additional payment. **The IAPF request that the additional payment should be treated as income of the spouse under the individualisation rules**

5. The Irish Association of Pension Funds

The Irish Association of Pension Funds (IAPF) was established in 1973 and is a non-profit, non-commercial organisation. Our members provide retirement security to over 200,000 employees, pay pensions to nearly 70,000 people and are responsible for some €50 billion in retirement savings.

As the voice of Irish pensions our principal aims are:

- To represent the interests of pension scheme members, trustees and sponsoring employers;
- To promote financial security for all retired people; and
- To provide a forum for discussion and debate of pension issues.