



## **Musgrave Group plc**

# **Response to a Strawman Public Consultation for an Automatic Enrolment Retirement Savings System for Ireland**

## **Introduction**

The Musgrave Group is one of Ireland's oldest and largest private sector employers. We currently operate businesses in the Republic of Ireland, Northern Ireland and Spain. We directly employ c. 5,300 employees in our Irish businesses while our independent retail partners, who operate stores across Ireland under our SuperValu and Centra brands, directly employ c. 27,000 employees.

The Musgrave Group currently operates a significant portfolio of pension schemes catering for colleagues directly employed in the various areas of our business. These schemes are compulsory in nature with membership being a condition of employment. All stakeholders in our pension schemes (the trustees, the sponsoring employers, members and our 3<sup>rd</sup> party advisors) work to achieve good outcomes for members in their retirement.

As an employer with a long history of funding pension provision for colleagues we welcome the publication of the Strawman as an important step in addressing the fact that a significant proportion of private sector workers in Ireland do not currently have any level of second pillar pension provision.

It is however vital that any Auto-Enrolment system, that is to be introduced on foot of the current consultation process, is implemented in a manner that will not have negative consequences for business' ability to re-invest for the future and generate employment across the Irish economy.

Auto-enrolment will of course result in significant cost increases for SuperValu and Centra retailers. In general, these are small businesses for whom any cost increase can exert significant pressure. Moreover, increases of this nature must be considered against a backdrop of other cost pressures. Currently, retailer costs are being affected by the ever-increasing cost of labour; 12%-15% increases in energy costs; significant increases in the cost of packaging arising from the drive for sustainability; 5%-10% rise in insurance costs, together with new regulatory provisions that are also driving costs such as the alcohol regulations and new regulations regarding hours of work.

Furthermore, with Brexit negotiations stalled at present and the prospect of a "No-Deal" Brexit becoming a reality careful consideration should be given to the timing of the introduction of the Auto-Enrolment system given the likely negative impact that "No-Deal" would have on the Irish economy.

Finally, care must also be taken than any new Auto-Enrolment system will not negatively impact existing occupational pension provision that currently caters for c.50% of Irish private sector employees and which has served current and past generations of Musgrave employees well over the past 50 years.

## **Administrative Arrangements and Organisational Approach**

1. Is the rationale for use of a CPA sound?

The rationale for a pot-follows-member approach appears to be sound as the future of work is such that pension pots are better associated with members than the various employers they may work with throughout the course of their careers.

2. What are the potential strengths and weaknesses of a CPA structure? Do you believe that the CPA model proposed can be improved? If so, how?

The use of a CPA could have benefits in terms of minimising employer involvement in the enrolment of employees in the AE system. However, the CPA does have the potential to add an additional layer of complexity (and therefore cost) between the member and the Registered Provider.

3. If you don't agree with the CPA model, can you suggest alternatives?

No comment.

4. Have you suggestions for how the operating costs of the CPA could be covered?

The set-up and running costs for the CPA are likely to be significant and these should be borne by the State until such time as the AE system achieves a critical mass at which point the CPA costs should be met from within the suggested maximum charge of 0.5% p.a. of assets under management.

5. Is the use of commercial providers for the provision of retirement savings options the right approach?

This would seem to be the only viable approach.

6. Is it appropriate to limit the number of approved AE Registered Providers, as proposed, in order to provide economies of scale and drive down unit costs?

There is merit in limiting the number to make this market viable for commercial providers.

7. If so, is the maximum figure proposed of four providers about right? Or should it be more or less, and if so, why?

No comment.

8. Are there alternatives that can achieve the economies of scale required other than to select a limited number of providers by open tender?

No comment.

9. What do you believe is the optimum governance structure for Registered Providers and why? (e.g. Master Trust or insurance-based contract providers).

A trust-based system would ensure the appropriate fiduciary duty is in place to protect members. This isn't as easy to achieve under a contract arrangement.

10. Where a member elects not to choose a provider and fund option, is it appropriate to allocate them to the default fund of one of the AE Registered Providers on a carousel basis, or is there a better alternative you would suggest?

Assuming that a CPA is established this seems like a reasonable approach.

11. What is an appropriate maximum limit on the level of administration/investment management fees?

For the provision of administration and investment management services the fee of 0.5% of assets under management appears ambitious. The fees for these services via a PRSA contract currently stands at 1%.

12. What is the appropriate timeframe between each tender round (e.g. 5, 7, 10 years) and why?

Given the set-up costs for a commercial provider it would seem that contracts would need to be awarded for lengthy period (10 years may be appropriate), subject of course to appropriate break clauses.

13. Do you think the proposed timeframe for the roll-out of AE is reasonable and achievable?

The timeline appears reasonable albeit achievement of AE system “go-live” by 2022 will require the State to mobilise its implementation plan in the immediate future.

14. Do you believe that employees should select their preferred provider or should employers be required to select a Registered Provider on their behalf?

Given the target audience for the AE system it is likely preferable that employers would not select the preferred provider from the list of available Registered Providers as many of them won't have the administrative capacity or the expertise to make such decisions on behalf of their employees.

## **Target Membership**

15. Should there be a lower/upper earnings threshold triggering automatic enrolment?

There should be a lower earnings limit as employees on low incomes, such as part-time employees, student workers etc., will not be able to afford to prioritise long-term retirement savings over their current living needs. In addition, the State Pension generally provides employees on lower levels of income with adequate Replacement Rates of income in retirement.

There should be an upper earnings threshold of €50,000 with an option for individuals earning income above this level to pay Additional Voluntary Contributions (that would not be subject to a matching employer contribution) if they wish to pension elements of their earnings that are not catered for within the AE system.

16. If so, is the proposed earnings threshold of €20,000 p.a. above which members will be automatically enrolled into the system appropriate? If not, what would you propose as the earnings threshold and why?

Based on the data in Table 1 of the Strawman document a lower earnings limit of €25,000 would seem to be appropriate given the Replacement Rate based on State Pension/Secondary Benefits.

17. Do you agree with the proposal to review the earnings threshold on a five-yearly basis? If not, what adjustment process would you propose?

The operation of the earnings threshold should be increased annually in line with earnings.

18. Should there be a lower/upper age threshold for automatic enrolment?

Yes.

19. If so, are the proposed age thresholds appropriate? If not, what would you propose as the age thresholds and why?

There should be a lower age threshold of 23, which would mean that a new entrant to the AE system would potential participate in the system for 45 years to their State Pension Age of 68.

The upper age threshold should be 5 years from State Pension Age.

20. Should employees outside of the age/earnings criteria triggering automatic enrolment be able to opt-in?

Yes, we believe that would be appropriate for such employees to be able to opt-in and effectively pay Additional Voluntary Contributions to the AE system should they so wish. In such circumstances employers should not be obliged to make a matching employer contribution unless and until the employee meets the eligibility criteria set down for automatic enrolment.

21. How should those with more than one source of employment be treated?

Multiple employments should be linked via employee PPS numbers and such employees should be subject to the AE system if their earnings in aggregate exceed the lower earnings threshold.

22. Do you agree with the approach proposed for self-employed people? If not, what modifications would you propose?

No comment.

23. Should people outside of the workforce (e.g. carers, homemakers) be eligible to opt-in? If so, suggest how that might work in terms of contributions, etc.

No comment.

24. Should all eligible members be enrolled immediately on commencing employment?

No. Most existing occupational pension schemes operate a waiting period for full membership which is generally linked to a period of probationary service. It would be appropriate to operate a waiting period of 6 months before an employee is enrolled in the AE system.

25. Should members of existing pension schemes be allowed to transfer into the AE system?

If an employee is in an existing occupational pension scheme that provides adequate pension provision they should be precluded from switching to and/or transferring existing benefits to the AE system. Such membership movements would add significant complexity to the operation of pension arrangements at a Company level.

### **Employer and Employee Contribution Rates**

26. Do you agree with the approach to starting with a low level of contributions increasing on a phased basis to a higher level over a period of six years? If not, what approach would you propose and why?

It is reasonable to phase contributions in over a prescribed period in order that employees and employers can plan for the impact of the AE system. In our view a period of 6 years seems to be too short a period over which to target the full implementation of the AE system. Consideration should be given to phasing the roll-out of the AE system by employer size to enable smaller employers in particular, who typically may not have in-house HR, Finance or Payroll resources, to make adequate preparations for AE.

27. Do you agree with the proposed contribution levels? If not, what contribution levels would you propose and why?

The proposed contribution levels are based on the policy objective:

*To supplement the first pillar (State pension) and enable people to maintain, to a reasonable degree, the standard of living enjoyed whilst working, for the duration of their retirement years.*

This begs a question about the level of adequacy required. The existing occupational pension scheme system was devised on the basis that over a full career a pension of 2/3rds of Basic Salary at age 65 (inclusive of the State Pension) was adequate. It would be beneficial if the AE system overtly articulated what level of Replacement Rate is “adequate”.

In our view, based on the figures in Table 1 of the AE Strawman document, a Net Replacement Rate of 78% at an earnings level of €20,000 is too high a bar in the context of the existing occupational pension scheme system. In the alternative a Replacement Rate of 50% (inclusive of the State Pension) is perhaps a more realistic objective, particularly given that the AE system is aimed at capturing employees who have no second pillar pension provision at present.

For lower paid employees, contributions at the levels proposed in the AE Strawman may be more than is required to enable the maintenance of a reasonable standard of living post retirement as their Replacement Rate from State Pension and Secondary State Benefits may already be at adequate levels.

If adequacy is the primary policy objective perhaps the levels of both employee and employer contribution should be tailored within bands to address the “gap” in the Replacement Rate that an employee might need to close. This gap will vary by income level or indeed at different stages over the course of an employee’s career.

In such a scenario an employee earning €26,000 (being €1,000 more than our suggested lower earnings threshold) may only require a 1%/1% contribution to achieve an adequate outcome whereas an employee earning €36,000 would require a higher level of contribution.

Assuming that the AE system were designed in this manner it is our view that the overall maximum contribution that employers should be required to make should be limited to 3%.

Employee specific income Replacement Rates could be estimated using the same Statement of Reasonable Projection methodology that currently applies in DC schemes. This would also protect existing occupational DC pension schemes, many of which supplement Company DB schemes that are now closed to new entrants and future accrual, from having to amend their structures to align with the proposed AE system contribution rates, which would effectively become the least common denominator levels of contribution in Ireland.

28. Should there be an upper threshold on qualifying earnings along the lines described in the Strawman or should qualifying earnings be uncapped?

Yes. We would suggest an upper threshold of €50,000 as mentioned in the response to question 15 above.

29. Should the Irish AE system incorporate a 'disregard' such as used in the UK's AE system whereby Salary earnings between £0 and £6,032 are not subject to a contribution requirement? If so, why do you believe a 'disregard' should apply and at what level?

In our view a disregard should be applied to the earnings that qualify for the AE system. All employers and employees currently make PRSI contributions towards the cost of providing State Pension Benefits and therefore this should be reflected in the second pillar pension provision to be delivered through the AE system. In our view the disregard should be 1 x State Pension.

30. Should employer matching contributions be required for those outside the automatic enrolment age/earnings trigger criteria, who choose to opt-in?

No. The opt-in facility should be provided to enable employees who don't meet the AE system eligibility criteria to pay voluntary contributions towards their own retirement provision should they wish to do so. In such circumstances employers should not be obliged to make a matching employer contribution unless and until the employee meets the eligibility criteria set down for automatic enrolment.

### **Financial Incentives Provided by the State**

31. Do you agree with the Strawman approach to State incentives – i.e. a potential State bonus top-up based on matching member contributions with a payment of €1 for every €3 they save?

No. We are strongly of the view that the proposal would greatly add to the complexity that exists within the Irish pension system and is counter-intuitive to the work being done by the Interdepartmental Pensions Reform and Taxation Group to simplify pension provision in Ireland.

Were the proposed basis of incentives to be introduced we can envisage a circumstance where members of existing occupational pension schemes could seek to opt-out of their existing pension provision (subject to income tax relief at marginal rates) with a view to opting-in to the AE system to avail of potentially higher levels of State “contribution” and/or to avail of the proposed T/E/E system.

In our view the current system of tax relief at marginal rate is designed to only tax individuals when they are drawing on their income (either while employed or post retirement in the form of pension). As such the current E/E/T system does not drive a loss of tax revenue for the State rather it impacts the timing of when this tax revenue is collected.

Education and awareness campaigns could be undertaken to improve tax payers understanding of the existing system and the value of the State contribution to their second pillar pension provision.

The introduction of a T/E/E system would significantly undermine the existing occupational pension scheme system in addition to adding complexity and cost for employers who currently operate pension schemes in this space that cater for c.50% of Irish private sector workers.

32. What level of top-up or State incentive would you propose?

Leave the current system of marginal rate income tax relief unchanged.

33. If you don't agree with the 'top-up bonus' approach what type of incentive would you propose?

Leave the current system of marginal rate income tax relief unchanged.

34. Is it appropriate to cap State incentives? If so, what should be the value of this cap?

The current system of capping State incentives, relating both to the maximum contributions allowed and the maximum benefits that can be accrued over a working lifetime is appropriate.

## **Investment Options**

35. Do you agree with the suggested approach to limiting the AE Registered Providers to offering three 'standard choice' DC savings options with one fund acting as the default?

Yes. The exact design of the default strategies would require further consideration as the establishment of a default with very low risk will minimise the extent to which investment performance over 40+ years of AE system membership can have a meaningful impact on the adequacy of pension income in retirement. If too little investment risk is factored into the AE system adequacy can only be achieved through higher levels of contribution.

36. If not, what retirement savings options do you consider should be provided?

Not applicable.

37. An alternative to conventional DC is the target benefit approach – do you believe that a target benefit approach merits consideration as one of the ‘standard choice’ options for the AE Registered Providers?

We would not be in favour of a Target Benefits approach as this would inevitably lead to a false expectation of a guaranteed level of income replacement in retirement.

38. Do you agree with the approach to provide for maximum annual management and investment charges at 0.5% of assets under management?

In principle yes, however the provision of administration and investment management services for a fee of 0.5% of assets under management may prove to be too ambitious. The fees for these services via a PRSA contract currently stands at 1%.

39. If not, what approach to management and investment fees would you propose?

No comment.

40. Do you agree with the proposal to allow members switch between funds?

Yes. The more engaged individual members are with their pension fund the better the likelihood that the outcomes they enjoy will be in line with their expectations.

### **Policy for Opt-Out and Re-Enrolment**

41. Do you agree with the concept of a minimum compulsory membership period and that six months is an appropriate minimum period?

Yes.

42. What is your view on an opt-out window of two months in months seven and eight of membership?

In our view it is appropriate to have an opt-out window but would suggest that this window should be longer than the 2 months suggested in order to allow employees time to make an informed choice on whether or not to opt-out. It would also be reasonable to provide employees with more than one opportunity to opt-out as personal circumstances can change over time and this would need to be catered for within the AE system.

We are also of the opinion that once an employee opts-out that they should not be subject to re-enrolment for a period of 5 years. This would serve to ensure that the decision to opt-out is given due consideration by the employee.

43. Do you agree that people who opt-out should be automatically re-enrolled after a defined period (e.g. three years)?

Yes, but only after a period of 5 years.

44. Do you agree with the concept of allowing members to take a period of Saving Suspension? If so, are there specific conditions that should attach to such suspensions?

Yes. In a circumstance where an employee takes a period of Saving Suspension the employer should not be obliged to contribute on their behalf unless and until they are automatically re-enrolled in the AE system.

45. Do you agree with the approach which sees employer and State contributions retained/credited to the CPA to contribute to its costs, in the case of member opt-out?

No. We couldn't support this element of the AE Strawman under any circumstance.

There is no rationale for employers being asked to contribute to the costs of the CPA in this way. If the State can process modest refunds to individual employees who choose to opt-out of the AE system, there is no additional administrative burden on the State associated with processing equivalent refunds to employers. These employer refunds could be used to offset the ongoing employer costs associated with participating within the AE system.

### **Arrangements for Benefits and the Pay-Out Phase**

46. Do you agree that Registered Providers should provide a standard range of investment/draw-down options?

Yes, on the assumption that these mooted drawdown options are also made available to members of existing occupational pension schemes. Otherwise such options would only add to complexity and the likelihood of employees looking to arbitrage the differences between the AE and occupational pension scheme systems.

47. Should members be allowed to allocate their accumulated fund across all of these post-retirement options?

Yes. Employees should be able, within the limits of regulations relating to tax-free cash and income drawdown, to construct their retirement benefits in a manner that best suits their particular circumstances and needs.

48. Should members be required to invest a minimum proportion of their accumulated fund in a lifetime annuity (pension)? If so, in what circumstances?

This very much depends on the value of an employee's pension pot on retirement. Where pots are small (in the context of trivial commutation regulations) tax-free cash or a single taxed cash sum may be the most appropriate and cost-effective way for benefits to be paid out at the point of retirement.

For more meaningful pot sizes some form of deferred income (annuity) facility would be an attractive way of providing security for pensioners as they move from active retirement into the later phases of retirement when they may be more sedentary and/or infirm.

Again, our working assumption here is that such options would also be made available to members of existing occupational pension schemes. Otherwise such options would only add to

complexity and the likelihood of employees looking to arbitrage the differences between the AE and occupational pension scheme systems.

49. Do you agree that the appropriate age to grant access to the retirement draw-down products is the State pension age? If not, what age would you suggest?

Generally, yes. However, under existing occupational DC pension schemes members can retire early from age 50. Obviously, this is only feasible if the member can afford to retire and fund their lifestyle at the point of retirement.

Given the policy ambition of adequacy, early retirement should be provided for within the AE system if an employee can demonstrate that they can afford to retire early and have the means to do so. This could be certified by a QFA at the point of retirement looking at an individual's broader financial landscape and financial well-being and not just through the narrow focus of the value of their AE system pot and their pre-retirement earnings.

50. Do you agree that early access to accumulated retirement savings should be provided on the grounds of ill health and enforced workplace retirement? If so, under what conditions and from what age?

Yes. Early retirement on the grounds outlined of ill-health and/or enforced workplace retirement both seem reasonable grounds to allow an individual to access their AE system pot.

## Other Considerations

The following is a list of additional considerations that should be borne in mind when finalising the construct of the AE system:

- The term “gross earnings” is not defined in the AE Strawman document. The occupational pension schemes currently operated by Musgrave, as is the case for the vast majority of occupational pension schemes in Ireland, define Pensionable Salary as some function of Basic Salary which would exclude fluctuating emoluments such as bonuses, overtime, allowances etc. It is not typical for fluctuating emoluments to be pensioned other than via an individual employee choosing to pay an Additional Voluntary Contribution.

For simplicity the contributions AE system should relate to Basic Salary for adequacy Replacement Rate and contribution purposes.

- The AE system needs to be designed in such a way as to minimise the administration burden for employers. Of particular concern would be issues relating to the determination of who should be auto-enrolled and when. Some examples:
  - If an employer issues a temporary contract for a weekly salary of €500. Over the term of the contract the employee will earn less than the lower earnings threshold. Should s/he be auto enrolled?
  - An employee is paid an annual salary below the lower earnings threshold but has the opportunity to earn a conditional bonus payment, the payment of which would bring them above the lower earnings threshold. Should s/he be auto enrolled based on potential earnings?
  - Where an employee is contracted to work part time but subsequently works extra hours bringing their annual earnings over lower earnings threshold. At what point should the employee be auto enrolled or is this to be assessed on a pay period by pay period basis as is the case in the UK?
- We would have a concern about how the AE system will inter-act with existing occupational pension provision. The Musgrave Group has been operating pension schemes since 1968 and the vast majority of these have been established on the basis of compulsory membership. The pension landscape has evolved greatly over the past 50 years and we now operate a myriad of pension arrangements including a number of closed DB pension schemes and a range of DC pension schemes.

Many of our DC pension schemes have been designed to supplement underlying preserved DB pension scheme entitlements and therefore in aggregate employees “Musgrave” pension benefits may meet an adequacy test that may not be met if you were to look at our DC pension scheme contribution levels in isolation.

- While there may never be a “right time” to introduce an AE system it must be noted that with Brexit fast approaching, this seems to be the entirely wrong time to introduce the Irish AE system. Brexit is causing a significant amount of uncertainty for Irish business and contingency plans need to be made to mitigate the impact of a no-deal Brexit. Consideration should be given to the broader AE system implementation timeline in the

context of the impact the Brexit is likely to have on the Irish economy and business community.

- The introduction of the AE system will increase the cost of business in Ireland both directly by virtue of the contributions that companies will be obliged to make on behalf of eligible employees and indirectly as a result of higher pay demands from employees to offset the cost of employee contributions to the AE system.
- At your recent Consultation Seminar in Cork it was mentioned that in other jurisdictions the cost of AE was offset from wage inflation demands more generally. As a business we would have little confidence of this being the case in Ireland given that employers are operating in a local pay bargaining environment.