Response to the

Consultation on Supplementary Pensions Reform

from the

Irish Association of Pension Funds

iapf

representing pension savers

Introduction

We welcome this consultation and an opportunity to contribute on a subject we have worked on over a number of years. We strongly believe that there needs to be simplification and reform of the pensions system to ensure people in Ireland can have pensions that are secure, fair and simple. The current system has evolved with a lot of layering of additional rules and regulation. It is welcome that there is an opportunity to now examine these and streamline the system in a way that will ensure better outcomes for members.

The proposals in this consultation cannot be taken in isolation and there are other initiatives arising from the *Road Map for Pensions Reform 2018 - 2023*, including the introduction of Auto-enrolment, that will need to be brought together before final decisions are made. The introduction of IORPS II is also imminent.

The introduction of Auto-enrolment is welcomed. However, it is not proposed that Auto-enrolment will commence until the end of 2022. In 2019, new and strengthened regulatory requirements will be introduced by way of implementation of IORPs II and as part of proposed Pensions Authority reforms.

There is a real concern that the introduction of too stringent regulatory requirements and/or changes to the tax reliefs available to supplementary schemes will damage the existing supplementary pension system and actually lead to a reduction in supplementary pension coverage. At 31 December 2016 the supplementary pension schemes on the register of the Pensions Authority had a total membership of 771,390. Care must be taken to ensure that any regulatory reforms introduced are evidence based, are balanced and are done in such a way as to protect and support the existing supplementary pension system.

The IDPRTG consultation paper, at Section B, raises a number of questions with respect to the existing taxation treatment of supplementary pensions. The background note to Section B states that participation rates in supplementary pensions remain low and suggests that the existing financial incentives for pension saving do not work. Whilst it is evident that supplementary pension savings in the private sector are low, the reasons for this are multiple including the complexity of the system and that many people either will not save for retirement or cannot afford to do so (see for example The Central Statistics Office Quarterly National Household Survey Quarter 4 2015). There is no evidence that changing the rates at which tax relief is provided to supplementary pension schemes will do anything to increase coverage. If anything, it is more likely to reduce coverage.

We therefore urge that there is co-ordination between the various Departments and agencies to ensure all changes are considered in a holistic and comprehensive way.

Section A – Simplification & Reform

Reduction of Pension Savings Vehicles

A1. Do you agree that PRSAs, BoBs and RACs largely fulfil the same function for a consumer and that it would be beneficial to simplify the DC contract landscape by prospectively ceasing BoBs and RACs? If not, why?

In general, yes. However, there are features of the various products that differ and careful consideration needs to be given to those differences and how changes may impact on policyholders.

Those differences are not necessarily logical and make detailed financial advice a necessity for any individuals planning to save for retirement. The whole process should be simplified so that the main focus is on the decision to save, how much to save and how to invest those savings. The vehicle to be used should not be an issue. Some of the current anomalies in the system include:

- There are differing ages at, and circumstances in which benefits can be accessed
- Benefits cannot be transferred to or from all products
- There are differing rules on the calculation of lump sums at retirement and this can also impact on how the remaining benefits are taken
- There are different disclosure requirements
- There are different rules on charges and investment options

A2. What, if any, positive or negative consequences would you foresee from the prospective cessation of BoBs and RACs? What changes would be required to the legislation governing PRSAs? What transitional measures would be required?

Presumably existing BoBs and RACs would be allowed to continue and eventually phase out as benefits are taken. Buy-out Bonds provide a good value option for transfers from schemes that are winding-up, and charges are often much lower than PRSAs.

A3. What changes would you recommend to the design of the PRSA product?

The requirement to complete a Certificate of Benefit Comparison should be abolished. It results in unnecessary additional cost and offers little value. The decision to transfer to a PRSA (including by someone with more than 15 years in a DB scheme) should be made on receipt of independent financial advice.

In a wind-up situation, it would be particularly unfair on members who would currently have their benefits transferred to a BoB that they would in the future have their benefits transferred to a product with higher charges and additional requirements, such as a Certificate of Benefit Comparison.

A4. In terms of pension vehicle rationalisation, what impact could the introduction of the pan-European Personal Pension Product (PEPP) have?

It is difficult to be definitive until the final structure of the PEPP has been determined. However, the introduction of an additional product seems counter-productive in the context of the proposals to streamline the types of products available.

Harmonisation of Rules

A5. In what ways would consumers benefit or be disadvantaged by the standardisation of minimum and maximum drawdown ages across occupational schemes and personal pension products?

There is an advantage to having the same rules as everyone can be clear on when they can and can't retire. On the other hand, having different ages at which benefits can be taken can allow people to phase their retirement.

A6. Would harmonising the treatment of employer contributions to occupational schemes and PRSAs be beneficial? How would this be best achieved? Would it result in a shift from single member *schemes (and possibly SSAPS?) to PRSAs? How would any change impact the funding incentives for employees/employers?*

It would be beneficial to have clear and consistent rules. If that was the case the only decision an employer has to make when establishing a scheme would be whether to do so under a trust or contract arrangement. The more restrictive contribution rules on PRSAs are undoubtedly a major factor in the establishment of smaller trust-based schemes. A change, together with the additional governance requirements the Pensions Authority is proposing, is likely to result in a shift to PRSAs from smaller trust-based schemes. Funding by employees/employers is largely driven by what is affordable and appropriate and there is unlikely to be any great change to funding of arrangements.

A7. Would harmonising the calculation method for maximum tax-free portion of the retirement lump sum across DC occupational schemes and personal pension products be beneficial? How would this be best achieved? Would it result in a shift away from single member schemes?

It would be beneficial in that it removes another variable from the system. At a very minimum, there should be no link between the format in which a tax-free lump sum is taken and the decision to purchase an annuity or transfer to an ARF.

We suggest that everybody should have a maximum lump sum entitlement as the greater of 1.5 times final salary or 25% of their fund (subject to current minimum qualifying period for maximum 1.5 times salary). DB schemes could use SFT factors to calculate notional fund value for alternate 25% of fund calculation for TFLS.

A8. Should the rules around the tax treatment of death-in-service benefits between DC occupational schemes and personal pension products be harmonised? How would this be best achieved?

All death in service benefits should allow for a lump sum of four times salary plus the value of the fund. The dependant should be allowed to transfer any excess to an ARF or have it paid to the estate, subject to tax.

A9. Are there constructive changes that could be made to eliminate inconsistencies in the treatment of DC and DB scheme members?

The same options should be available to all members at retirement for the remainder of their benefits after taking any lump sum – ARF or annuitise or combination of both.

For DB benefits, the TV basis could be used to offer the opportunity to take some or all of the retirement income as a transfer to an ARF or to a bought-out annuity.

Section B – Costs to the Exchequer

B1. How should the economic and social benefits of tax relief on pension contributions and investment returns be considered/measured and how do you believe the system of tax relief performs in that context?

The rationale for tax relief is a deferral of the tax on income until it is actually received by the tax-payer. It is perfectly reasonable that, where someone is investing part of their income for a long period and they have no access to it until retirement, that they should not be taxed on it until that time. The economic benefit of tax relief should be measured in that way. The measurement should compare the value of the tax not being paid now, relative to the value of the tax the taxpayer will pay on the income they receive in retirement and the tax on their expenditure in the economy on this income and any tax-free lump sum. It should also consider the opposite impact of someone not saving for retirement and the consequences for them, and the State, through the level of additional support they may need in retirement.

There is also the difficult to measure, but important factor, of people being able to live a comfortable and happy retirement as a result of having sufficient savings to do so.

B2. To the extent that the State's tax expenditure on pensions has not resulted in high coverage rates, what in your view explains this?

The most recent labour force figures from the CSO indicate that there are 2,255,000 people employed in the labour force in Ireland. The auto-enrolment Strawman has calculated that there are 410,000 people who need to be auto-enrolled. This would indicate that the Government believes that there is only 18% of the workforce that should be making retirement savings, that aren't currently doing so.

The reasons for "low" coverage are varied but the complexity of the system is also a factor. However, the major factor is that many people either will not save for retirement or cannot afford to do so (see for example The Central Statistics Office Quarterly National Household Survey Quarter 4 2015).

B3. What adjustments, if any, could be made to marginal relief to best support the rollout of automatic enrolment?

There is no evidence that changing the rates at which tax relief is provided to supplementary pension schemes will do anything to increase coverage. If anything, it is more likely to reduce coverage if the rate of relief is being reduced. The argument for a different type of relief is based on it being easier to understand. The existing system of relief can be explained in a similar way and the contributions payable to a scheme can be broken down into those by the individual, the employer and the State. The key element in increasing coverage in auto-enrolment is in enrolling people, not the tax system that operates.

As a response to the low level of supplementary pension coverage, the *Road Map for Pensions Reform 2018 - 2023*, amongst other measures, proposes the introduction of an automatic enrolment system ("AE"). The introduction of AE is welcomed. However, it is not proposed that AE will commence until the end of 2022. In 2019, new and strengthened regulatory requirements will be introduced by way of implementation of IORPs II and as part of proposed Pensions Authority reforms.

There is a real concern that the introduction of too stringent regulatory requirements and/or changes to the tax reliefs available to supplementary schemes will damage the existing supplementary pension system and actually lead to a reduction in supplementary pension coverage. At 31 December 2016 the supplementary pension schemes on the register of the Pensions Authority had a total membership of 771,390. Care must be taken to ensure that any regulatory reforms introduced are evidence based, are balanced and are done in such a way as to protect and support the existing supplementary pension system.

B4. What form of financial incentives for supplementary pensions, alternative to existing ones offered by the State, would better encourage lower and middle income earners to save for their retirement?

There is no evidence that alternative financial incentives would encourage additional savings.

B5. In evaluating equity in the distribution of the economic and social benefits from this tax expenditure, what factors should be considered?

This should be examined in the context of the overall pensions system and how redistributive it is, including the State Pension. The objective of the system is to provide adequate income in retirement and that includes the State pension and any additional savings through occupational or personal pensions.

B6. Should changes be made to the existing tax treatment of pensions in any of the following stages?

• *Tax treatment of employee contributions*

Currently there are complex annual contribution limits relating to age and salary with an additional Standard Fund Threshold (SFT) limit of €2m applying to the total amount saved.

We do not think there should be any annual limits where the SFT is in place. It should not matter how people save for retirement where there is an overall limit. This would give more flexibility to people to save more when they can afford to.

The lifetime limit (SFT) should be indexed in a transparent manner to allow individuals plan their saving for retirement.

• *Tax treatment of employer contributions*

There are significant differences between trust based and non-trust-based arrangements regarding the treatment of employer contributions. These don't count towards the contribution limits and do not attract a USC payment for trust-based arrangements. The same provisions should apply to PRSAs.

• *Tax treatment of growth in pension fund*

There are no changes required and, in any case, would be very difficult to apply to DB and unfunded schemes.

• *Tax treatment of drawdown of pension If so, what kind of changes should be introduced and for what reasons?*

As previously outlined, a harmonisation of the tax-free lump sum rules and that should not dictate the form of benefits taken as a result.

It has been indicated during the consultations on the auto-enrolment Strawman that there might be no taxation on benefits paid from the auto-enrolment system. This would add further complexity to the overall system and could possibly allow arbitration within the system. It would be difficult for anyone to make a decision on how to save without getting detailed financial advice. This undermines the objective of simplifying the system and should be avoided.

Section C – Approved Retirement Funds

C1. What, if any, limitations are appropriate for pension savers when drawing down benefits in retirement? Should the current suite of retirement savings drawdown options be changed in any way? For example, should savers be required to defer a portion of pension drawdown for a defined period?

The current requirements are almost redundant with individuals being able to satisfy the income requirement with an entitlement to a full State pension. Indeed, following the most recent budget, the increased State Pension from March 2019 would allow all recipients of the full State Pension to satisfy the current income requirements. There is also no rational link between the income requirement and the amount required to be placed in an AMRF.

C2. What, if any, changes need to be made to ARF access, and why?

It is difficult to apply rules in this area as they won't reflect any additional savings an individual has or income their partner may have. Whether or not an ARF is appropriate should be determined after receiving comprehensive independent advice.

C3. Given the narrowing gap between State pensions and the AMRF income threshold, what is an appropriate minimum level of required income where an AMRF would not be necessary and should this amount be indexed? What is an appropriate setaside amount and should it vary? If so how? Should the conversion age of 75 be adjusted?

Rather than being rules based, this should be an individual decision taken on receipt of comprehensive independent advice.

C4. Are the current imputed distribution requirements appropriate? What changes, if any, would be appropriate?

The current rules effectively force people to take income they may not need and would have been more beneficial to them in later life if it continued to be invested. The rules are driven by concerns that ARFs were being used for inheritance planning rather than retirement planning. In that case it may be more appropriate to consider the inheritance tax provisions. That was also at a time when access to ARFs was restricted to individuals who were more likely to use them for inheritance planning rather than retirement planning. That has now changed as ARFs are much more widely available and utilised and the imputed distribution should be reconsidered in that light. There should be some flexibility as effectively forcing individuals to withdraw money irrespective of their needs or market conditions can increase the prospect of having their funds extinguished.

C5. To improve data capture and to facilitate the assessment of retirement outcomes, what additional returns should be required of Qualifying Fund Managers (QFMs)?

The amounts transferred into ARFs and annual funds values should be collated.

C6. Are current consumer protection arrangements in relation to ARFs effective? How might consumer protection requirements be improved? Is there a role for maximum or standard charges?

The decision to transfer to an ARF should only be made after receipt of comprehensive independent advice. This should not only cover the transfer to an ARF but all options available to the member at retirement. Maximum or standard charges can be counter-productive as a maximum can become the standard and they can also restrict the types of investments that can be made.

C7. How can ARF owners be adequately informed and supported to make the decision that best suits their needs through retirement, especially given that ARFs require ongoing management? Is there a role for mandatory advice? How can access to good quality affordable advice be facilitated/provided for?

There should be ongoing advice and also provisions in place that can deal with issues where the owners may not have the capacity to make financial decisions. Consideration should be given to having a default post-retirement investment strategy and requiring any members not in it to reconfirm their position at appropriate intervals.

C8. How might in-scheme drawdown and group ARFs be facilitated? What additional requirements should be placed on schemes that want to provide in-scheme drawdown to ensure they have the capacity and capability to do so?

There should be some legal protection for trustees in choosing Group ARFs that would still ensure members interests are catered for but also offer comfort to trustees who make decisions in good faith.

Schemes that wish to offer drawdown facilities should be able to demonstrate to the Pensions Authority that they have the financial strength, systems and processes in place to do so. Issues that would need to be considered are:

- Dealing with conflicts of interests by ensuring members get independent advice
- The ability to consolidate savings members may have in other arrangements
- How to deal with drawdown within a scheme if the scheme winds up

Conclusion

Many of the issues raised in this consultation are complex and we would be happy to discuss our views in further detail with the Interdepartmental Pensions Reform and Taxation Group.

Jerry Moriarty
CEO
IAPF
Jerry.Moriarty@iapf.ie
Direct Line: +353 1 6130872
Main Line: +353 1 6612427
Suite 2, Slane House, 25 Lower Mount St. Dublin D02 V029