Report of the Interdepartmental Pensions Reform & Taxation Group
2020
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Executive Summary

Introduction & Background
The Roadmap for Pensions Reform 2018-2023 allocated a number of Actions to the Interdepartmental Pensions Reform & Taxation Group (IDPRTG) for consideration. These relate to three general areas: proposals aimed at simplifying and harmonising the supplementary pension landscape; an assessment of the cost of State support for pension savings; and a review of the Approved Retirement Fund (ARF).

The IDPRTG\(^1\) is chaired by the Department of Finance and includes representatives from:

- The Department of Public Expenditure and Reform;
- The Department of Social Protection;
- The Office of the Revenue Commissioners;
- The Pensions Authority.

To inform its work, the Group conducted a public consultation exercise in 2018 and the responses to this consultation will be published alongside this document. It is also worth noting at the outset that the lack of adequate and timely data materially hindered the Group in conducting its work. A number of initiatives are already underway that should go some-way in addressing this issue, but additional focus on data capture to help improve evidence-based policy work is warranted.

This summary should be read in tandem with the table of conclusions set out at the end of this report.

Domestic Pension Environment
Broader, global and secular trends such as declining worker-to-population ratios and falling interest rates are having a significant impact on pension saving. Specific domestic factors, including the planned introduction of an Automatic Enrolment system, also need to be considered and evaluated before embarking on any pension-related policy review.

Having reflected on these issues, the IDPRTG has structured its conclusions within the following framework that sets out the presumed future vision for pension saving in Ireland:

- First Pillar: State pension would provide 34 per cent of average earnings;
- Second Pillar: Covering authorised occupational pension schemes that meet an adequate standard and a new Automatic Enrolment system;
- Third Pillar: Comprising a single personal pension product catering primarily to those who fall outside the catchment of Automatic Enrolment, including those who opt-out of Automatic Enrolment and those who wish to have more direct control over their pension.

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\(^1\) IDPRTG Terms of Reference are at Appendix 1
saving. This product would also operate as a flexible drawdown product, replacing the functions of the Approved Retirement Fund.

The IDPRTG recognises that reform initiatives must be cognisant of the overall sustainability of State support for pension savings and has also set out a range of principles to guide this reform process. These include placing the consumer at the heart of reforms by focusing on choice, simplicity, equity, and neutrality of outcome. They also include providing adequate transition measures for existing arrangements, engaging with stakeholders in implementing reforms, and providing for a period of post reform policy certainty.

Reform and Simplification
The supplementary pension system, which is comprised of Second Pillar trust-based occupational schemes and Third Pillar contract-based personal pension products, is undoubtedly complex for consumers to navigate. The availability of multiple pension savings vehicles providing retirement benefits and inconsistencies between the rules applying to different arrangements, are among the factors that can cause confusion and may discourage individuals from engaging with the system.

The taxation treatment of the different supplementary pension saving arrangements has evolved in an ad hoc manner over time. This arises largely due to separate pension policy and tax policy related decisions and has resulted, for example, in the tax treatment of contributions, lump sums, and death-in-service benefits becoming a complicated function of an individual’s employment status and their choice of pension saving vehicle. These inconsistencies are also partially due to the legacy of an era when Defined Benefit (DB) was the predominant form of pension available for new entrants. Reforms are now required to reflect the current predominance of Defined Contribution (DC) pensions.

The mandate of the IDPRTG is to identify measures aimed at simplifying and harmonising the supplementary pension system. In some cases, achieving full harmonisation would involve fundamental changes to pension saving models (DB, DC and other products). For the most part the IDPRTG has focused on identifying measures that offer the possibility of ease of introduction and which, taken together, go a long way towards harmonisation. The IDPRTG also recognises the need for transitional measures to pension arrangements made previous to this initiative.

The first set of conclusions in this area involves recognising the Personal Retirement Savings Account (PRSA) as the sole Third Pillar product aimed at both addressing identified weaknesses (which have sustained alternative products) and suggesting amendments aimed at modernising the product. The second set of conclusions is aimed at harmonising the rules applying to PRSAs and occupational schemes to the extent that is practicable.

State Support for Supplementary Pension Saving
In common with most developed countries, fiscal support for private pension saving exists in Ireland. This support is provided by way of tax relief, with its inclusion in the tax code predating the foundation of the State. The policy objective has been to meet a target level of supplementary pension coverage
(most recently defined as 70 per cent of the workforce aged over 30) and an income replacement target, (most recently defined as half of pre-retirement income).

Though the lack of granular data makes it difficult to assess this in detail, it is clear that both policy objectives have not been fully achieved. It is challenging to determine whether, and to what extent, this represents a failure of existing saving incentives which come at a significant cost to the Exchequer and, in turn, the extent to which relief is afforded to savings that represent deadweight i.e. savings that would have been made regardless. Clearly, for those who do not pay income tax there is no tax incentive. For those eligible for relief on contributions, other reasons such as affordability can explain the lack of coverage.

Consistent with the majority of OECD and EU countries, Ireland has adopted an ‘Exempt, Exempt, Taxed’ system of pension taxation where tax relief is provided on contributions, the investment returns on pension savings are not taxed, while actual pension drawdown is taxed at the individual’s marginal tax rate. Such systems invariably involve a long-run net cost to the Exchequer which varies as a regime matures.

Due to limited availability of data, accurately costing tax reliefs to incentivise pension saving presents a challenge. However, it is clear that a net tax advantage exists for pension savers, as pension savings accumulate on a tax-free basis and effective tax rates are lower in retirement than pre-retirement. Estimating revenue forgone in relation to pensions is also complex due the inherent difficulty in measuring behavioural responses to policy change.

**Measuring Success: Coverage & Adequacy**

Evaluating equity in the distribution of tax expenditures on pensions depends on how broadly or narrowly equity is defined. In a narrow sense, tax relief is regressive by nature, as by definition only those who pay tax qualify. Given the particular design of the Irish pension tax regime, including recent changes to limit reliefs at the higher end, middle income earners are proportionately the main beneficiaries of the current system of pension tax relief while a lower incentive is available to lower income groups. However, a broader definition of equity, factoring in the general social insurance system, (including the State pension) illustrates the scale and effectiveness of social transfers in the Irish system. Accordingly, the flat rate State pension represents far greater benefit to those on lower incomes.

Finally, Automatic Enrolment (AE) has the potential to become a ‘game-changer’ in terms of addressing both coverage and adequacy gaps set out above. However, designing financial incentives for such a system is complex. Consideration should be given to both the value/proportion of State support along with the method of calculating the incentive. A matching contribution by the State, depending on the design, could be argued to be more beneficial in relative terms to those on lower incomes. It may also be more easily understood than marginal tax relief. However, operating two incentive systems in parallel has the potential to create challenges, including introducing various
complexities, scope for arbitrage and could run counter to the pension ‘simplification agenda’. Work on this issue is being progressed by the Automatic Enrolment Programme Board (AEPB), led by the Department of Social Protection.

**Review of the Approved Retirement Fund**

The accumulation phase of pension policy has been the primary focus of policy makers and other stakeholders over the past decades. As our population ages and DC becomes more prevalent than DB, a growing number of individuals will face significant financial choices before, at the point of, and during retirement. In turn, an increased scale of savings will be channelled into decumulation products – effectively into Approved Retirement Funds (ARF) or annuities. Accordingly, it is timely to review the ARF product.

Recognising that the ARF has evolved into a mass market product, the IDPRTG is of the view that the ‘ARF option’ should be discontinued on a prospective basis to be replaced by a combination of in-scheme drawdown and a re-designed PRSA which operates as a whole-of-life product. This would both simplify the pension landscape and enhance consumer outcomes by improving regulation and reducing costs.

Schemes and trustees should be given the option of remaining engaged and involved with members post-retirement. In addition, having a trust-based arrangement available for drawdown could reduce costs for individual savers. However, it is important to remember that any additional role for schemes or trustees brings increased responsibilities and the nature of the risks differ to the accumulation phase. Accordingly, schemes should have the option rather than an obligation to provide such services.

In-scheme drawdown is clearly not an option for individuals with personal pension products. In-scheme drawdown on an opt-in basis means an additional cohort will also be precluded from availing of in-scheme drawdown where schemes do not opt-in. A proposed solution, supported by the IDPRTG, is to provide for the establishment of trust-based drawdown-only schemes, or ‘Group ARFs’, building on the Master Trust infrastructure currently being developed by the Pensions Authority.

The IDPRTG is also of the view that the ARF should be replaced by a re-designed, whole-of-life, PRSA product. The PRSA already operates as a drawdown product, and replacing the ARF with a whole-of-life PRSA would re-anchor drawdown product rules in pension and financial regulatory legislation, while ensuring tax legislation focuses on taxation. Replacing the ARF with a whole-of-life PRSA would also serve to simplify the pension landscape without losing functionality.

The Group also recommends a range of reforms that would apply to the ARF or any replacement product. The Group recommends abolishing the Approved Minimum Retirement Fund (AMRF) requirement, improving the regulatory and advice framework, including disclosure requirements and reforming the treatment of ARF assets on death. Importantly, the Group further recommends an
increased regulatory focus on pension drawdown and the need to provide for advice before, at the point of, and during retirement.

It should be highlighted that the focus of this Report is on supplementary or personal pensions. It is separate from the work of the newly established Commission on Pensions where the main focus will be on challenges in relation to sustainability of the State Pension System.

Finally, the impact of the COVID-19 pandemic has presented many challenges including to the pensions saving market and operating environment, potentially leading to lower future retirement incomes and creating market distortions. While some of the more immediate impacts are still being worked through, organisations such as the OECD indicate that policy makers still need to focus on the longer-term benefits of retirement savings over a multi-decade horizon. It is in that context that this Report is formulated and addresses, where appropriate, issues which have ongoing impact upon the Irish supplementary pension system.
1. Introduction & Background

1.1 The purpose of this document is to report, in a consolidated fashion, on the work assigned to the Interdepartmental Pensions Reform & Taxation Group (IDPRTG or ‘the Group’) under the Roadmap for Pensions Reform 2018-2023 (the Roadmap). Having assessed the work assigned to it, and reflecting on the interconnected nature of this work, the Group decided that stakeholders would be best served by considering relevant issues in a holistic manner.

Roadmap for Pensions Reform 2018-2023

1.2 The Roadmap was agreed by the previous Government and published in February 2018. In presenting six complementary strands under which reform measures would be progressed, the Ministerial foreword noted:

There have been other pension strategies and reports published by previous Governments that have correctly diagnosed the challenges we face. This plan builds on those reports, identifies the specific actions we will take and sets out a timetable for implementation. When implemented it will eliminate anomalies in the State pension system and ensure its sustainability. It will foster and support a new culture of retirement saving to improve outcomes for all. It will provide for improvements in the governance and supervision of public and private pensions. Most importantly, all of the actions taken together, will promote the continued and active engagement of older people in society to ensure that all of us as we get older can continue to enjoy a life of security and opportunity (Government of Ireland, 2018, p. 3).

1.3 The six strands identified in the Roadmap are as follows (Government of Ireland, 2018, p. 3):

I. Reform of the State Pension - including the ‘Total Contributions Approach’;
II. Building Retirement Readiness - A New Automatic Enrolment Savings System;
III. Improving Governance and Regulation - including the EU Pensions Directive ‘IORP II’;
IV. Measures to Support the Operation of Defined Benefit Schemes;
V. Public Service Pensions Reform;
VI. Supporting Fuller Working Lives.

The Interdepartmental Pensions Reform & Taxation Group

1.4 The IDPRTG is allocated a number of Actions under the Roadmap – these Actions primarily fall under Strand 3, ‘Improving Governance and Regulation - including the EU Pensions Directive, IORP II’. The IDPRTG is chaired by the Department of Finance and includes representatives from:

- The Department of Public Expenditure and Reform;
- The Department of Social Protection;
- The Office of the Revenue Commissioners;
• The Pensions Authority.

1.5 The Group met on 13 occasions and also established sub-groups. It conducted a public consultation process to better inform its work and engaged bilaterally with the Central Bank of Ireland in completing its report.

Roadmap Actions Allocated to the IDPRTG

1.6 As noted above, the Roadmap allocates a number of Actions to the IDPRTG (Government of Ireland, 2018, pp. 27 - 42). These Actions are set out below:

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<td>3.11</td>
<td>The Interdepartmental Pensions Reform and Taxation Group will identify and progress measures to improve the harmonisation of rules to eliminate anomalies in the treatment of different retirement arrangements including taxation treatment.</td>
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<tr>
<td>3.12</td>
<td>Identify the options and develop recommendations to coherently rationalise the number of individual pension vehicles which exist at present.</td>
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<tr>
<td>3.13</td>
<td>Review the cost of funded supplementary pensions to the Exchequer. To inform decisions relating to financial incentives for retirement savings and underpin the development of the Automatic Enrolment system (see Strand 2), this will include an assessment of the economic and social benefits delivered and an evaluation of equity in the distribution of tax expenditure on pensions.</td>
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<td>3.14</td>
<td>Undertake a broad review of the utilisation of the ARF option and consider whether regulatory oversight of this product is fit for purpose. This will include a review of ARF criteria set out in tax legislation including specified minimum income requirements. It will also include identifying measures to address any provider/consumer protection gap and the potential to facilitate group ARF products or in-scheme drawdown.</td>
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<tr>
<td>6.6</td>
<td>The Interdepartmental Pensions Reform and Taxation Group (see Action 3.11) will review the legislation governing the various ages at which pensions can be drawn down together with any apparent anomalies arising in the treatment of different retirement arrangements with a view to a standardised upper age limit.</td>
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History of Reform Initiatives

1.7 In the recent past, there have been a number of initiatives to reform the domestic pension system. Many of these addressed, at least in part, issues core to this report, namely, reform of the supplementary pension system. A very brief summary of the various initiatives is provided below:

• National Pensions Policy Initiative (1998): The National Pensions Policy Initiative (NPPI) was published by the Pensions Board (what is now the Pensions Authority) in 1998 and
was intended to ‘facilitate national debate on how to achieve a fully developed national pension system and to formulate a strategy and make recommendations for actions needed to achieve this system’ (The Pensions Board, 1998, p. v);

- National Pensions Review (2005) and Special Savings for Retirement (2006): The National Pensions Review was published by the Pensions Board in 2005 with a defined purpose to review the current national pensions system (The Pensions Board, 2005). The Special Savings for Retirement report, also published by the Pensions Board, was commissioned to set out general principles in relation to the introduction of a mandatory or quasi-mandatory pension system (The Pensions Board, 2006);

- Green Paper on Pensions (2007): The Green Paper on Pensions was published by the Department of Social and Family Affairs building on the earlier work of the two reports above (Department of Social and Family Affairs, 2007);


- National Pensions Framework (2010): The National Pensions Framework (NPF) was published by the Department of Social and Family Affairs (2010, p. viii) with the overarching aim of seeking to ‘deliver security, equity, choice and clarity for the individual ... increase pension coverage, particularly among low to middle income groups and to ensure that State support for pensions is equitable and sustainable’;


1.8 Many of the actions or approaches recommended in the above reports have not been implemented or have only been partially implemented. This, of course, is due in part to the economic challenges of the past decade. Measures taken in recent times have tended to focus on limiting what was considered overly generous tax relief for savers to support fiscal consolidation.

1.9 This previous work has informed the IDPRTG. With a number of conclusions reflective of this, there is limited value in repeating the work of previous reports. Accordingly, the focus of the IDPRTG is narrower in scope than the reports listed above and the intent is to develop and articulate practical, implementable findings, which can help improve the existing pension landscape.

Consultation Process

1.10 In order to engage more broadly, and to seek the views of interested parties, the IDPRTG conducted a public consultation process. Submissions and views were sought, through the Department of
Finance website, on the Actions assigned to the IDPRTG. The Consultation Paper\(^2\) was structured on a similar basis to this report and posed twenty-three specific questions seeking to elicit the views of stakeholders\(^3\).

1.11 The consultation process ran from 28 June to 19 October 2018. Forty-nine submissions were received, ranging from a small number covering single issues to comprehensive and detailed responses covering all issues raised. The Group plans to publish submissions received along with this report. The views expressed and key themes of consultation submissions are summarised in the relevant chapters. The majority were made by industry stakeholders, and it must be acknowledged that these will therefore mostly reflect an industry view. A small number of private citizens, academics and employee representative bodies also responded.

Data

1.12 In preparing this report, a key factor that hindered the Group’s analysis was the lack of granular, quality and timely data. Recent initiatives should help improve data quality for future analysis. Both the European Central Bank (ECB) and the European Insurance and Occupational Pensions Authority (EIOPA) have introduced new reporting requirements for occupational pension schemes. The introduction of PAYE Modernisation (P.Mod)\(^4\) should, in time, also improve data availability in relation to the tax treatment of pension savings and drawdown. This report also makes specific recommendations for further improved data capture where warranted.


\(^3\) Consultation questionnaire is available at Appendix 2.

\(^4\) The Revenue Commissioners introduced real time reporting of payroll under PAYE Modernisation (P.Mod) which has been in operation for all employers in the State since 1 January 2019.
2. Domestic Pension Environment

2.1 This report does not propose to dwell in detail on the external environment within which this pension reform initiative is advanced. However, it is important to consider, at least briefly, the macro backdrop which informs the domestic policy context for initiating reforms and to set out some guiding principles that flow from the Roadmap.

Demographics and other Secular Trends in Pensions

2.2 It is instructive to consider some of the secular social, economic and financial trends impacting pension policy. This summary assessment of the forces influencing pension policy is intended to set the work of the IDPRTG in a broader context and inform national policy.

Demographics

2.3 Recent work undertaken by the Department of Finance sets out, in some detail, the scale of the demographic changes facing the country and its economy. This report notes that:

In many advanced economies – the US, EU, Japan – a demographic turning point has been reached: the number of people of working age has peaked and is on a clear downward trajectory. As a direct result economic growth rates are slowing and demographically-sensitive public expenditure is rising in many of these countries (Department of Finance, 2018a, p. iii).

![Figure 1: Irish Population Data and Forecasts](source: Eurostat (2020) data on population projections)
2.4 Though Irish demographic trends are more favourable than most developed economies, we are not immune to future challenges. Figure 1, based on Eurostat population forecasts to 2070, best illustrates how the structure of our population is forecast to change.

2.5 Such forecasts are of course subject to uncertainty, but the general direction of travel is clear. The implication for existing policy is also clear – a doubling of Ireland’s old-age dependency ratio by the middle of the century will put significant strains on the State’s fiscal resources (Figure 2). Encouraging our population to save adequately for their retirement is part of the policy solution.

2.6 In a recent report, the Department of Finance noted that ‘a country’s ability to increase its living standards over time depends to a large extent on its ability to improve its output per worker, in other words its productivity level. Indeed, disparities in living standards, commonly measured by output per capita, are largely reflected in the different levels of productivity across countries’ (Department of Finance, 2018b, p. 1). Related to this, the value of saving (or the benefit of deferring consumption) is related to long-term growth rates which in turn are determined by productivity gains. Whether the current prolonged declining trend in productivity in developed economies proves to be a structural change (i.e. secular stagnation) or whether it reverts to a higher level will affect future returns on pension savings.

2.7 An expectation of high single digit real returns for equities, in line with what we have seen for much of the past century, may not be realistic. In the US, expected medium-term pension return has trended down materially in the past two decades. Although this reflects the position in the US, it is representative of the wider global investment environment. Medium term return forecasts are materially lower than historic averages\(^5\). In addition, real bond yields have been low in the US and negative in Germany for a period. Figure 3 is a graphical representation of this.

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\(^5\) This of course is in part reflective of current valuations – and is only medium term.
Domestic Policy Context for Reform

2.8 The focus of the work of the IDPRTG is on simplifying and reforming the existing supplementary pension system. Despite this specific focus, it is useful, and necessary, to set out the broader context. The domestic approach to pension policy is best summed up in the Green Paper on Pensions:

The overall objective of our pensions system is to provide an adequate basic standard of living through direct State supports and to encourage people to make supplementary pension provision so that they may have an adequate income in retirement (Department of Social and Family Affairs, 2007, p. iv).

2.9 Supplementary pension policy is supplemental in that it builds upon First Pillar pension provision. The Roadmap notes:

Our pension system, including the State pension and other measures like the free fuel and travel schemes, has largely protected older people from the effects of poverty. People aged over 65 are now four times less likely to experience poverty compared to the population as a whole and are significantly less likely to be at risk of poverty than they would have been 10 years ago. (Government of Ireland, 2018, p. 2)
2.10 With the existence of the State pension (First Pillar), the goal of supplementary pension policy in its broadest sense is to move beyond poverty prevention and to improve income adequacy for all in retirement. This goal is typically evaluated along two dimensions; firstly, the proportion of the population with supplementary pension coverage; secondly, for those with such coverage, the adequacy of income replacement. This is generally defined as the percentage of an individual’s pre-retirement income covered by their retirement income.

2.11 Occupational pension schemes, also known as Second Pillar schemes, have traditionally been the source of supplementary pension coverage. Third Pillar coverage, by means of a personal pension product, represents a smaller proportion of supplementary coverage and has typically catered for the self-employed and those seeking to top-up Second Pillar entitlements. In more recent times, and since the introduction of the Personal Retirement Savings Account (PRSA), Third Pillar products are more common among employees than was previously the case, albeit from a low base.

2.12 Despite available incentives, supplementary coverage has remained below target with various surveys and other measures suggesting coverage has hovered around 50 per cent of the working population in recent decades\(^6\). After a number of proposals and recommendations made in previous policy documents to initiate some form of mandatory or quasi-mandatory supplementary scheme, the previous Government made commitments to introduce an Automatic Enrolment retirement savings system.

**Automatic Enrolment**

2.13 The Roadmap sets out a proposal to introduce an Automatic Enrolment system in 2022. More recently this has been included as a commitment in the new Programme for Government. The proposal is described as a soft-mandatory system in the sense that it allows individuals who have been enrolled to opt-out. The Roadmap specifically notes, in the context of Automatic Enrolment, that ‘workers with pre-existing personal or occupational pension arrangements will be able to retain those arrangements’ (Government of Ireland, 2018, p. 18). The clear intention behind the introduction of Automatic Enrolment is to complement existing supplementary pension arrangements rather than replace them. As a result, any proposed simplification or reform measures need to be conscious of the rollout of Automatic Enrolment and have, as an overarching ambition, the coherence and consistency of the supplementary pension landscape.

2.14 Between August 2018 and March 2019 a public consultation process for an Automatic Enrolment retirement savings system took place. To inform the consultation process a Strawman proposal was drafted, setting out a proposed approach to the design of an AE system with the intention of generating discussion and improving ideas. Taking into account feedback from the consultation process and the findings from additional research, including an economic impact analysis of AE conducted by the ESRI, the previous Government approved, in October 2019, significant elements of the design of the AE system. Key decisions were made in relation to a range of issues, including the target membership,

\(^6\) The NPPI advocated a coverage level of ‘70% of the total workforce over age 30’ (The Pensions Board, 1998, p. 11).
the contribution rates, the policies in relation to opting-out and re-enrolment, the administrative arrangements and organisational approach and the investment options.

In terms of the target membership the previous Government decided that:

- Current and new employees aged between 23 and 60 years of age and earning €20,000 or above per annum (across all employments) will be automatically enrolled.
- Those earning below €20,000 per annum (across all employments) and those employees aged under 23 and over 60 will be able to ‘opt-in’ to the system.
- Employees who are existing members of a pension scheme/contract which meets prescribed minimum standards and contribution levels will not be automatically enrolled for the employment to which that pension relates.

There were five main areas in the design of AE where work continues so as to produce options for Government to consider in due course. These areas relate to the following:

- Scope and role of the Central Processing Authority;
- Nature and functions of the Registered Providers, including an examination of the inclusion of a public body as a Registered Provider;
- Investment framework and funds to be offered by Registered Providers, including the design of the default fund, and also the pay-out phase;
- State financial incentive; and
- Phasing of implementation.

2.15 In considering the Actions assigned to it, the Group has factored in the eventual introduction of an Automatic Enrolment System. The introduction of a functioning quasi-mandatory pension system with broad applicability will have widespread implications, ranging from designing appropriate incentives to redefining the role of the Third Pillar and the PRSA.

2.16 Therefore, conclusions made in this report assume the introduction of Automatic Enrolment. Where relevant, any conclusions which are acted upon should be progressed in parallel with the introduction of Automatic Enrolment or amended to reflect the final design of the system. However, progressing pension simplification measures should not be contingent on the introduction of Automatic Enrolment. Indeed, reducing the complexity of the current supplementary pension system is a valid policy objective in itself that aims to help increase coverage and lead to better outcomes for those who already have supplementary pensions.

**Overall Vision**

2.17 In summary, drawing on the vision outlined in the Roadmap, the IDPRTG has framed its conclusions within the following framework:

- First Pillar: State pension would provide 34 per cent of average earnings;
Second Pillar: Would be made-up of authorised occupational pension schemes\(^7\) that meet an adequate standard, in addition to a new Automatic Enrolment system;

Third Pillar: Would be made-up of a single personal pension product catering primarily to those who fall outside the catchment of Automatic Enrolment, including those who opt out of Automatic Enrolment, and those who wish to have more direct control over their pension savings. This product would also operate as a flexible drawdown product replacing the functions of the Approved Retirement Fund.

Success is then measured against both a coverage ambition and a desired replacement rate ambition. This subject is discussed in more detail in Chapter 5.

**Sustainability**

2.18 Policy objectives are generally subject to constraints. The chief constraint for the State in supporting pension provision is its fiscal capacity to do so. The direct corollary of an ageing population and an effective State pension system is materially higher Exchequer costs over time. Furthermore, the State is also liable for public sector pensions and also provides tax incentives for supplementary pension savings.

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\(^7\) The Roadmap provides that ‘a new process will be developed to require all new and existing schemes gain ‘authorised status’ from the Pensions Authority in order to carry out activities and to obtain tax relief. This process will require trustees to demonstrate compliance with new fitness and probity requirements and governance obligations’ (Government of Ireland, 2018, p. 22). This shift aligns overall with increased governance requirements set out in IORP II Directive, which when transposed, will apply to all occupational pension schemes in Ireland.
2015 (Department of Public Expenditure and Reform, 2017; KPMG, 2017). Figure 4 shows how State pension expenditure as a proportion of total Social Insurance Fund (SIF) expenditure is expected to evolve over time. It also shows the annual net position of the Fund as projected out to 2071. Later in this report we also discuss the cost to the Exchequer of providing tax incentives to encourage supplementary pension provision.

### Guiding the Reform Process

2.19 It is widely accepted that the complexity of the domestic supplementary pensions sector undermines the dual ambitions of increasing coverage and improving adequacy. Such complexity adds to the challenge of overcoming behavioural biases that militate against engagement by individuals with their long-term financial needs and can, in turn, lead to suboptimal outcomes for those with supplementary pension coverage, for a variety of reasons.  

2.20 In furthering the State’s ambition to simplify and reform pension provision, it is useful to set out a number of guiding principles against which proposed reforms can be measured:

- **Consumer Focus:** Reforms should consider the needs of the individual saver, with the intention of building confidence in and improving the understanding and comprehension of pensions. Understanding the target consumer and their level of financial literacy is important in developing effective policy;

- **Simplicity:** The objective should be to create as simplified a pension landscape as possible. There is significant research demonstrating how inaccessible pensions are perceived by members of the public. Though some degree of complexity is unavoidable, simplicity should be a key objective;

- **Choice:** There is a trade-off between simplicity and choice. Some individuals will wish to have more active engagement with their pension savings, particularly in relation to investment decisions. This should be facilitated to a reasonable extent;

- **Neutrality:** Reforms, to the extent possible, should seek to achieve neutrality of incentive and outcome for consumers between different types of supplementary pension arrangements;

- **Equity:** Supplementary pension policy targeted outcomes should be equitable. Pension taxation policy acts as an incentive for savers to invest in their supplementary pensions and seeks to diminish pension saving barriers, such as affordability;

- **Fiscal Sustainability:** the population is ageing and current public debt levels are high. Reforms should be conscious of the State’s capacity to support initiatives in the medium to long-term and reflect various competing demands on the State’s finite resources;

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8 *The Actuarial Review of the Social Insurance Fund 2015* was undertaken by KPMG on behalf of the Department of Social Protection.

9 Complexity allows consumers to justify their inertia in committing to voluntary supplementary pensions; requires a high level of intermediation between the consumer and the voluntary supplementary pension arrangement; drives up costs for consumers through payments (fee and commissions) for intermediation and advice services; can lead to suboptimal outcomes for some by choosing a suboptimal arrangement and/or being required to move funds (and incur associated costs) between different arrangements to achieve a desired optional outcome.
• **Transition:** Individuals already engaged with the pension system have made plans based on current rules. Reforms should, where possible, take account of this and provide for transitional measures where relevant;

• **Policy Certainty:** Saving for and the draw down associated with a pension can encompass periods of up to 75 years. There is a broad consensus about the need to reform our supplementary pension system and any programme of proposed reforms (to include the introduction of Automatic Enrolment) should receive due consideration and be implemented in a prudent and transparent fashion. Ideally, a period of certainty where no new *ex post* measures are introduced should then be provided for;

• **Engagement:** Where proposals of the IDPRTG are accepted by Government, the IDPRTG suggests that draft proposals are published to seek stakeholder input. While a high-level consultation process has already been conducted, in enacting or implementing specific actions, additional stakeholder input should be sought.

2.21 Finally, many of the conclusions in this report are interdependent and should be seen in that light. In some cases, a policy change made in isolation could result in unintended consequences.
3. Reform & Simplification

Objective and Background

3.1 The supplementary pension system, which comprises Second Pillar trust-based occupational schemes and Third Pillar contract-based personal pension products, is undoubtedly complex for consumers to navigate. Amongst the complexities that discourage individuals from engaging with the system is the availability of multiple pension savings vehicles and the inconsistencies in terms of treatment amongst these pension arrangements.

3.2 The taxation treatment of the different supplementary pension savings arrangements has evolved in a somewhat ad hoc manner over time arising from both pension and tax policy related decisions. This has resulted, for example, in the taxation treatment of contributions, lump sums taken at drawdown, and death-in-service benefits becoming a complicated function of an individual’s employment status and choice of pension savings vehicle. In part, these inconsistencies are a legacy of an era when Defined Benefit (DB) was the predominant form of pension provision for new entrants. Reforms are now required to reflect the current environment where Defined Contribution (DC) provision is more prevalent.

3.3 The objective of this Chapter is to make a number of practical recommendations to simplify the supplementary pension system. This involves rationalising the number of Third Pillar arrangements and harmonising rules to the greatest extent possible between remaining Second and Third Pillar arrangements. This should benefit individual consumers so they can easily understand, compare and choose an arrangement that suits their requirements and reduce the need for complex advice. Rather than focusing on tax efficiency, access to benefits, or the availability of a particular drawdown option, consumers should be able to consider value for money; product suitability; the desire for trustee involvement; and the scope of investment options.

3.4 Chapter 3 is set out as follows:

- Overview of submissions to our public consultation;
- Analysis of the impact of the introduction of Automatic Enrolment on the Third Pillar;
- Discussion around existing occupational schemes and personal pension products landscape;
- Consideration of transitional requirements;
- Discussion of proposals for simplification and harmonisation.

3.5 The Group’s vision for a simplified Third Pillar, in keeping with the objective set out in Action 3.12 of the Roadmap, is that of a single personal pension product. The Group considers that this will be best achieved by the prospective cessation of Retirement Annuity Contracts (RACs) and Buy-out Bonds (BOBs), leaving instead a revised Personal Retirement Savings Account (PRSA) product as the sole Third Pillar offering which is extended to a whole-of-life product. The future supplementary pension
landscape would then incorporate Second Pillar occupational schemes complemented by a new Automatic Enrolment system and the Third Pillar made up of a revised PRSA product.

3.6 Finally, the Group is aware that current products exist for a reason and existing rules were guided by past decision making. This is reflected in the discussion on simplification and manifests itself in the need to provide for transitional arrangements should certain policy recommendations be actioned.

Actions Addressed

3.7 Chapter 3 addresses Action 3.11, 3.12 and 6.6 of *A Roadmap for Pensions Reform 2018-2023*:

<table>
<thead>
<tr>
<th>Action</th>
<th>Detail</th>
</tr>
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<tbody>
<tr>
<td>3.11</td>
<td>The Interdepartmental Pensions Reform and Taxation Group will identify and progress measures to improve the harmonisation of rules to eliminate anomalies in the treatment of different retirement arrangements including taxation treatment.</td>
</tr>
<tr>
<td>3.12</td>
<td>Identify the options and develop recommendations to coherently rationalise the number of individual pension vehicles which exist at present.</td>
</tr>
<tr>
<td>6.6</td>
<td>The Interdepartmental Pensions Reform and Taxation Group (see Action 3.11) will review the legislation governing the various ages at which pensions can be drawn down together with any apparent anomalies arising in the treatment of different retirement arrangements with a view to a standardised upper age limit.</td>
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Consultation General Feedback

3.8 Responses to the public consultation indicate that there is general support for simplification and reform of the current supplementary pension landscape. This includes rationalising the number of Third Pillar vehicles, which would be achieved by prospectively ceasing RACs and BOBs leaving PRSAs as the remaining Third Pillar option.

3.9 Numerous respondents highlighted that this would require amendments to the PRSA product to incorporate some of the features of RACs and BOBs. Issues around transferability between Second Pillar occupational pension schemes and Third Pillar products would also need to be addressed.

3.10 However, a number of detailed submissions were received on the nature of required transitional arrangements. For example, providing for the run-off of existing products and the need to retain some features of these were highlighted in this context.

3.11 Harmonising rules applying to the Second and Third Pillar also received substantial support. However, there was less agreement on the nature and detail of proposals to harmonise in this area. Some proposals aimed at simplification had far-reaching implications and involved substantive alterations to existing vehicles.
Impact on Third Pillar of Introduction of Automatic Enrolment System

3.12 The proposed introduction of a system of Automatic Enrolment, as set out in the Roadmap, will significantly alter the landscape of supplementary pension provision in Ireland. This poses key questions in the context of reform and simplification, in particular in relation to the future of Third Pillar provision.

3.13 Employers are currently obliged under Section 121 of the Pensions Act 1990, as amended, to provide access to a PRSA to their employees, in the case where they do not operate a pension scheme or where there is a defined restriction on eligibility. As Automatic Enrolment will introduce an obligation on such employers to enrol employees in this new retirement savings system, this PRSA related obligation will likely lose its relevance. However, while the PRSA was originally targeted at those in employment without occupational pension scheme cover, most PRSAs taken out since 2003 have not been for this purpose. The majority of PRSAs have been used for: Additional Voluntary Contributions (AVCs) both in the public and private sector; by the self-employed; and for transfer values paid from occupational pension schemes and other arrangements. Pensions Authority PRSA statistics for Q4 2019 show that only 37 per cent of PRSAs established in that quarter relate to employer designated PRSA schemes.

3.14 On the assumption that Automatic Enrolment proceeds as a Second Pillar employment-linked, DC pension scheme, the Group envisages future Third Pillar arrangements catering primarily to those falling outside the Automatic Enrolment catchment; those who opt-out of Automatic Enrolment who wish to have more flexibility in managing their own pension savings; those who want to make additional pension savings outside their existing scheme (i.e. AVCs); and those who need a vehicle to hold a transfer value from other arrangements. Overall, policy design requires an understanding of the consumer and their needs so as to best protect them and offer a product that they can utilise. For example, Automatic Enrolment, in line with international experience, may be more appealing to employees than to the self-employed. In this regard, the self-employed would be an important group to capture in the design of the Third Pillar. According to CSO data from 2019 Q3, only 30 per cent of self-employed had supplementary pension cover in comparison to 54 per cent of employees10 (CSO, 2020).

Existing Supplementary Pension Landscape

3.15 Before comparing and contrasting the treatment of various pension arrangements and making reform proposals, it is useful to set out, in general terms, the characteristics of existing supplementary pension provision. As previously stated, the supplementary pension landscape is made up of Second Pillar trust-based occupational schemes (and will include the Automatic Enrolment system, although its governance structure has not yet been finalised) and Third Pillar contract-based personal pension products (PRSAs, BOBs, and RACs).

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10 Employees captures both public and private sector employees.
Second Pillar Occupational Schemes Incl. Small & Single Member Schemes

3.16 Occupational pension arrangements can be designed as defined benefit (DB) or defined contribution (DC). DB arrangements have specific rules setting out benefit entitlements under various circumstances (retirement, death etc.). Benefits are usually expressed in terms of ‘pensionable salary’ and years of service. Almost all public service schemes and some funded occupational schemes are defined benefit. In DC arrangements, the benefits at retirement or leaving service depend on the value of the investment fund accumulated for the member and there is no guarantee of any minimum benefit. Many funded private sector occupational schemes and all personal pensions (PRSAs, BOBs, and RACs) are DC.

3.17 According to the Pensions Authority, there are around 140,000 occupational pension schemes in operation in Ireland. A little under half of these are frozen, where no new contributions will be made but assets continue to be invested. At end December 2019, there were over 66,000 non-group pension schemes (established for one member only) with active members, and just over 8,500 group schemes (established to be capable of taking more than one member) with less than 100 members. Around 600 group schemes have 100 or more active members. In addition, at any time there are also a number of schemes in the process of winding-up.

3.18 Small Self-Administered Pension Schemes (SSAPS) are a type of trust-based, mostly single member schemes where the scheme member is also the trustee.11 As noted above, over 66,000 active occupational pension schemes are one member schemes, and of these, over 8,000 are SSAPS. The primary motives for establishing a SSAPS arrangement is to benefit from employer funding rules and to avail of the investment and borrowing flexibility afforded such schemes. Transposition of the IORP II Directive12 is expected to have significant implications for single member schemes. Such small schemes will have to operate within an environment of increased regulatory standards and increased standards of scheme governance. In addition, the capacity of SSAPS to borrow for investment purposes will be removed.13

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11 Having regard to the identity of interests between the employer, the beneficiary and the trustee, and to ensure the schemes are bona fide established for the sole purpose of providing relevant benefits as required by the Taxes Consolidation Act 1997, additional requirements were introduced in order for such schemes to receive exempt approved status from the Office of the Revenue Commissioners.

12 According to the Pensions Authority (2018a, p. 1), the [IORP II] Directive provides for EU wide pension scheme standards including: an effective system of governance (covering areas such as: fit and proper standards for trustees; the appointment of Key Function Holders for risk management, actuarial and internal audit; written policies on risk management, internal audit, and, where relevant, actuarial and outsourced activities; and standards relating to internal controls, administrative and accounting procedures, contingency plans and remuneration) and communications with, and information to be provided to active members, prospective members, deferred members, those nearing retirement and pensioners. The Directive also covers the general principles of prudential supervision with an emphasis on a forward looking and risk-based approach, with greater interventionist powers available to the regulator, including a reach to outsourced service providers’.

13 Under existing rules, comprising of investment regulations issued under the Pensions Act 1990, the Taxes Consolidation Act 1997 as amended (TCA) and guidance issued by the Office of the Revenue Commissioners, single member schemes are distinguished from multi-member schemes in a number of ways. A key distinction is a single member scheme's capacity to borrow. The Occupational Pension Schemes (Investment) Regulations, 2006, impose restrictions in relation to investments and borrowing by schemes but parts of these regulations do not apply to single schemes. In addition, Section 16 Finance Act 2004 sets out that the presence of a rule in retirement benefit schemes which allows for borrowing by that scheme will not prevent it from retaining or obtaining approval under Section 774 TCA.
3.19 The Group, in considering the impact of IORP II measures on Second Pillar single member schemes, has endeavoured to ensure that its reform and simplification recommendations are coherent with changes arising from its application. The Group has considered the need for a future pension saving destination for the cohort who would typically have chosen to save for their retirement in a single member scheme and has deliberated on this issue in the context of its consideration of the future structure of the PRSA product, given that at end December 2019 there were 298,532 PRSAs established with asset value of €7.5 billion.
### Figure 5: History of the PRSA

A PRSA is a contract between an individual and an authorised PRSA provider (such as an insurer, credit institution or investment firm) in the form of an investment account. It is a long-term personal retirement account designed to enable an individual save for retirement in a flexible manner. It is structured as an individual, contract-based DC product.

The original concept of the PRSA was proposed by the Pensions Authority (then the Pensions Board) in the NPPI Report, 1998 and it was first introduced in the Pensions (Amendment) Act 2002. The intention at that time was that the PRSA would go on to replace other DC contract-based products. Since its introduction, PRSAs have grown as illustrated below.

![PRSA Growth Over Time](image)

Source: Pensions Authority Schedule A Statistics. **Note:** Number of contracts figures refer to contracts established.

As set out in the NPPI report, the PRSA was primarily intended for segments of the population where occupational pension coverage was low, where occupational schemes were not traditionally offered, and for workers who regularly move between employments. However, the majority of PRSAs taken out since 2003 have related to other groups.

There are two types of PRSAs – a Standard and Non-Standard PRSA. The difference between the two is that Standard PRSA charges are capped at 5 per cent of PRSA contributions paid and 1 per cent per annum of PRSA assets*. Non-Standard PRSAs have no such caps on charges. The other main difference is that standard PRSAs can only invest in pooled funds (also known as managed funds), whereas non-standard products have a wider investment choice.

*Section 104 Pensions Act 1990.

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### Third Pillar Products: Retirement Annuity Contracts

3.20 Retirement Annuity Contracts or RACs (also known as personal pensions) are specifically Revenue approved insurance policies taken out by an individual with an insurance company. In character, they are DC pension saving arrangements, and have traditionally been used by self-employed individuals as pension saving vehicles. RAC savers can occasionally also include employees who are not included by their employer in an occupational pension scheme for retirement benefits.
3.21 Data provided to the Pensions Authority and to the Office of the Revenue Commissioners support an estimate of between 120,000-140,000 RACs in existence, accounting for in excess of €3.4 billion in assets. It is estimated that around 4,000 regular premium RACs and 8,000 single premium RACs are taken out each year.\(^\text{15}\)

3.22 Trust RACs are a group trust version of the individual RAC, established by a body representing the majority of individuals engaged in the State in a particular occupation. Examples of Trust RACs are those operated by the Institute of Chartered Accountants, the Bar Council of Ireland and the Law Society of Ireland. Individuals in these categories can choose between investing in a RAC, PRSA, Trust RAC or a combination of the above. According to the Pensions Authority, while there are less than ten Trust RACs in existence, no new Trust RAC has been established in recent years. The provisions of IORP II will apply to such entities, introducing additional regulatory and governance requirements which will increase costs. This gives rise to questions about the sustainability of existing trust RACs and makes it unlikely that new ones would be established.

3.23 It was originally intended that PRSAs would replace RACs. Once the standard documentation for a RAC is approved by the Office of the Revenue Commissioners\(^\text{16}\) a pension provider can sell any number of these policies, as individual approval is not necessary. RACs, however, are still popular in the market place as there is the option of including life assurance.\(^\text{17}\) If the sale of RACs was ended on a prospective basis, subject to facilitating access to life assurance in line with what is provided for in Section 785 of the TCA, then PRSAs would be a viable alternative.

**Third Pillar Products: Buy-out Bonds**

3.24 BOBs\(^\text{18}\) (also known as Personal Retirement Bonds - PRBs) are personal financial contracts (usually insurance policies but can also be non-insured BOBs not with life offices). They are established by the scheme trustees in the name of an occupational pension scheme beneficiary, and into which, 100 per cent of the value of the member’s accrued rights in the scheme, on leaving service or on scheme wind up, is transferred. Assets in the BOB are invested as the member instructs but no further contributions can be made.

3.25 The BOB, which pre-dates the PRSA, is permitted under Section 770(2) TCA to ensure the availability of an appropriate destination for pension saver assets where the member leaves a scheme or where the scheme is being wound-up. The BOB reflects the rules of the scheme from which the transfer is made including in relation to how and when benefits can be taken. However, a BOB holder can now

\(^{14}\text{A regular premium RAC is different from a single premium RAC on the basis that a regular premium RAC involves an on-going contribution on a monthly basis whereas a single premium RAC is a RAC that is set up with a single contribution and does not have on-going contributions.}\)

\(^{15}\text{It should be emphasised that this data is estimated based on a survey of providers and is incomplete.}\)

\(^{16}\text{Office of the Revenue Commissioners approval under Section 784 of the TCA}\)

\(^{17}\text{As it is possible to get tax relief on life insurance contributions via an occupational scheme, this facility was provided for in Section 785 of the TCA for RACs ensuring equal treatment for the self-employed.}\)

\(^{18}\text{A BOB is a pension vehicle approved by Revenue which is used for receiving transfer payments from occupational pension schemes, as a result of the winding up of the scheme, due to the scheme member leaving service to house preserved benefits for deferred members, and to hold transfers in the context of a Pension Adjustment Order.}\)
access the Approved Retirement Fund (ARF)\textsuperscript{19} option regardless of the scheme it transferred from (such as a DB scheme).

3.26 No reliable data is available on the number or volume of assets in current BOBs. However, from an informal survey of providers, it is estimated, on a conservative basis, that there are at least 150,000 BOBs in existence, holding €7 billion in assets. A mean value of less than €50,000 suggests a large amount of lower-value BOBs (though we have no insight into the distribution).

\textbf{Previous Efforts to Streamline Third Pillar Provision}

3.27 The issue of pension simplification and rationalisation of Third Pillar arrangements has featured in previous pension reform initiatives, notably in the NPPI (1998) and the NPF (2010). As previously stated, the original intention, and then recommendation, of the NPPI Report was to have the PRSA replace other contract-based pension savings arrangements (The Pensions Board, 1998).

3.28 Legislation was enacted which would have implemented, in part, the recommendation of the NPPI report, through Section 122 of the Pensions (Amendment) Act 2002, providing for the replacement of BOBs. However, to date that legislation has not been commenced due to restrictions applying to the PRSA product and the industry view that BOBs and RACs continue to meet a customer need (which the PRSA does not fulfil). The objective of the IDPRTG is to build upon this previous work and develop practical, deliverable recommendations in order to simplify Third Pillar provision.

\textbf{Transitional Requirements}

3.29 Individuals and their advisers have planned for future pension saving and drawdown under the existing set of rules and regulations. To the extent possible, efforts to harmonise and simplify should operate on a prospective basis, recognising the long-term nature of pension saving. However, while recognising the importance of transitional provisions, it is crucial that they do not give rise to excessive complexity, which is not in the interest of consumers and is onerous for pension providers. Furthermore, and unsurprisingly, suggestions aimed at harmonisation or ensuring adequate transition often involve ‘levelling up’ which has costs, and efforts to level-up which may ostensibly appear fair, could be perceived as inequitable by cohorts that miss out.

\textbf{Proposals for Simplification and Harmonisation}

3.30 This section sets out specific areas where reforms are needed to meet the goal of simplifying pension provision by removing some complexity and harmonising rules. The objective is to consider the feasibility of a single Third Pillar product, the PRSA, and harmonise, to the extent possible, rules applying to it and Second Pillar provision. Implementing the conclusions below would require changes to existing rules – both primary and secondary legislation, as well as to Revenue guidance.

\textsuperscript{19} The ARF option will be discussed in greater detail later in this Chapter and is primarily discussed in Chapter 6.
Conclusions:

- Revenue will review and update the Pensions Manual to reflect any changes introduced on foot of the Pensions Roadmap process.

RACs and BOBs to be discontinued on a Prospective Basis

3.31 The general support in consultation responses for confirming the PRSA as the only future Third Pillar product was invariably caveated with the need to ensure appropriate transition arrangements for existing savers. There is a need to achieve an outcome that protects the rights and entitlements of existing RAC and BOB holders, while simultaneously attempting to achieve an objective of pension simplification, recognising that to some extent these can be contradictory objectives.

3.32 A key issue is whether existing RAC and BOB holders would be required to transfer to an amended PRSA product or alternatively would the existing legislative and administrative infrastructure be maintained to enable such contracts to continue in their existing format. The least disruptive option would appear to be to close the existing products to new customers and allow the existing cohort to run-off naturally. This option would protect existing savers’ rights and entitlements but would be disadvantageous from a reform perspective as harmonisation would not be fully achieved for a number of decades.

3.33 The most disruptive option for existing savers would be to close the products and transfer the accrued funds to PRSAs. While this option could achieve the objective of pension simplification with immediate effect, its potential to disadvantage customers is significant and must be taken into consideration. Features that are particular to RACs and BOBs which may not be easily replicated in a PRSA are a significant obstacle to closing the products without a run-off for existing contracts. RAC and BOB contracts that have been taken out in the past may include features such as bonuses, investment guarantees or guaranteed annuity rates which consumers may not be able to replace if required to transfer to a PRSA. However, a well-designed new form of PRSA contract could encourage existing RAC and BOB holders to transfer and, as such, simplify this transition process.

3.34 To simplify the Third Pillar product offering for consumers, the Group is of the view that RACs and BOBs should cease to exist on a prospective basis. Such an approach will allow existing BOBs and RACs to run-off. If a saver so desires, they may transfer their existing BOB/RAC into a PRSA. This would require some amendments to the PRSA product, which are discussed in the following paragraphs.

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20 Such an approach is not without its own challenges as expertise and scale both within industry and Government stakeholders with regard to these products will fade over time, particularly given the likely long tail related to these products.
PRSA Amendments to Fulfil RAC / BOB Functions

The 15-year rule, its origin and impact

3.35 The 15-year rule, which prohibits transfer from occupational schemes to PRSAs where the individual has more than 15 years qualifying service, was introduced in the Pensions (Amendment) Act 2002 together with the introduction of the PRSA product. It is understood that the 15-year restriction was originally put in place to prevent widespread transfers out of schemes, the concern being that PRSAs would attract substantial volumes of transfers from schemes which could unintentionally undermine existing pension provision.

3.36 Currently a member leaving employment or whose scheme is winding-up with more than 15 years’ service is limited in transfer options to either another occupational pension scheme with a new employer, or to a BOB. In order to ensure the availability of an alternative transfer vehicle if the BOB was ceased, this restriction, where the member has more than 15 years scheme service, would need to be removed.

Conclusions:

- In order to facilitate the prospective cessation of BOBs, the provision in the TCA banning transfers to PRSAs for scheme members with more than 15 years qualifying service should be removed.

Allowing transfers from existing BOBs to PRSAs.

3.37 Currently BOB holders are permitted to transfer to an occupational pension scheme or another BOB. However, transfers from BOBs to PRSAs are not permitted. Section 122(2) of the Pensions (Amendment) Act 2002, which has not yet been commenced, allows for BOB holders to terminate their contracts and transfer to a PRSA in a similar manner to transfers from RACs to PRSAs.

Conclusions:

- In order to facilitate the prospective cessation of BOBs, Section 122(2) of the Pensions (Amendment) Act 2002, should be commenced to permit existing BOB holders to transfer to PRSAs.
Allowing transfers from existing RACs to schemes

Currently RAC holders are permitted to transfer to another RAC or to a PRSA while transfers to occupational pension schemes are not provided for at present. However, there is scope for RAC holders to get around this restriction by transferring first to a PRSA and then into an occupational pension scheme.

Conclusions:

- Direct transfers from existing RACs to occupational pension schemes should be provided for.

PRSA as a transfer vehicle

Under Section 35 of the Pensions Act 1990, trustees have the power to effect a transfer payment of a deferred benefit in a scheme without that member’s consent once they comply with certain obligations. Transfers can be made to a BOB or a PRSA. However, views were expressed that trustees would generally prefer to transfer deferred members to a BOB rather than to a PRSA. Three reasons were highlighted in particular:

- A Certificate of Benefit Comparison\(^{21}\) is required on transfer from a scheme to a PRSA, however, it is not required on transfer from a scheme to a BOB.
- With respect to tax-free lump sums, BOB holders can access either the traditional (1.5 times salary) or the ARF option (25 per cent of fund).\(^{22}\) However, only the ARF option is available to PRSA holders. Depending on the individuals' fund size and salary, transferring to a PRSA, instead of a BOB, may mean they only have access to the smaller of the lump sum options.
- Trustees who are bulk transferring deferred members’ funds can often negotiate reduced charges for members.\(^{23}\) Under Section 104 of the Pensions (Amendment) Act 2002, charges can only vary between contracts provided by a PRSA provider in certain ways and therefore, as the Act currently operates, discounts cannot be offered in the same way.

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\(^{21}\) The Certificate of Benefit Comparison is discussed in greater detail in the next section.

\(^{22}\) Tax Free Lump Sums are discussed later in this Chapter.

\(^{23}\) Despite many comments pointing to the value offered by BOBs compared to PRSAs as a transfer vehicle, it should be noted that the Pensions Council, reporting on BOB charges, highlighted significant variability in charges and importantly that ‘charging structures used in insured BOB products are complex, making it extremely difficult for the average consumer (or even their intermediary) to determine the relative charge status of any BOB product compared with other similar BOB products in the marketplace’ (Pensions Council, 2017, p. 6). It is also important to note that the Pensions Council’s data was limited to the insured sector.
3.40 The Group is of the view that constructive changes could be made to the PRSA to address these issues. The rigidity in PRSA pricing could be addressed to allow for bulk discounts. In terms of lump sum options, allowing both tax-free lump sum options to apply to the ring-fenced assets (arising from an occupational pension scheme transfer) in a PRSA, would achieve the current position. All other assets in the PRSA, from on-going contributions, would be subject to the 25 per cent maximum tax-free lump sum as currently is the case.

Conclusions:

- Allowing discounts to be offered in the case of bulk transfers from schemes to PRSAs should be provided for.
- The ring-fencing of lump sum benefits within a PRSA to allow for a salary and service based lump sum for the portion of assets related to a transfer in from an occupational scheme should be provided for.

Review of the requirement for a Certificate of Benefit Comparison

3.41 When assets are transferred from an occupational scheme to a PRSA, the PRSA provider is required to furnish the individual with a Certificate of Benefit Comparison (CBC) which compares the possible benefits of the scheme with the possible benefits from a PRSA. Respondents to the public consultation have cited issues with the CBC as it applies to DC schemes. It was put forward that a CBC was of limited value in the case of a transfer from a DC scheme; it discouraged transfers to PRSAs; it was costly to produce with the expense ultimately borne by the consumer; and the length and prescribed structure of current certificates were highlighted as not being user-friendly.

Conclusions:

- The Pensions Authority will reconsider the requirements in relation to the provision of Certificates of Benefit Comparison, in particular in relation to transfers to PRSAs from DC arrangements, and make recommendations to the Department of Social Protection for legislative change where necessary.

RAC & Life Assurance

3.42 It is argued that one of the key reasons that RACs have remained popular is the ability to provide for life cover under a personal pension product, thus ensuring equality of treatment with those in Second Pillar occupational schemes. Therefore, the basis for facilitating access to life assurance within a Third Pillar product is well-founded on the grounds of equality of treatment.
Chapter 3: Reform & Simplification

The Pan-European Personal Pension Product – PEPP

In 2017, the European Commission published a proposal for a Pan-European Personal Pension Product (PEPP). The aim of the proposal is to lay the foundations for a safer, more cost-efficient and transparent market in affordable and voluntary personal pension savings that can be managed on a pan-European scale. The PEPP framework will constitute a complementary voluntary scheme alongside national regimes. PEPP will be authorised and supervised by national competent authorities and the taxation treatment of PEPP will remain a Member State competence. PEPP providers must offer the product in at least two Member States. The Regulation will enter into application a year following the publication of technical guidance (hence the Regulation will apply circa Q4 2021).

Responses to the consultation showed general support for PEPP, although at the time of the consultation negotiations were still underway. In an Irish context, PEPP is likely to be of most interest to mobile workers. The existence of the PRSA and the fact that apart from portability, a PRSA has potentially more flexible features than a PEPP, means that the PEPP is unlikely to be more attractive to consumers. However, it may introduce greater competition if European providers choose to market PEPP to Irish savers.

Some respondents suggest that the addition of another personal pension product will add complexity to the pensions market in Ireland at a time when the overarching policy objective is greater simplicity and rationalisation. The IDPRTG recognises this and sees merit in potentially aligning PEPP with a reformed PRSA, or establishing it within the PRSA structure. Such an approach would not be without challenge as the PEPP Regulation has a number of specific requirements that do not apply to, or are not comparable to, the PRSA. For example, the PEPP Regulation currently contains a requirement for mandatory advice, for providers to account for Environmental, Social, and Governance (ESG) factors, and has a cost cap specific to the default option.

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24 Within three years of the date of application of this Regulation.
25 Consideration will also have to be given, as part of the design of any Automatic Enrolment scheme, to mobile workers. A material proportion of those enrolled may be non-nationals or may emigrate. Data from Eurostat (2018) shows that almost a quarter of those employed in Ireland between the ages of 25 and 49 are foreign born workers (three quarters of these are EU nationals). A destination for transfers out of Automatic Enrolment in the event of a change of residency within the EU will have to be considered in time.
26 It may be the case that PEPP providers may wish to operate in Ireland with a view to marketing and selling PEPP on a cross-border basis.
27 Environmental, social and governance (ESG) relates to the three key factors in measuring the sustainability and ethical impact of an investment in a company or business which enables a more inclusive economic system.
Proposed Revisions to the PRSA

Previous sections have discussed proposed changes to the PRSA based on the motives of simplification and harmonisation. As noted in Chapter 2, the planned introduction of Automatic Enrolment also necessitates a re-evaluation of the PRSA product and the role it should play in the future. Along with the changes recommended above, consideration is given below to amendments that will attempt to modernise and update the PRSA product.

Administration, Communication & Rigidity in Fund Choice

The rigidity of the charging cap regime was raised in a number of consultation responses from industry bodies in the main. Though charging caps play a role in protecting consumers, there is a broader recognition that there are rigidities within the PRSA design that could be addressed, including in the areas of charging and product approval.

Respondents also focused on some of the cumbersome rules regarding member communication and administration. Such requirements increase cost and discourage engagement. In addition, the view was expressed that the application of the full regulatory product pre-approval process to minor product amendments is excessive.

Consolidating PRSAs

Some concern was raised that some savers needlessly end up with multiple products such as multiple PRSAs. It is possible that more than one PRSA may be established for good reason, for example, to let a particular investment play out. However, it may also be the case that contributors may not be aware that there is general transferability and, as such, may not raise the issue with providers if a subsequent PRSA is being established. Multiple PRSAs can lead to an individual facing increased costs, increased complexity, and may in time give rise to multiple ARFs, with little to no benefit for the

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28 Under Article 36(1)(f) of IORP II Directive and Article 24 of the proposed PEPP Regulation, documentation and information shall be provided to customers free of charge electronically, and on paper upon request (The European Parliament and the Council of the European Union, 2016).

29 Section 108(1) of the Pensions Act (1990) expressly holds void ‘any provision of a PRSA contract purporting to prohibit a contributor from entering into another PRSA contract and transferring his PRSA assets to the PRSA provider with whom he has entered into the other such contract’. Section 104(7) of said Act also states that ‘no initial charges […] shall be made on transfers received from other pension arrangements entered into by a contributor’. Section 104(8) states that ‘no charges shall be made under a PRSA contract in respect of a termination by a contributor of a PRSA contract to which he is party or in respect of a transfer of funds effected from such a contract’. Section 108(2) also holds void any provision of a contract purporting to require a payment by a contributor in respect of such transfers.
member. As such, the existence of individuals with multiple PRSAs most likely reflects the need for better advice and information.

**Non-Standard PRSA**

3.50 An obvious question in redesigning the PRSA is whether there is merit in maintaining the standard/non-standard designation. On balance, the Group is of the view that there is merit in maintaining this distinction. Despite the fact that Automatic Enrolment is likely to capture, in the main, the original target market for the standard PRSA, there will be those who will decide for one reason or another to establish a PRSA (depending on the final design of Automatic Enrolment). Not all of these individuals will necessarily have the financial literacy required to navigate the pensions landscape, and would therefore benefit from the additional protections afforded by the standard PRSA.

3.51 As well as providing a vehicle for those who wish to more actively engage in the management of their pension savings, in the context of the defined policy objective to reduce the number of single member trust-based schemes, a revised non-standard PRSA design should act as a destination for existing schemes. A revised non-standard PRSA is unlikely to be a compatible destination for all such single scheme assets but there is a strong case for designing a product with less rigidity than a standard PRSA, giving savers more flexibility in managing their retirement savings (for example access to a broader choice of investment assets). Such an approach, combined with harmonised funding rules, should help to ensure that the non-standard PRSA can operate as a functional product and as a destination for current single scheme savings.

**Conclusions:**

- The Pensions Authority will review the PRSA product approval process with a view to eliminating the need for pre-approval in the case of non-material changes to an existing PRSA product.
- In order to manage and contain costs, PRSA communication requirements should be primarily in electronic form, in-line with IORP II and PEPP. Consideration will also be given to enhancing communication requirements in the area of transferability.
- The Pensions Authority will examine whether charging rigidity acts to limit investment choice for PRSA providers and if amendments to the non-standard PRSA are required to facilitate transfers from single member schemes.
- The Pensions Authority will review the use of / need for multiple PRSAs by individuals and will identify whether any changes to the product should be advanced.
- Where changes considered appropriate by the Pensions Authority require legislative amendment, the Pensions Authority will put forward recommendations to the Department of Social Protection for consideration.
**Vested PRSA and PRSA as a whole-of-life product**

3.52 In order to avoid restrictive tax rules applying to ARFs, individuals began to leave pension savings within their PRSA at retirement. A vested PRSA is a PRSA from which retirement benefits have commenced. Additional changes were subsequently introduced to ensure ARFs and Vested PRSAs were treated equally from a tax perspective. As a consequence, the PRSA already operates as a drawdown product.

3.53 Chapter 6 reviews the ARF product and recommends that the ARF is replaced by the PRSA and discusses this proposal in more detail. Given that the PRSA already operates as a drawdown product, once access is provided to the PRSA as a drawdown product, abolishing the current restriction ensuring that benefits cannot be taken from a vested PRSA after the age of 75 is the only measure required to ensure the PRSA operates as a whole-of-life-product. However, Chapter 6 recommends a range of changes that should apply to either the ARF or PRSA as a drawdown product.

**Drawdown Ages**

3.54 Standardising drawdown ages would be a significant measure in simplifying the pension landscape. Achieving standardisation while attempting to protect the rights and entitlements of existing pension savers is not without challenge. Members of occupational pension schemes can generally access benefits at ‘normal retirement age’ (NRA) of between 60 and 70, without a requirement to terminate employment. A member may be able to take early retirement benefits from age 50 onwards subject to the termination of employment, the agreement of the employer, and the termination of involvement in the employer’s business in the case of 20 per cent directors, including the disposal of all shares in the company. Such an option would also have to be provided for in the trust deed and the rules of the scheme.

3.55 At present, PRSA and RAC holders can access benefits at any age between 60 and 75 without any requirement to cease economic activity. PRSA contributors who retire early from employment can access benefits from ages 50. However, this option does not apply to PRSA contributors who are unincorporated self-employed; they cannot access benefits until the age of 60 in circumstances of normal health. Likewise, RAC holders cannot access benefits until the age of 60 other than for reasons of permanent incapacity. Rules around drawdown from BOBs reflect the rules of the occupational scheme that the BOB holder transferred from.

3.56 A recommendation to raise the age from which early retirement benefits can be accessed to the age of 55 would be consistent with increased longevity, potentially helpful towards increasing benefit adequacy, and aligned with the policy direction of longer working as signalled by the increasing age
for receipt of the State pension and the intention of Strand 6 of the Roadmap (Supporting Fuller Working Lives). The standardisation of the lower age limit from which retirement benefits can be accessed is potentially disruptive to the plans, rights, and entitlements of existing pension savers. However, such a recommendation would have negative implications for existing scheme members, PRSA contributors who are employees, and BOB holders who might be intending to take early retirement and access benefits from the age of 50. On that basis, consideration should be given to having a lead-in period before it takes effect. This would allow those intending to retire early in the shorter term to continue to do so.

3.57 The standardisation of upper age limits appears to be less disruptive to the entitlements of existing savers. A recommendation to increase the upper NRA limit for occupational pension schemes from 70 to 75 would seem to offer additional flexibility to occupational scheme members to continue contributing to their pension pot for a longer period. It would also bring them in line with Third Pillar arrangements (PRSAs and RACs). In addition, such a recommendation would appear to be logical in light of trends towards increased longevity and would be in line with the intention of Stand 6 of the Roadmap.

3.58 It is also worth noting that the Automatic Enrolment Strawman document proposed that benefit drawdown from the AE system would be linked to the State Pension age. Should this be the case in the final design of Automatic Enrolment, it is worth considering the inconsistency with other parts of the supplementary system and the potential impact on savers who have pension income from different arrangements that may need to be consolidated.

Conclusions:

- The lower age limit at which savers can access retirement benefits should be increased to 55. Consideration should be given to providing for a lead-in period to allow those retiring early in the shorter term to do so.
- The upper bound of 'normal retirement age' should be increased to age 75.

Definitions of Ill-Health

3.59 In certain circumstances, savers can access pension benefits earlier than otherwise provided for, on the grounds of ill-health. There is a key distinction between early access to pension benefits due to ill-health in the case of occupational schemes/BOBs vs. PRSAs/RACs. In the case of occupational pensions and BOBs, ill-health is defined by the Office of the Revenue Commissioners as involving a 'physical or mental deterioration which is serious enough to prevent the individual from following his/her normal employment. It does not mean simply a decline in energy or ability'. Often members of DC schemes have access to Permanent Health Insurance cover (PHI) which will provide the individual with an income until they recover or reach normal retirement age. In the case of DB schemes, members may be able to get an equivalent pension income depending on the rules of their

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33 Revenue Commissioners Pensions Manual. Appendix I
scheme. Occupational pension schemes can also include a rule which provides for the commutation of a pension where the member is in ‘exceptional circumstances of serious ill-health’. In the case of 20 per cent directors and Small Self-Administered Pension Schemes, this full commutation of a pension is subject to the agreement of Revenue.

3.60 On the other hand, PRSAs/RACs require an individual to have serious ill-health and be ‘permanently incapable through infirmity of mind or body of carrying on his or her own occupation or any occupation of a similar nature for which he or she is trained or fitted’ as per Section 784(3)(b) of the TCA. They can apply for access to benefits at any age under this provision. As such, occupational schemes/BOBs are more flexible with respect to early access on the grounds of ill-health. In the absence of harmonisation, this inconsistency could have the effect of discouraging consolidation.

Conclusions:

- To the extent possible, the respective definitions of ill health to access benefits at any age before age 60, should be harmonised.

Lump Sum Rules

3.61 The entitlement to a tax-free lump sum is a key motivator in saving for a pension. Different rules apply to the calculation of a lump sum entitlement depending on the accumulation savings vehicle, subject to an overall lifetime limit of €200,000 which encompasses all retirement lump sums paid to an individual on or after 7 December 2005. There is no objective basis for this differential treatment and the discrepancy arises from the traditional link to salary and service which cannot be replicated in a personal pension product. A singular focus on maximising one’s lump sum entitlement can act as a detriment to proper post-retirement planning as it can limit the available decumulation options. Alternatively, the size of an individual’s lump sum entitlement is determined by the choice of decumulation product they choose.

3.62 The harmonisation of the calculation method for the tax-free portion of a retirement lump sum between Second Pillar and Third Pillar arrangements is particularly challenging and has the potential to produce adverse outcomes for existing savers. At present, members of DC occupational schemes and BOB holders can take a retirement lump sum, calculated by reference to length of service and final remuneration with compulsory annuity purchase, or they can take up to 25 per cent of the fund value as a retirement lump sum and reinvest the balance in an ARF. DB scheme lump sums are determined solely by salary and service. PRSAs and RACs permit a maximum lump sum of 25 per cent of the fund value with the option of reinvesting the balance in an ARF, using it to purchase an annuity, or in the case of a PRSA, retaining it in the PRSA (the PRSA then becomes a ‘Vested PRSA’).34

3.63 As a result, members of DC schemes, including one-member schemes and holders of BOBs are potentially permitted a higher tax-free lump sum than PRSAs or RACs if the lump sum calculated by reference to salary and service is higher than 25 per cent of the fund. However, if this is the case, the

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34 Tax-free lump sum options under the various pension types are set out in Figure 33 on page 92 of this Report.
individual availing of the salary and service based lump sum must use the remaining portion of their pension pot to purchase an annuity – the traditional annuity option.

3.64 Again, the challenge in harmonising treatment across pillars and products requires an assessment of existing entitlements, equity and the cost of ‘levelling up’. In general terms, the Group sees merit in the following options:

- ‘Levelling-up’ by allowing all DC vehicles to select the higher of salary and service or 25 per cent of fund based lump sum calculations and not restricting the choice of annuity or ARF after the lump sum has been paid. It should be noted that the salary and service option would be challenging to replicate in a PRSA contract structure which has no linkage to salary and service, or;
- Apply the 25 per cent limit to both DC schemes and personal pension products. This would be detrimental to existing savers planning on a lump sum based on salary and service (particularly where pot size is small) and would likely need to be flagged well in advance. Moreover, it would arguably be inequitable to exclude DB schemes from such an approach, or;
- A hybrid approach could be explored involving a max lump sum of 25 per cent or a specified monetary amount. This approach is attractive in that it protects those with smaller pots, harmonises the position across products and schemes and caps the Exchequer cost of lump sums.

3.65 A further issue worthy of consideration is the link between DB and DC entitlements arising from the same employer (a relatively common occurrence as employers have shut DB plans to be replaced by a DC scheme). Currently, all retirement benefits relating to the same employer must be taken at the same time and must avail of the same retirement option (salary and service based or ARF based). There is an argument that, subject to overall benefit limits, individuals should be able to avail of a combination of approaches. For example, an individual should be able to avail of a salary and service option in relation to their DB service and the ARF option in relation to their DC service.

Conclusions:

- The mandatory requirement to purchase an annuity having taken a lump sum based on the salary and service methodology should be abolished. The ARF option should also be available to the DC element of pension savings where an individual has DB and DC entitlements from the same employer.

Funding Rules

3.66 Maximum contribution funding rules, from a taxation perspective, favour occupational schemes. Initiatives aimed at simplification and harmonisation of tax rules in this area are complicated by the differing nature of product and occupation based pension models. Current tax rules are discussed in more detail in Chapters 4 and 5, but in summary, employer contributions to their employees’ occupational scheme are not subject to the age-related percentage limits or to the overall percentage
of earnings cap that apply.\textsuperscript{35} Employees are not liable for Benefit-in-Kind (BIK) on employer contributions to an occupational pension scheme. However, where an employer contributes to an employee’s PRSA, those contributions are chargeable to BIK, though it is only where the combined employer and employee contributions exceed relevant age and earnings related limits that a BIK charge arises.

3.67 The reasons for the concessionary treatment of employer contributions to occupational pension schemes are that the controls over occupational schemes have historically been benefit as opposed to contribution-based. Occupational schemes are not permitted to fund a pension benefit for an individual of more than two-thirds of his/her final salary.\textsuperscript{36} With the emergence of personal pension products, the traditional benefit limits that existed for occupational schemes were supplemented with contribution-based limits, due to the fact that for personal pension plans a salary and service based benefit limit would not be practical. The differential treatment of employer contributions to occupational schemes as compared, for example, to PRSAs is likely to be a primary reason for the establishment of so many occupational schemes in Ireland, the vast bulk of which are single member schemes.

3.68 On the face of it, the absence of any BIK charge on employees in respect of employer contributions to occupational pension schemes on their behalf represents a significant tax relief. This, when coupled with the fact that employer contributions to such schemes are not included in the age-related percentage limits that apply to tax relieved employee pension contributions, represents a significant benefit. This is particularly the case for individuals, such as proprietary directors, who can influence their remuneration packages in a way that allows them to maximise their pension savings through employer-based pension contributions. However, this tax treatment should be seen in the context of a regime where limits are applied at the point where benefits are drawn. In addition, as drawdown is taxed at the marginal rate, applying BIK would involve taxing the same income twice.

3.69 With the introduction of the Standard Fund Threshold\textsuperscript{37}, both contribution and benefit limits now apply to all types of pension saving. This can be confusing for consumers and it is worth considering, in the context of simplification and harmonisation, whether a simplified approach would achieve the same outcome.

3.70 One potential, partial remedy to the differential treatment would be to remove the impacts of the current restrictions on employer-related contributions to PRSAs.\textsuperscript{38} This would have the effect of levelling the

\textsuperscript{35} Another factor of note is that the rules governing occupational pension schemes allow for the accelerated funding of pension benefits for employees who cannot, by reason of their date of entry into a scheme, complete 40 years’ service before normal retirement age. A pension of 2/3rds final salary can therefore be provided for service of not less than 10 years to normal retirement age. Significant tax relief can be obtained via back-funding of pension schemes (i.e. making higher than normal contributions to take into account previous years of employment).

\textsuperscript{36} In addition, the rules governing occupational pension schemes allow for the accelerated funding of pension benefits for employees who cannot, by reason of their date of entry into a scheme, complete 40 years’ service before normal retirement age. A pension of 2/3rds final salary can therefore be provided for service of not less than 10 years. This provision is in place, in part, to facilitate entrepreneurs/proprietary directors who often do not fund for their retirement until late in their career, frequently opting instead to invest in their companies in the early stages.

\textsuperscript{37} The Standard Fund Threshold is currently €2 million. See \textsuperscript{4.31} for more details on the Standard Fund Threshold.

\textsuperscript{38} The application of IORP II to all schemes increases the regulatory obligations on small schemes including one-member schemes. This may increase regulatory costs and will remove some of the investment and borrowing flexibility currently available to such schemes. The Roadmap sets out the policy objective of encouraging consolidation within
playing field. This could potentially increase the annual cost of tax relief on pension contributions to the Exchequer; however, this is based on an assumption that the current limits bind, whereas savers have other options (for example, to incorporate). Such a change would also likely result in a change in behaviour, encouraging increased PRSA contributions. However this is likely to be a displacement of contributions that otherwise would have been made to new single member schemes.

3.71 Another approach would be to introduce an annual tax-exempt limit on the combined amount of employee and employer contributions to pension savings. The scope of this proposal goes well beyond harmonisation and simplification and any consideration of changes to the pension contribution limits regime for tax relief purposes to capture employer contributions to occupational schemes would have to have regard, among other things, to the impact on the different forms of pension arrangements. Any change would have to ensure comparable treatment between DC pension arrangements (where separate employer and employee contributions are transparent) and DB pension arrangements (where employer contributions to funded schemes are not employee-specific or, in the case of unfunded public service schemes, are not actually made). The application of annual limits to employer contributions would have particular implications for proprietary directors who often do not fund for their retirement until late in their career, often opting instead to invest in their companies in the early stages.

3.72 Finally, there may be an argument for relying solely on benefit limits and abolishing age related contribution limits. Modelling undertaken by the ESRI suggests little fiscal impact in reducing the annual earnings limit from €115,000 to €75,000, suggesting a low level of contributions close or at percentage of salary limits (Doorley et al., 2018). Again, the scope of this proposal goes well beyond the ambition of harmonisation and simplification and contribution limits are already high.

Conclusions:

- The differential treatment of the PRSA for funding purposes should be abolished and employer contributions to PRSAs should not be subject to BIK.

Death-in-Service Rules

3.73 Different rules apply to the payment of death-in-service benefits, between occupational schemes (whereby the lump sum death-in-service benefit is limited to four times the deceased member’s final remuneration plus a refund of the member’s own contributions) and PRSAs and RACs (whereby the total funds may be paid as a lump sum on death). If the fund of a deceased member of a DC scheme exceeds four times final remuneration, the balance must be used to purchase taxable annuities for the Irish pension landscape and reducing the number of one-member and small schemes. The obvious need for a future pension saving destination for the cohort who would typically have chosen to save for their retirement in a single member scheme is an issue that requires consideration in the context of the tax treatment of employer contributions.

39 An aggregate contribution limit applies in the UK. A cap on the BIK exemption for employer contribution was also discussed by the Commission on Taxation (Commission on Taxation, 2009, p. 394).

40 See paragraph 5.35 for reference and broader discussion.
dependents. However, in the case of PRSAs and RACs, the entire fund can be paid out as a lump sum and inherited tax-free by a surviving spouse/civil partner.

**Conclusions:**

- As an alternative to compulsory annuitisation, the ARF option should be available for excess funds remaining after the payment of the maximum death-in-service lump sum.
4. State Support for Supplementary Pension Saving

4.1 In common with most developed countries, fiscal support for private pension saving exists in Ireland. This support is provided by way of tax relief and its inclusion in the tax code predates the foundation of the State. In providing incentives, states are motivated by the policy objective of increasing aggregate savings or encouraging citizens to provide for their retirement, by deferring a sufficient amount of income and consumption today to provide for their later years. This is based on an assumption that individuals require an incentive to lock-up savings until they retire given that alternative saving vehicles allow on-going access.

4.2 The current structure of tax relief to incentivise pension saving has been, and remains, the subject of much commentary and scrutiny. The focus of this discourse has mainly been on tax relief for pension contributions. Those who advocate change note that marginal relief on contributions is costly and favours those on higher incomes, while those on lower incomes receive a smaller or no incentive whatsoever. An alternative view proffered is that, through a broader lens, accounting for the progressive character of the State pension and the fact that taxation on contributions is deferred rather than relieved indefinitely, marginal relief should be retained. The sections below attempt to flesh out these arguments and offer some views.

4.3 The table in Figure 6 serves to highlight the focus on tax incentives for pension saving in recent times in policy documents and various Programmes for Government. As noted, the emphasis has tended to be on tax relief for personal contributions (as opposed to employer contributions or taxation of pension income), and proposals motivated by seeking to improve the equity or effectiveness of the incentive or improve the State’s fiscal position. Though a number of measures have been introduced to limit the extent of reliefs in recent years, marginal relief on contributions remains in place.

<table>
<thead>
<tr>
<th>Report</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Green Paper on Pensions</td>
<td>1. Can tax incentives be better targeted to encourage improved coverage in a cost-effective way?</td>
</tr>
<tr>
<td>(Department of Social and Family Affairs, 2007, p. viii)</td>
<td>2. Should the over-riding principle be coverage or equity and should incentives be offered at the marginal, standard or a hybrid rate?</td>
</tr>
<tr>
<td>Renewed Programme for Government (Government of Ireland, 2009, p. 4)</td>
<td>[We will] introduce a single 33% rate for tax relief on private pension provision in the context of the national pension’s framework.</td>
</tr>
<tr>
<td>Commission on Taxation Report (2009, p. 30)</td>
<td>The current tax relief for personal retirement provision should in the medium to long-term be replaced by a matching Exchequer contribution of €1 for each €1.60 contributed by the taxpayer.</td>
</tr>
<tr>
<td>National Pensions Framework</td>
<td>There will be a matching State contribution equal to 33% tax relief (delivery mechanism to be decided).</td>
</tr>
<tr>
<td>(Department of Social and Family Affairs, 2010, p. iii)</td>
<td></td>
</tr>
</tbody>
</table>
Objective and Background

4.4 The main objective of this Chapter is to endeavour to review the costs of funded supplementary pensions to the Exchequer. Fiscal support on funded supplementary pensions comprises one of the larger tax expenditures in Ireland. In line with the holistic approach outlined in the Roadmap, it is timely to review how existing pension tax incentives function and how much they cost the Exchequer. To the greatest extent possible, this review will adhere to the principles underlying the Department of Finance (2014) *Guidelines for Tax Expenditure Evaluation*. However, it must be emphasised that structural data shortcomings, particularly relating to the taxation of pension income, severely constrain the Group in its attempt to conduct a complete review of costs to the Exchequer.

4.5 The rest of Chapter 4 is set out as follows:

- Overview of submissions to our public consultation;
- Overview of existing pension taxation;
- Review of costs to the Exchequer.

4.6 It should be noted that the scope of Action 3.13 is limited to funded supplementary pensions, though references are made to unfunded pensions (such as pay-as-you-go - PAYG pensions) where relevant.

Actions Addressed

4.7 Chapter 4 partially addresses Action 3.13 of the *Roadmap for Pensions Reform 2018-2023*[^1], with the additional points being addressed in Chapter 5:

[^1]: Government of Ireland, 2018, p. 27.
Chapter 4: State Support for Supplementary Pension Saving

<table>
<thead>
<tr>
<th>Action</th>
<th>Detail</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.13</td>
<td>Review the cost of funded supplementary pensions to the Exchequer. To inform decisions relating to financial incentives for retirement savings and underpin the development of the automatic enrolment system […] this will include an assessment of the economic and social benefits delivered and an evaluation of equity in the distribution of tax expenditure on pensions.</td>
</tr>
</tbody>
</table>

Consultation General Feedback

4.8 As mentioned, the Group conducted a public consultation in 2018 in which a number of questions were posed in relation to financial incentives and supplementary pension saving. Below is a summary of the views expressed in submissions to the IDPRTG public consultation on Action 3.13. Again, it should be noted that the majority of respondents to the public consultation were industry representatives.

4.9 Views on existing pension taxation regime:

- Responses largely acknowledge the challenges in designing a ‘one-size-fits-all’ system of financial incentives that encourages appropriate levels of pension saving across income groups, work patterns and life stages;
- Views on the explanation for existing levels of supplementary coverage point to factors outside of taxation, such as inertia, affordability, lack of financial education and poor understanding of pension taxation;
- The majority of respondents, reflecting the profile of the respondents, support the retention of marginal tax relief on contributions. It is argued that the current system incentivises pension saving, once workers are made aware of the benefits available to them;
- A few respondents support the abolition of all pension-related tax relief.

Existing system of pension taxation

Demographic Change

4.10 For generations, people have been saving during their working life to fund a period in retirement. Across the developed world, the state has long been involved in incentivising this behaviour. It is clear that pensions will play an increasingly pivotal role in the maintenance of adequate living standards and lifestyles in retirement. Increasing life expectancy will result in longer retirement periods and demographic shifts mean that working populations will fall as a proportion of total populations. From an Irish perspective, in 2016, there were almost 630,000 people aged 65 years and over - by 2051, an additional one million people will be in this age cohort; amongst these, the number of over 80s will more than triple to 549,000 in comparison to 2016 (CSO, 2017). More time spent in retirement demands additional saving to fund living expenses and healthcare costs. The increasing onus on
individual saving is complicated by the dynamic of interest rates, annuity pricing and real returns on savings.

**Pensions & State Intervention**

4.11 Pensions are complex, and it is generally accepted that the nature of pensions (involving imperfect information) requires some form of State intervention in this market (Barr and Diamond, 2009; McCashin, 2004). More recently, as behavioural finance has increased in prominence, research suggests that decision making in relation to pensions is difficult for individuals (Madrian and Shea, 2001). Most people lack the financial literacy required to assess the future risk and uncertainty facing them in retirement. The distance to retirement also makes it less likely that individuals sacrifice consumption today for deferred consumption in the future. Attempting to overcome this ‘present bias’ is one of the reasons workers need to be encouraged in some way towards saving for retirement.42

4.12 Evidence and views are mixed in relation to the impact of financial incentives on pension take-up. The OECD considered these issues in its recent international review of *Financial Incentives and Retirement Savings* (OECD, 2018a).43 While incentives do play a role in the decision to save and do increase aggregate savings for retirement, some suggest tax incentives merely shift savings into tax-favoured investment such as pensions which would otherwise be saved in some other form.44 Others argue that incentives are effective in creating new savings and that there is merit in having savers simply earmark savings for retirement, thereby reducing the potential burden on the State.

4.13 Having reviewed the literature, the OECD concluded that:

> Low-to-middle income earners are more likely to respond to tax incentives by increasing their overall savings, but they hold disproportionately less private pension assets. By contrast, high-income earners hold a large share of total private pension assets but tend to reallocate their savings. The overall share of new savings is therefore likely to be well under 50%. (OECD, 2018a, p. 95)

4.14 In overall terms, the OECD concluded as part of its policy guidance that:

> Financial incentives are useful tools to promote saving for retirement. They encourage people to participate in and contribute to retirement savings plans, while keeping individual choice and responsibility for retirement planning. (OECD, 2018a, p. 12)

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42 The presentation of information to savers in relation to pensions and incentives for pensions appears to influence decision making (Duflo et al., 2003), and the use of simple graphics as opposed to text encourages more positive outcomes such as deciding to opt-in and contributing higher levels of savings towards a pension (Lunn and McGowan, 2019).

43 See pp. 84 - 95 (OECD, 2018a) for a more comprehensive assessment of this issue.

44 This point is noted in the ESRI’s article on the tax treatment of pension contributions (Doorley et al., 2018).
International Experience of Financial Incentives

4.15 Before considering the domestic system of financial incentives, it is instructive to briefly assess the international approach. Relief from taxation is the main tool used by states to incentivise saving for a pension. Incentives also include non-taxation tools such as matching contributions, subsidies, loyalty bonuses, and early access to one’s pension fund. According to the OECD\textsuperscript{45}, ‘EET’ is the most commonly used system for taxation of pension savings, in use in 20 of the 42 countries included in their 2018 study.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure7.png}
\caption{Use of EET systems in the OECD}
\end{figure}

\textit{Contributions}

4.16 Exempting contributions from taxation is the most common approach across the OECD and EU. However, the taxation of contributions to pension savings exists, in some form, in 32 per cent of EU Member States. A number of countries have introduced financial incentives that target low-income groups; a profile of one such example in Germany is provided in Figure 8.

\textit{Return on pension fund assets}

4.17 The most common approach internationally is to exempt the return on pension fund investments from taxation, with taxation applied to pension fund gains in just 6 out of the 42 countries studied by the OECD (e.g. Denmark and Sweden). Different approaches to taxation of investment returns include whether nominal versus real returns are taxed and also vary depending on when the taxation occurs (e.g. at withdrawal or as they accrue) (Whitehouse, 2005).

\textit{Pension income}

4.18 The majority of countries in the OECD tax (partially or fully) pension income; 13 out of the 42 countries studied do not tax pension income (e.g. New Zealand and Australia). The tax treatment of the pension income also may depend on the type of pension savings product.

\textsuperscript{45} It should be noted that any reference to OECD research in this section (\textit{International Experience of Financial Incentives}) is taken from the OECD’s Pensions Outlook 2018 (2018b).
Other financial incentives

4.19 Non-taxation financial incentives are also used to encourage pension saving, particularly to target cohorts such as lower income earners, families or younger age groups. Matching contributions are offered in 16 out of the 42 countries in the OECD study. However, income-neutral matching contributions are more beneficial the higher the contribution. They would therefore be more advantageous to higher rather than lower earners in absolute terms unless limitations are set. Moreover, matching contributions may be proportionally more advantageous than tax relief, again depending on the level of taxation and the limitations on contribution levels.

4.20 State subsidies comprise a fixed sum paid to the saver, such as offered in Germany’s Riester pension plan. Flat-rate subsidies do not vary according to income or contribution and may therefore be considered more equitable, relative to other incentives. However, there is a risk that an individual is not incentivised to save above the level required to qualify for the subsidy. This criterion plays an important role and must be considered to ensure people are saving enough for income adequacy in retirement. Matching contributions and subsidies tend to be proportionately more advantageous to low or average earners than tax incentives and may be easier to communicate and to understand. These forms of incentives can ‘smooth out’ the advantage that middle and higher income earners have over lower income earners in tax systems that offer standard exemption/deferral of income tax on contributions to pensions. However, this does not account for the fact that tax incentives on contributions tend to involve the subsequent taxation of pension income and generally on a progressive basis. In addition, matching contributions tend to be combined with after-tax-income of the saver, hence the contributions have already been subject to tax. Therefore taxation at the point of drawdown would be unlikely; this would result in a TEE taxation system for matching contributions, as opposed to an EET taxation system for tax incentives on contributions.

4.21 Pensions systems are culturally and politically sensitive, therefore it is worth noting that comparative analysis of pension policy and taxation should be exercised with caution. Comparing discrete aspects of pension taxation across different countries will not account for the specific social and economic contexts within which each pension system operates.

Development of Tax Relief for Pension Saving in Ireland

4.22 Ireland’s pension system operates across three ‘pillars’, which combined aim to provide income security in retirement and old age. The First Pillar (the State pension) constitutes a publicly funded and managed system with mandatory participation. This was introduced in Ireland in 1908 (though the First Pillar was initially non-contributory). Government support to alleviate poverty in old age through redistribution in the form of the State pension is well-established and its rationale clear. By comparison, Second and Third Pillar pensions primarily involve privately managed and funded pensions, comprising voluntary savings (with contributions from employers in the former). These aim to provide consumption smoothing and insurance, as opposed to poverty relief and redistribution (Barr and Diamond, 2009).
‘Riester’ pensions, introduced in Germany in 2001, are voluntary personal pension plans designed to address the ‘pensions gap’ brought about by reduced public pension benefits (Börsch-Supan, Coppola, and Reil-Held, 2012). State incentives include subsidies and tax relief. Notably, the State subsidies for Riester pensions are targeted towards low income individuals and families with children. The Riester incentives comprise:

- A basic subsidy, matching the savers contribution, up to 4 per cent gross earnings;
- A subsidy for those with children;
- A tax deduction, maximum €2,100 per annum.

**Impact of Riester State subsidies**

Overall saving for retirement has increased in Germany in the past decade, with the proportion of households without a supplementary pension falling from 73 per cent in 2003 to 39 per cent in 2013 (Börsch-Supan et al., 2014). However, it should be noted that this is due to a combination of increased coverage in occupational as well as personal pension plans. Uptake of Riester pensions suggests the State incentives have been a mixed success, with families, more so than low-income earners, more likely to avail of the available subsidies and relief (Börsch-Supan, Coppola, and Reil-Held, 2012). 40 per cent of eligible households have a Riester plan. However, just 20 per cent of those in the lowest quintile have taken up a Riester pension plan, compared to 60 per cent of households in the upper quintile, despite the fact that the basic subsidy, matching contribution, represents a significant proportional benefit to low income earners (Börsch-Supan et al., 2014).

A key criticism of the Riester plan is the complexity of the design of the State incentives, which makes it difficult for savers to understand how to maximise those available to them. For example, a minimum contribution is required in order to qualify for the full amount of incentive available. Simplification of the eligibility criteria and operation of the subsidies which were implemented since 2005 have addressed the slow initial take-up.

Experts suggest therefore that it takes more than establishing incentives to encourage low income households to save (Börsch-Supan, Coppola, and Reil-Held, 2012). For some, there is a lack of information and knowledge about the State incentives for Riester pensions, and this is related to income, so many of those eligible simply do not know about the incentives available to them or underestimate the value of them (Ziegelmeyer and Nick, 2012). Information and communication is therefore a key driver of retirement saving.
promoting ‘thrift’, and reducing Exchequer expenditure on the Old Age Pension (which was then means-tested);

- With Irish independence in 1922, the entire UK tax system was adopted by the Irish State and the Finance Act remained the core of Irish tax legislation until it was rationalised again with the Income Tax Act of 1967.\(^{46}\)

- During the 20th century, successive Irish Governments introduced a comprehensive social insurance pensions system. By 1990, the social welfare pensions system provided a basic level of pension to both employees and the self-employed.\(^ {47}\) The development of a social insurance system, which based eligibility for payment on the level of social insurance contributions rather than on means, meant that one of the rationales that had been offered for tax relief for pension contributions (reducing Exchequer expenditure on the Old Age Pension) became slightly less important. However, it should be noted that the Exchequer remains the residual financier of the Social Insurance Fund (SIF);

- In 1982, the first Commission on Taxation stated that providing tax relief on pensions is only justified where the State wishes to encourage individuals to save for their retirement. In its 1986 report, the Commission on Social Welfare noted that the objective of tax relief for pension contributions was two-fold: first, to promote formal arrangements for the protection of employees in retirement, or if incapacitated, and to protect their families in the event of their death; secondly, to encourage savings through the accumulation of funds under a pension scheme, providing an important source of investment capital;

- In introducing the Pensions Bill in the Dáil in May 1990, the Minister for Social Welfare reiterated this rationale.\(^ {48}\) The Minister for Finance, when introducing Budget 2006, again emphasised the policy goal of pension tax reliefs: to ‘encourage earlier and more substantive saving by the generality of individuals to meet the cost of providing

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\(^ {46}\) The provisions relating to superannuation pension schemes and retirement annuities were set out in Part XII of the 1967 Act. The current legislation governing the tax treatment of pensions is contained in Part 30 and Schedules 23 to 23C of the TCA.

\(^ {47}\) In 1988, the self-employed became compulsorily insured as self-employed contributors, which would provide them with access to a number of social welfare benefits, including what was referred to as the Old Age (Contributory) Pension - now known as the State Pension Contributory.

\(^ {48}\) It was noted that a comprehensive system of tax reliefs was in place to encourage the development of occupational pension s e provision of retirement pensions and for dependents in the event of death. These are designed to assist employees in maintaining the standard of living to which they had been accustomed while in employment. Secondly, they encourage national savings by the accumulation of pension funds [...] They facilitate the provision of pensions which will result in employees during retirement and after death, their surviving dependants, being considerably less dependent on State funded services. This leaves the State with more resources to devote to those who have to rely mainly on State schemes for pensions and other essential services’. 

\(^ {48}\)Available at https://www.oireachtas.ie/en/debates/debate/dail/2005-12-07/31?highlight%5B0%5D=2013&highlight%5B1%5D=network&highlight%5B2%5D=bill&highlight%5B3%5D=bills&highlight%5B4%5D=bill.chemes and the objectives of such tax reliefs were identified as: ‘First, they promote formal arrangements for the provision of retirement pensions and for dependents in the event of death. These are designed to assist employees in maintaining the standard of living to which they had been accustomed while in employment. Secondly, they encourage national savings by the accumulation of pension funds [...] They facilitate the provision of pensions which will result in employees during retirement and after death, their surviving dependants, being considerably less dependent on State funded services. This leaves the State with more resources to devote to those who have to rely mainly on State schemes for pensions and other essential services’.
themselves with a reasonable and affordable pension\textsuperscript{49}. The most recent articulation of the rationale for relief was set out in a Tax Strategy Paper (TSG 12/21, p. 10): ‘It has been long established policy to encourage individuals on middle incomes to provide for some level of private pension which would (in addition to the basic State pension) help provide for an adequate replacement income in retirement’.

**Existing EET system in use in Ireland**

Ireland is not an outlier in that it operates an EET system of pension taxation relief, like the majority of OECD countries; contributions and investment returns are exempted from income tax but pension drawdown is taxed (see Figure 9). In its recent release of policy guidelines, the OECD recommended that:

Countries with an ‘EET’ tax regime already in place should maintain the structure of deferred taxation. The upfront cost incurred at the introduction of the pension system with deferred taxation is already behind in most countries and the rewards in the form of large tax collections on pension income are in the horizon. (OECD, 2018a, p. 12)

The extent to which any EET system realises large tax collections on pension income is dependent on fund size, drawdown rates, and effective tax rates in retirement.

![Figure 9: Tax treatment of supplementary pensions in Ireland (EET)](image_url)

<table>
<thead>
<tr>
<th>Contributions to pension</th>
<th>Pension fund gains</th>
<th>Income from pension</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exempt*</td>
<td>Exempt</td>
<td>Taxed</td>
</tr>
</tbody>
</table>

* Subject to age-related percentage and income limitations (see Figure 10)

\textsuperscript{49} Available at: https://www.oireachtas.ie/en/debates/debate/dail/2005-12-07/31/?highlight%5B0%5D=2013&highlight%5B1%5D=network&highlight%5B2%5D=bill&highlight%5B3%5D=bills&highlight%5B4%5D=bill.
Contributions

4.25 Employee contributions to supplementary pensions are exempt from income tax, but are liable for PRSI and USC. Tax relief is given at the individual’s marginal income tax rate, currently 20 per cent or 40 per cent. Two main limitations apply in relation to tax relief on such contributions; employee contributions are subject to age-related limits (see Figure 10), restricting the proportion of remuneration that can be contributed to a pension scheme. In addition, the maximum amount of earnings taken into account for calculating tax relief on contributions is €115,000 per year. This applies whether an employee is contributing to a single pension product or to multiple pension products.

<table>
<thead>
<tr>
<th>Age</th>
<th>Percentage limit</th>
<th>Example 1: An employee aged 42 earns €40,000 pa: €40,000 x 25% = €10,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 30</td>
<td>15%</td>
<td>This employee can get tax relief on annual pension contributions up to €10,000.</td>
</tr>
<tr>
<td>30 – 39</td>
<td>20%</td>
<td>Example 2: An employee aged 42 earns €200,000 pa.</td>
</tr>
<tr>
<td>40 – 49</td>
<td>25%</td>
<td>As the net relevant earnings limit is €115,000 the percentage is calculated on €115,000 rather than the actual income of €200,000. The employee can get tax relief on annual pension contributions up to €28,750.</td>
</tr>
<tr>
<td>50 – 54</td>
<td>30%</td>
<td></td>
</tr>
<tr>
<td>55 – 59</td>
<td>35%</td>
<td></td>
</tr>
<tr>
<td>60 or over</td>
<td>40%</td>
<td></td>
</tr>
</tbody>
</table>

4.26 Employer contributions to their employee’s occupational scheme are not subject to the age-related percentage limits nor the overall earnings cap. Employees are not liable for BIK on employer contributions to an occupational pension scheme. However, where an employer contributes to an employee’s PRSA these contributions are not exempt from BIK. The age limits and earnings cap apply to the combined value of employer and employee contributions to PRSAs. It is only where the combined employer and employee contributions exceed the relevant age and earnings related limits that a BIK charge will arise.

50 USC applies to pension contributions and at drawdown (subject to income limits, various exemptions etc.). PRSI is payable up to age 66.
Growth in pension funds

Pension fund returns, depending on how they are managed and the prevailing economic conditions, can take various forms including capital gain, interest or dividend received. The investment income and capital gains of a pension scheme are exempt from income and capital gains tax. Furthermore, transactions entered into by pension funds which might also normally be subject to transaction taxes are exempted (e.g. stamp duty).

Drawdown

As discussed in Chapter 3, taxation rules allow scheme members or individuals, subject to certain conditions, to take a tax-free retirement lump sum from their fund and further provides for the taxation of the remaining pension entitlements. The Commission on Taxation Report noted that: ‘Although the tax-free status of this lump sum is an arrangement of long standing, it is not possible to identify an objective rationale for it’ (Commission on Taxation, 2009, p. 410).

For Revenue approved schemes, the maximum lump sum benefit available at normal retirement age to an employee is one and a half times final remuneration (including retained benefits) i.e. 3/80ths of final remuneration for each year of service over a 40 year period. Under RACs and PRSAs, or where a DC member wishes to avail of an ARF, up to 25 per cent of the fund can be taken as a retirement lump sum. In this case, the first €200,000 of a retirement lump sum is tax-free, the portion of a lump

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51 A number of age related income tax rules exist which have the effect of lowering effective tax rates in retirement. These are discussed in more detail later.

52 Military and civil officers of the (British) East India Company received a lump sum as well as a pension on retirement during the 19th Century, and the modern benefit may owe its origins to this practice.

53 Late entrants can commute part of their pension at a higher rate than this but, in that regard, the maximum lump sum commutation of one and a half times final remuneration can only be provided where the employee has 20 years’ service with his or her current employer.

54 The tax-free amount of €200,000 is a lifetime limit and encompasses all retirement lump sums paid to an individual on or after 7 December 2005.
sum between €200,001 and €500,000 is taxed at the standard rate and the balance is taxed at the individual’s marginal tax rate.

4.30 All other income from supplementary pensions is taxable and subject to USC. Current rules also prescribe a maximum benefit that an individual can receive from a Revenue approved occupational pension at normal retirement age, as two-thirds of final remuneration. The rules envisage this accruing over a period of 40 years’ service with the same employer at the rate of 1/60th of final remuneration for each year of service – this is known as ‘the strict 1/60th basis’.

4.31 Tax legislation provides for a limit or ceiling on the total capital value of tax-relieved pension benefits that an individual can draw down in his or her lifetime from all of that individual’s pension arrangements. This is known as the Standard Fund Threshold (SFT) and was introduced in December, 2005. It has been reduced on a number of occasions since, most recently in Finance (No 2) Act 2013 which reduced the SFT from €2.3 million to €2 million from 1 January 2014. Its objective is to limit State support for pension accrual for reasons of equity. Rather than applying restrictions to pension savings or accrual during the contribution phase, significant additional tax charges are imposed on the value of retirement benefits above set limits when they are drawn down, to claw back a portion of the relief previously accrued.

Recent Changes to Limit the Range of the Tax Relief

4.32 Over the course of the past fifteen years, a number of reforms by way of restrictions and limitations were introduced in an effort to make pension taxation more equitable and reduce the cost to the Exchequer.

<table>
<thead>
<tr>
<th>Year</th>
<th>Change</th>
</tr>
</thead>
</table>
| 2005 | • Standard Fund Threshold introduces pension fund cap at €5 million.  
      | • ARF imputed distribution introduced. |
| 2007 | • Tax-Free Lump Sum limited to €1.25 million. |
| 2011 | • Pay-Related Social Insurance (PRSI) and Health Levy relief for pension contributions abolished.  
      | • Employer PRSI relief on employee pension contributions reduced by 50 per cent.  
      | • Annual earnings limit, for which tax relief is allowed on an employee’s pension contributions, reduced from €150,000 to €115,000.  
      | • Standard Fund Threshold reduced to €2.3 million. |

55 ARF distributions are not treated as pension income but they are taxable and subject to USC and also PRSI if under 66 years of age.

56 A higher limit, known as a Personal Fund Threshold (PFT), may be claimed where the capital value of an individual’s pension benefits exceeded the SFT on the date of its introduction or on the various dates on which it was reduced. Accordingly, the legislation provided that such individuals could protect his or her higher pension values, subject to certain ceilings and conditions, by applying to the Office of the Revenue Commissioners for a PFT certificate.

57 Though not a change in tax relief, a temporary Stamp Duty Levy applying to the assets of funded pension arrangements was introduced in 2011 to fund the Government’s Action Plan for Jobs. This Levy ceased in 2016.
<table>
<thead>
<tr>
<th>Year</th>
<th>Changes</th>
</tr>
</thead>
</table>
| 2012 | - ARF imputed distribution increased from 5 per cent to 6 per cent where assets exceed €2 million.  
- Imputed distribution of 6 per cent introduced for vested PRSAs with assets in excess of €2 million.  
- Removal of relief of employer PRSI for employee contributions. |
| 2014 | - Standard Fund Threshold reduced to €2 million.  
- Increased capitalisation factors for DB pension entitlements accrued after 2014. |

**List of Applicable Reliefs**

4.33 The following reliefs apply to various pension saving vehicles, in various ways and at various times:

**Contributions**

- Employee contribution income tax (IT) relief
- Employer deduction (CT – Corporation Tax or IT for self-employed)
- Employer value-added tax (VAT) recovery for pension fund management fees and set-up costs
- BIK exemption for employee on the employer contribution (emolument for employment normally taxable)
- Relief from Employer PRSI

**Return on Investments**

- Stamp duty
- Capital gains tax (CGT)
- Exit taxes
- All income (including DIRT - deposit interest retention tax) / profits taxation
- VAT exemption

**Drawdown**

- Tax-free lump sum and 20 per cent tax rate from €200k-€500k
- Beneficial inheritance treatment of ARF / AMRF (approved minimum retirement fund)
- Range of age-related (though non-pension specific) income tax reliefs

**Cost of Funded Supplementary Pensions to Exchequer**

*Data & Methodological Challenges*

4.34 The tax treatment of pensions represents one of the larger Exchequer tax expenditures. However, in common with other countries operating an EET system, the exact cost of this is difficult to quantify due to the general nature of tax expenditures and also specific pension-related challenges. Tax expenditures can be difficult to define, measure, and evaluate. At its most basic, a tax expenditure involves a particular group of taxpayers (e.g. low income) or a particular activity (e.g. saving in a pension) being treated differently than the standard tax system.
The Department of Finance’s Report on Tax Expenditures states – ‘a tax expenditure [is] a transfer of public resources that is achieved by:

- Reducing tax obligations with respect to a benchmark tax rather than by direct expenditure; or
- Provisions of tax legislation that reduce or postpone revenue for a comparatively narrow population of taxpayers relative to the tax base’ (Department of Finance, 2014, p. 1).

This definition takes into account that tax expenditures may involve a deferral rather than complete exemption from taxation, which is particularly relevant in the case of pension taxation.

In 1982, the Commission on Taxation noted that tax expenditure should be examined with respect to the same criteria and should be subject to the same review process as direct Government expenditure. However, tax expenditures are difficult to evaluate compared to direct spending (OECD, 2010). They are notional in the sense that their value represents the tax that would be collected, given a set of behavioural assumptions, rather than representing an exact level of spending (OECD, 2010).

According to the Department of Finance (2014), all tax expenditures of more than €25m should be subject to regular ex-ante evaluation. Department of Finance guidelines, referenced above, require existing tax expenditures of greater than €50m to be reviewed at least every 3 years. With regard to ex-post tax expenditure reviews, the Guidelines set out core questions that should be considered (Department of Finance, 2014, p. 3):

- Is the tax expenditure still relevant?
- How much did the tax expenditure cost?
- What was the impact of the tax expenditure?
- Was it efficient?

To the greatest extent possible, this Review will aim to address these questions, albeit constrained by the lack of relevant data.

Revenue Foregone Method

A number of approaches may be taken to estimate the cost of pension taxation, each with its own merits and shortcomings. The suitability of any approach will also be influenced by the system of pension taxation (EET – Exempt, Exempt, Taxed; TTE – Taxed, Taxed, Exempt, etc.) in operation. Generally, a number of challenges arise when attempting to estimate the cost of pension tax expenditures. Firstly, data-related limitations must be considered. Reliable and accurate data is needed in order to produce a tax expenditure estimate, up-to-date data is currently not available for all categories of pension taxation. Secondly, the behavioural assumptions upon which calculations are made will have implications for the estimated costs. For example, estimating the cost of tax relief on pension fund returns in an EET or TET (Taxed, Exempt, Taxed) system is based on the assumption...
that the Exchequer will gain in the absence of the exemption, as saving would continue in some other taxable form of investment.

4.39 Costing of pension tax expenditures in Ireland is partially conducted by the Office of the Revenue Commissioners, using a revenue forgone approach. This method is the most common approach to estimating tax expenditures within the OECD. This attempts to estimate how much tax would have been paid if contributions to pensions were treated under the benchmark tax system (it excludes behavioural responses) (Yoo and De Seres, 2004). In other words it aims to calculate how much a tax incentive reduces total tax revenues.

4.40 Within the revenue forgone method, a present-value or cash-flow approach can be taken (Yoo and de Seres, 2004). The latter is used by the Office of the Revenue Commissioners to estimate some of the component costs to the Exchequer and bases calculations on contributions made in the same year. In contrast, a present-value approach applies on a life-cycle basis and accounts for relief and taxation throughout an individual’s life.

Limitations to revenue forgone method

4.41 The assumption of unchanged behaviour is the most significant shortcoming associated with a revenue forgone method. Components of financial incentives are interdependent; changing one aspect of pension taxation will have implications for pension savings and therefore levels of taxation. For example, if the level of tax relief on contributions is reduced, contribution levels may fall or cease, thus reducing total gains on pension funds. Future withdrawal and lump sum amounts will likely be smaller, again impacting the deferral element of pension tax expenditure. Revenue forgone calculations do not account for this behavioural change. It is difficult to predict and measure behavioural responses to tax changes. Changes made to tax incentives may also lead to industry behaviour responses, with unforeseen consequences that may influence contribution or investment fund gains.

4.42 Unlike revenue foregone, a revenue gain method does attempt to account for behavioural change and calculate how much tax would be gained if the tax incentives were not in place (Yoo and de Seres, 2004). The main difficulty with a revenue gain approach is how to anticipate the size of the behavioural change, something uncertain when it comes to pensions.

Costing

4.43 As discussed, considerable uncertainty is attached to estimating the full costs of tax expenditures to the Exchequer in relation to pensions (see 4.52). This arises due to the difficulty in computing some elements, particularly in relation to the estimation of costs of the tax exemption on investment income and gains. Component imputed costs, where data is available, are illustrated and discussed in the following paragraphs.

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58 For more detail, see Yoo and de Seres, 2004; Whitehouse, 2005; OECD, 2018a; Australian Government: The Treasury, 2018.
Using a revenue foregone cash-flow approach, based on data from the Revenue Commissioners, the 2018 costs associated with the tax exemption of pension contributions are estimated at €1.8bn, as follows:

- Employees are eligible for tax relief at their marginal rate for contributions they make to an approved supplementary pension scheme or personal pension such as a PRSA or RAC. Annual income and age limits apply. According to a revenue forgone approach, in 2018 €0.9bn was the level of income tax foregone for this purpose. Public sector employee contributions are captured in this figure;
- Secondly, employers’ contributions to their employees’ pension schemes are exempt from Corporation Tax. An estimated €0.2bn was exempted in 2018;
- Thirdly, employer contributions to occupational pension schemes are exempt from BIK and the value of this to employees was estimated at €0.7bn in 2018.

Up to now, the Office of the Revenue Commissioners estimates were based on the available aggregate data for contributions to pension schemes from employers and employees. However, real time reporting of payroll under PAYE Modernisation (P.Mod) has been in operation for all employers in the State since 1 January 2019. Data from the first year of P.Mod\(^{59}\) shows that on average 775,000 people are making contributions every month through their employer payrolls. Those with higher incomes are making greater contributions but the average share of income set aside as a pension contribution is consistent across all incomes and typically 3% to 6%. Pension deductions by employees and employers totalled €2.5bn and €2bn respectively in 2019.\(^{60}\) In relation to receiving the 2019 costs of pension contributions, this won’t be possible until mid-2021. While the Revenue Commissioners has data on employer and employee pension contributions, it is not possible to estimate a tax cost without having full sight of a taxpayer’s income, as the rate of relief depends on the income level. This information will not be available until after returns for 2019 are filed at the end of this year and information is subsequently analysed. Clearly, the labour market shock arising from the COVID-19 pandemic can be expected to present distortions to such information on 2020 and beyond, for some time.

Due to structural limitations relating to data availability, only a partial assessment of cost to the Exchequer from pension fund income is technically possible. Pension funds are wholly exempt from

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\(^{60}\) The employees for which the employers are contributing to a pension fund are not necessarily the same employees who are themselves making contributions to their pension fund.
all taxes (including capital gains, exit taxes and stamp duty) and therefore there is no obligation to report the tax foregone to the Office of the Revenue Commissioners. Accordingly, as no data on this forgone tax is captured, any estimation of the cost to the Exchequer of the tax exemption of pension fund gains is problematic. An imputed approximation for 2016 was estimated at €0.9bn\textsuperscript{61}.

4.47 In sum, due to limited data availability, it is not possible to accurately estimate the cost of this relief. Figure 13 highlights the sensitivity of this calculation to various inputs. Any estimate involves assumptions that risk overlooking the dynamic complexity of investment returns, tax rates and the behavioural change that could result, in the absence of this tax exemption.

<table>
<thead>
<tr>
<th>Tax Rate</th>
<th>3%</th>
<th>4%</th>
<th>5%</th>
<th>6%</th>
<th>7%</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>0.33</td>
<td>0.44</td>
<td>0.55</td>
<td>0.66</td>
<td>0.77</td>
</tr>
<tr>
<td>15%</td>
<td>0.50</td>
<td>0.66</td>
<td>0.83</td>
<td>0.99</td>
<td>1.16</td>
</tr>
<tr>
<td>20%</td>
<td>0.66</td>
<td>0.88</td>
<td>1.10</td>
<td>1.32</td>
<td>1.54</td>
</tr>
<tr>
<td>25%</td>
<td>0.83</td>
<td>1.10</td>
<td>1.38</td>
<td>1.65</td>
<td>1.93</td>
</tr>
<tr>
<td>30%</td>
<td>0.99</td>
<td>1.32</td>
<td>1.65</td>
<td>1.98</td>
<td>2.31</td>
</tr>
</tbody>
</table>

Figures are in €bn using an asset base of €110bn (2019)

OECD Work on Cost of Providing Financial Incentives

In its review of financial incentives, the OECD models the net fiscal tax expenditure as a result of applying an ‘Exempt, Exempt, Taxed’ or EET regime. As the chart below highlights, there is a long-run net cost associated with an EET regime which varies as a regime matures. The steady-state net tax expenditure is driven by the benefit of tax deferral and the exemption of taxation on investment returns. It should be noted that this characterisation depends on a number of assumptions (set-out below), including that a consistent rate of taxation applies to all income. For example, a lower effective rate of taxation in retirement, as we have here in Ireland, is likely to increase the net tax expenditure. In addition, as seen from the graph below, pensions tax expenditure as a share of GDP decreases as individuals draw down and pay income tax on pensions.

Methodology: Calculations assume that individuals save from the age of 20 to 64 and draw pension benefits from age 65 to 84; contributions represent 3% of GDP; the number of people in each single-year age cohort is equal; the same average tax rate (30%) applies to all sources of income; a nominal rate of return of 5.06% (3% real return plus 2% inflation); and GDP growth at 3.28% (1.25% real growth plus 2% inflation).


4.48 **EET – Taxation of pension income**

In relation to the taxation of pension income, an assessment of costs to the Exchequer also remains incomplete due to limited data. On retirement, generally an individual is eligible to withdraw a tax-free lump sum, following which tax is payable on pension draw down. However, granular data is not available in relation to the cost of these tax-free lump sums so no precise revenue foregone estimate can be made. Pension income is taxable and the inclusion of associated income tax payments to the Exchequer is required to accurately reflect the net financial impact of the EET system. As pension income is not separately identified from employment income on employer returns, it is not possible to identify a precise value of tax payments associated with pension income. However, the Revenue Commissioners have tentatively estimated the tax on pension income as being in the order of €750m.62

4.49 A range of non-pension, but age-related, tax credits and reliefs operate alongside previously-mentioned drawdown anomalies resulting in net effective tax rates that leave many older people outside of the tax net. Combining under-funding of pensions (i.e. savers ending up with small pots and therefore smaller pensions), the tax-free lump sum and additional tax exemptions for those over a certain age, Ireland’s EET system is effectively ‘EE partial T’. Indeed, the OECD (2008a, p. 162) noted Ireland’s EET regime is close to being EEE (Exempt, Exempt, Exempt) for many, ‘where income channelled through pensions is unlikely to be taxed at any point in the life-cycle’. Having said that, as our EET system matures and our population ages, taxation on pension income could potentially increase (see discussion in Figure 15).

4.50 **Effective cash-flow cost of tax expenditure**

Excluding any examination of likely behavioural changes, there are a number of issues in aggregating cash-flow costs. For various reasons, a straight-line estimation does not account for the dynamic nature of pensions and taxation. In addition, estimates for the cost of relief on investment returns and tax-free lump sums are subject to a number of assumptions upon which it is difficult to rely. In relation to aggregating relief from CT and BIK on the same contributions - if the employer contribution was not made, the tax payable would increase only by the amount of the employer tax relief. Finally, tax paid on pensions would need to be incorporated for a complete costing of revenue foregone.

EET & Tax Deferral?

The integrity of an EET system depends on collecting ‘T’. The OECD notes that even where there is a consistent rate of taxation, there is a net fiscal cost associated with an EET system. This net fiscal costs increases when three additional factors are accounted for:

- The existence of a tax-free lump sum;
- Under-funding and lower income replacement in retirement which leads, in a progressive taxation system, to a lower effective rate of taxation;
- Concessionary tax treatment for those over a certain age.

The significance of this final point is highlighted in the chart below which plots effective tax rates (including PRSI, USC, IT) for specific age cohorts. Due to specific elements of the tax code (e.g. Age Credit, specific USC treatment, PRSI exemption) effective tax rates are lower in retirement. It is important to note that this beneficial age-related tax treatment applies to income generally and not solely to pension income. The combination of the three listed factors create effectively an EEE regime at lower income levels.

![Comparison of Effective Tax Rates](image)

*Calculation assumptions: Uses 2019 rates and bands / credits; incorporates Income Tax, USC and PRSI; assumes individual is entitled to full State pension.*
Alternative Methods to Estimating Costs of Pension Tax Expenditures

4.51 Alternative approaches to costing pension tax expenditures focus on the net relief available at various income levels across a life-cycle. These approaches generally attempt to measure the net effective rate of relief received by the individual.

4.52 Figure 16 measures the tax advantage received by an individual at various percentages of average income. The OECD (2018b, p.47) defines overall tax advantage as 'the difference in the present value of total tax paid on contributions, returns on investment and withdrawals when an individual saves in a benchmark savings vehicle compared to an incentivised retirement plan assuming a constant contribution rate during the entire career'. As illustrated, an EET regime provides a significant tax advantage. According to the OECD analysis, in Ireland this advantage is higher at the level of average earnings than at either sixty percent or four hundred percent of average earnings.

4.53 As part of the consultation process Insurance Ireland provided some research conducted on its behalf, also modelling the net effective rate of tax relief. There are two key methodological differences to these approaches. Firstly, in this case, the focus is only on the net effective rate of relief on contributions i.e. ignoring the relief on fund growth. This results in a lower rate of effective relief. Secondly, assuming savers have sources of income other than pension income, a variant of net effective rate is modelled assuming a higher rate of taxation in retirement (this is included in Figure 17).
4.54 Figure 17 incorporates measures of the net effective rate of relief discussed above.\(^{63}\) It is clear from these various measures that a material net tax advantage in the Irish EET system exists, with the highest tax advantage concentrated around the level of middle income earners, who make up the bulk of earners.

4.55 A number of challenges arise when interpreting such modelling exercises, mainly due to the requirement for, but lack of certainty in behavioural assumptions (e.g. regarding contribution level, savings period etc.). The assumption that in the absence of pension tax relief, individuals would transfer pension savings to other forms of savings, at the same contribution levels, is not certain. Evidence of deadweight loss is mixed.

4.56 Finally, such exercises generally assume that pension income (including the State pension) is the sole source of income in retirement and effective tax rates are determined from this. This will often not be the case, resulting in higher effective rates in retirement and lower net effective rates of relief. Nivakoski (2014) has undertaken an analysis of The Irish Longitudinal Study on Ageing (TILDA), see Figure 18. The data shows that just over half of retired men (52.4 per cent) and women (54.8 per cent) have some form of asset income (i.e. interest from savings, interest from financial assets, or rental income from property) albeit, on average, constituting a small proportion of a person’s retirement income. Asset income in retirement represents an average 4.3 per cent and 3.8 per cent of income for men and women respectively, with the highest levels of asset income (5.3 per cent and 4.8 per cent for men and women) for those in the upper income quartile (Nivakoski, 2014).

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\(^{63}\) Readers are encouraged to review the detailed methodologies of the various approaches taken by the OECD (2018b), Whelan and Hally (2018), and Insurance Ireland.
4.57 Action 3.13 of the Roadmap requires the IDPRTG to review the cost of funded supplementary pensions to the Exchequer. However, a complete assessment of costs is limited by the lack of accurate and up-to-date data, particularly in relation to the taxation of pension income.

Data Capture

4.58 To facilitate a better assessment of the effectiveness of this relief, more timely and granular data is required. The need for additional data is emphasised in paragraph 4.48, whereby only a partial assessment of costs to the Exchequer from pension fund income is possible. However, with the introduction of P.Mod, over time this should provide greater insight and more granular detail around the utilisation of those pension tax reliefs. Data is available on contributions by employers and employees to retirement benefit schemes; contributions by employers and employees to PRSAs; contributions by employees to RACS; contributions by employees to AVCs, all on an individual taxpayer level rather than on a macro level.

Conclusions

4.59 The Group has agreed the following conclusions:

Data

- Adequate and timely data is a pre-requisite for policy analysis. Supplementary pension policy, and pension provision more generally, is a key area of policy both in terms of Exchequer-impact and the well-being of the population. Further consideration is required in the area of pensions to specify and collect the necessary data to support policy analysis.
Objective and Cost of Incentives

- Like the majority of OECD and EU countries, Ireland has adopted an EET system of pension taxation. Such systems involve a long-run net cost which varies as a regime matures. The objective of this system of pension taxation is to encourage individuals to provide for later life and secure adequacy of income in retirement. Combining the scope and success of the State pension (subject to discussion in Chapter 5 on an appropriate replacement rate ambition) with a recognition that fiscal support for pension saving should be capped at a certain level of income, the focus of tax incentives for supplementary pension saving is on encouraging those on low-to-middle incomes to save for their retirement;

- Due to limited data availability on some features of the pension regime in Ireland, accurately calculating the total cost of all tax reliefs is a challenge. However, it is clear that a net tax advantage exists for pension savers, as pension savings accumulate on a tax-free basis and effective tax rates are lower in retirement than pre-retirement. This benefit is highest, on a proportionate basis, at middle income levels with those on higher incomes also benefiting.
5. Measuring Success: Coverage & Adequacy

Objective and Background

5.1 The economic and social benefits of financially incentivising pension saving are determined by the effectiveness of supplementary pension policy. As noted in the introduction to Chapter 4, supplementary pension policy success is measured against both a coverage and a replacement rate of income (adequacy) ambition. In 1998, the NPPI (p. 91 - 92) set out targets in relation to these measures:

- ‘The Pensions Board has come to a judgement that it would be reasonable to measure adequacy of gross retirement income from all sources (including lump sums and gratuities and other accumulated assets) against a benchmark of 50 per cent of gross pre-retirement income subject to a minimum of 34 per cent of average industrial earnings together with any associated Adult Dependant’s Allowance’;

- ‘In summary, the Pensions Board considers that comprehensive achievement of an adequate level of income over a lifetime would involve an ultimate goal of some 70 per cent of the total workforce over age 30 making, or having, supplementary pension provision. However, it will clearly take many years to reach that goal’.

5.2 Policy in this area has not fundamentally changed since the publication of the NPPI. However, in the context of Automatic Enrolment, the Department of Social Protection is examining the area of appropriate replacement rates, recognising that a one-size-fits-all approach might not be optimal. In other words, one might need a higher replacement rate at a lower income, with this replacement rate objective falling as income levels increase. It is also worth noting the Government has agreed, as per its decision of October 2019, that the income threshold for Automatic Enrolment will be set at €20,000 (not factoring the potential to opt-in). Using data from the Survey on Income and Living Conditions (SILC), the CSO estimates that the 30th percentile for gross employment income is €22,250 and is €20,520 when employees and self-employed are factored in. In other words, on the presumption that the coverage goal is replacement rate driven, the Automatic Enrolment cut-off point is broadly consistent with 70 per cent coverage (though noting that the 70 per cent coverage target is aimed at those over 30 years of age).

5.3 This Chapter will comment on equity in the distribution of, along with the economic and social benefits of, tax expenditures on pensions. This report, along with work to be undertaken by the Department of Social Protection, will help contribute to the development of financial incentives for those who will save for retirement under the future Automatic Enrolment system. The analysis of equity also interacts with

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64 See the section on Income Protection (paragraph 5.26) for a more detailed discussion of this issue.
65 Data sourced directly from the CSO.
Chapter 3 on the harmonisation and simplification of the pension landscape and its analysis of anomalies in the existing system of pension taxation. This chapter includes the following:

- Discussion of coverage and adequacy of supplementary pensions;
- Discussion of equity in distribution of pension taxation;
- Discussion of Automatic Enrolment and financial incentives.

**Actions Addressed**

<table>
<thead>
<tr>
<th>Action</th>
<th>Detail</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.13</td>
<td>Review the cost of funded supplementary pensions to the Exchequer. To inform decisions relating to financial incentives for retirement savings and underpin the development of the automatic enrolment system […], this will include an assessment of the economic and social benefits delivered and an evaluation of equity in the distribution of tax expenditure on pensions.</td>
</tr>
</tbody>
</table>

**Consultation General Feedback**

5.5 As mentioned previously, the Group conducted a public consultation in 2018 in which a number of questions were posed in relation to financial incentives and supplementary pension saving. Below is a summary of the views expressed in submissions to the IDPRTG public consultation on Action 3.13, relevant to this chapter. Again, it should be noted that the majority of respondents were pension industry representatives.

Views on the equity within the existing pension taxation system:\(^{67}\)

- Views differ on how broadly or narrowly the equity of pension saving incentivisation should be defined. Many argue that issues such as effective tax rates in retirement as well as the progressivity of the social insurance system (specifically the State pension) should be factored in when assessing equity;
- Also in terms of equity, respondents raised the issue of public versus private sector pension benefits;
- The need for incentives to attempt to bridge the pension gender gap, particularly at lower income levels, was also raised;

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\(^{66}\) Government of Ireland, 2018, p. 27

\(^{67}\) In responding to questions both on the existing incentive structure and in relation to Automatic Enrolment, a number of responses proposed, as part of any incentive structure, that early access to pension savings, in some form, should be facilitated (e.g. in the case of specific life events).
• A number of specific changes to the current tax model have been suggested. These include abolishing the universal social charge (USC) on pension income, or giving a relief for USC on contributions, and the indexation of caps.

Views on incentives for Automatic Enrolment:
• Most respondents are in favour of having one system of pension taxation, and for applying the current system of pension taxation to Automatic Enrolment. A minority suggest replacing tax relief with matching contributions;
• The main view expressed suggests that while the idea of a matching contribution (e.g. State matching employees contribution by €1 for every €3) is easy to communicate, having two separate incentive regimes may add complexity; brings with it the risk of arbitrage; and may fail to incentivise middle income earners brought in to Automatic Enrolment;
• Some respondents suggest that Automatic Enrolment alone will deal with the coverage gap by addressing inertia and therefore see no need to alter the current system of incentives;
• The need for long-term certainty and clarity on State incentives to ensure better understanding of the value of this support is strongly emphasised.

Coverage
5.6 Pension coverage is an area where detailed data is mixed, as referred to in Chapter 1 of this Report. Various surveys and other measures suggest coverage has hovered around 50 per cent of the working population in recent decades, with a recent dip following the financial crisis of 2008. The most commonly cited measure of coverage relies on survey data (from the CSO Labour Force Survey - LFS). According to the CSO (2020), 50 per cent of all individuals in employment in 2019 Q3 report having an active supplementary pension (only includes occupational pensions from current employment and personal pensions in current contribution). This result includes both public and private sector workers aged between 20 and 69. Separately, estimates from analysis by the ESRI of the micro-economic impact of Automatic Enrolment using the SWITCH model indicate that the current pension coverage rate is 45 per cent for all employees.68

5.7 LFS data from Q3 2019 reports that 57 per cent of those in employment aged 30 plus have supplementary pension coverage,69 well short of the 70 per cent target set out in the NPPI (1998). The data also points to a low coverage rate for those in employment between the ages of 20 and 29 with only 24 per cent of this cohort having a supplementary pension plan.

68 The SWITCH model is compiled from the 2013, 2014 and 2015 waves of SILC and is adjusted to make it representative of the population in 2019. ESRI A micro-macro economic analysis of pension auto-enrolment options (2019).
69 The coverage data reported here relates only to those with occupational pensions from their current employment and personal pensions in current contribution.
5.8 Based on P.Mod data from the Office of the Revenue Commissioners, in 2019 a total of 775,000 individual taxpayers received pension tax relief due to their contributions to an occupational pension scheme. However, data for those operating under self-assessment and paying into private pensions in 2019 is not yet available. Moreover, it must be pointed out that while the majority of those returns will represent individuals only, some will represent taxpayer units (comprising of single people and/or married couples/civil partners). Also, while some individuals make employee contributions through their employer, and others make RAC or PRSA contributions, it cannot be assumed that there is no overlap between the two cohorts.

5.9 According to membership data held by the Pensions Authority, in 2019 there were 882,240 active members of DB and DC occupational pension schemes and 298,532 individual PRSA contracts. A useful insight can be gained into pension coverage, using this data, by estimating how many contributors joined their scheme voluntarily. Broadly speaking, all public service schemes, all private sector defined benefit schemes and most large defined contribution schemes have compulsory membership. All other pension contributors, including PRSA and RAC contributors, are saving voluntarily. Accordingly, if we assume that all DB schemes and all DC schemes with more than 10 active members are compulsory, this implies that about 798,000 are compulsory members. If the total pension coverage is about 50 per cent of the workforce, this suggests that only a small percentage of workforce contributions are discretionary.

5.10 As part of the evidence building process for the development of an Automatic Enrolment system, the ESRI estimated supplementary pension non-coverage levels across age groups as set out in Figure 19. The table shows that younger workers aged between 23 and 30, as well as those earning under €30,000 a year are less likely to be covered by a supplementary pension and that the highest levels of coverage are observed among older and higher-earning groups. Figure 20 provides a snapshot of pension coverage in Ireland, using available SILC data. It is clear that those without pensions are concentrated in lower income groups with a median income of €21,800 (compared to €52,920 for those with a pension) and three-quarters of those without a pension have an income of less than €32,000.

Figure 19: Percentage within each age-income group not covered by a supplementary pension

<table>
<thead>
<tr>
<th>Gross Annual Pay</th>
<th>23 - 30</th>
<th>31 - 40</th>
<th>41 - 50</th>
<th>51 - 60</th>
<th>All ages</th>
</tr>
</thead>
<tbody>
<tr>
<td>€14,000 to €20,000</td>
<td>98.3</td>
<td>85.1</td>
<td>76.0</td>
<td>71.2</td>
<td>85.9</td>
</tr>
<tr>
<td>€20,000 to €30,000</td>
<td>91.1</td>
<td>79.8</td>
<td>74.6</td>
<td>52.8</td>
<td>79.8</td>
</tr>
<tr>
<td>€30,000 to €40,000</td>
<td>68.0</td>
<td>57.7</td>
<td>38.6</td>
<td>26.0</td>
<td>51.7</td>
</tr>
</tbody>
</table>

5.11 Employment type and work patterns, sector and employer size are key determinant factors in supplementary pension coverage. Part-time and self-employed workers tend to have much lower coverage rates compared to full-time and PAYE workers. ESRI research on retirees in Ireland found the availability of a pension scheme at work determined, to a significant extent, supplementary pension coverage (Nivakoski, 2014). This evidence suggests that being enrolled automatically by employers into a pension scheme will address some of the underlying causes of low coverage (inertia and lack of availability), though affordability remains a key barrier to be considered.

5.12 Age is also a factor in pension coverage. Separately, CSO data from 2019 also indicates that younger workers are less likely to have a private pension, with 24 per cent of workers aged 20 to 29, compared to 57 per cent of those aged 30 to 65 covered (CSO, 2020). This also represents a challenge in ensuring pension adequacy, owing to the power of compound interest, saving as early as possible has a material impact on eventual pension fund size.

<table>
<thead>
<tr>
<th>Income Range</th>
<th>Coverage Rate</th>
<th>Coverage Rate</th>
<th>Coverage Rate</th>
<th>Coverage Rate</th>
<th>Coverage Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>€40,000 to €50,000</td>
<td>37.7</td>
<td>33.1</td>
<td>29.9</td>
<td>13.1</td>
<td>30.0</td>
</tr>
<tr>
<td>€50,000 to €75,000</td>
<td>Too Few</td>
<td>13.8</td>
<td>16.1</td>
<td>6.3</td>
<td>16.2</td>
</tr>
<tr>
<td>€75,000 and over</td>
<td>Too Few</td>
<td>17.3</td>
<td>4.6</td>
<td>3.9</td>
<td>9.1</td>
</tr>
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<td>All Incomes</td>
<td>75.3</td>
<td>51.5</td>
<td>42.5</td>
<td>31.3</td>
<td>52.3</td>
</tr>
</tbody>
</table>

Source: Analysis by ESRI using SWITCH which relies on a single dataset, compiled from the 2013, 2014 and 2015 waves of SILC and made representative of the population in 2019. Note: ‘Too few’ means that there are less than 100 cases in this age-income group.
The Survey on Income and Living Conditions (SILC) in Ireland is a household survey and is the official source of data on household and individual income.

Based on this data, the CSO has produced, for the Department of Finance, a distributional analysis comparing the earnings of those currently in employment and participating in a pension scheme with those currently in employment and not participating in a pension scheme. The analysis was carried out using the CSO’s SILC 2017 dataset. It should be noted that this survey is not designed specifically to measure pension participation. An estimate is possible, based on the data collected. The data is sample based data and the results, whilst weighted to the overall population, are best taken as indicative only. As a result, though more granular data is available, we focus on top line numbers as they are a more reliable guide.

The chart above plots mid-point income for those in employment (every €5,000 from €0 to €100,000+) against the number of individuals in that income bracket, delineated by whether they are in a pension scheme or not. The red line represents the cut-off point for Automatic Enrolment as agreed by the previous Government.

According to SILC 2017, 44.6% of those currently in employment (both employees and self-employed) are participating in a pension scheme or will receive a pension other than the State pension on retirement.

For those participating in a pension scheme, the median gross employment income is €52,920 and the interquartile range is €38,997 - €71,881. By contrast, the median gross employment income for those not in a pension scheme is €21,800 with an interquartile range of €12,578 to €31,932.
While financial incentives play a role in pension coverage, it is difficult to determine the exact extent to which the tax treatment of pensions is a driver of coverage in Ireland. State financial incentives are not cited as a reason by those who do not have a private pension. However, recent Irish evidence suggests that affordability, lack of an available occupational pension and inertia are the key reasons explaining low take-up of supplementary pensions. In a 2020 CSO Labour Force Survey, the following reasons were cited by workers who had chosen not to be part of their employer's pension scheme:

- Not able to afford one (33 per cent);
- Never got around to it (36 per cent)

However, 53 per cent of workers without an occupational pension state that their employer does not offer a pension scheme.

Separate research by Mercer’s *Healthy, Wealthy and Work-Wise: The New Imperatives for Financial Security – Ireland* (2018), affordability (34 per cent), unemployment (21 per cent) and lack of opportunity to join pension in work (19 per cent) were the leading reasons cited by those without a supplementary pension.

Figure 20 illustrates that with the planned introduction of Automatic Enrolment a large cohort of those currently in employment but not participating in a pension scheme will now be covered. As indicated in Chapter 2, the State pension is not designed to provide a high level of pension adequacy in retirement however this is not the case for those on lower incomes. Those under the cut-off point of €20,000, who are not in a pension scheme, may find that the State Pension provides a sufficient rate of replacement.

Insights from behavioural science point to the difficulties people have in making decisions around retirement savings, which ultimately lead to inertia. Tackling inertia is the key behavioural insight behind the success of an Automatic Enrolment policy – the majority of people favour ‘status quo’ and if enrolled, will remain enrolled in that pension (Benartzi and Thaler, 2004). Automatic enrolment addresses inertia and can quickly lead to significantly higher coverage rates. For example, in the UK, the supplementary pension coverage rate increased from 47 per cent of employees in 2012 to 77 per cent in 2019 following the introduction of an Automatic Enrolment system.

A lack of understanding of financial incentives is evident even among people availing of them. Recent work undertaken by the ESRI, supported by the Pensions Authority, noted that:

The results of the present study raise concerns about the operation of tax relief and matching contributions as incentives for increasing people’s willingness to contribute to their pension. A representative sample of participants, who were incentivised to respond accurately and most of whom had degrees, produced responses to multiple-choice...
questions about how these incentives work that were essentially no better than chance.

(Lunn and McGowan, 2019, p. 27)

5.17 In conclusion, assessing the success of tax incentives in achieving supplementary pension coverage is a challenging exercise. Coverage is lower than desired with the most recent data indicating that the current level is around 57 per cent of those in employment aged 30 to 65. However, the level of coverage is materially higher for incomes above two times the State pension (i.e. an income where the State pension represents a 50 per cent replacement rate). This indicates that at incomes where marginal tax relief is available, it is, at the very least, correlated with pension saving. Research suggests that people struggle to understand the value of pension saving incentives and that tackling inertia can materially increase coverage rates.

Adequacy

5.18 As retirement is an expected life event with related changes in income, it is expected that forward-looking actors would smooth their consumption so that they could enjoy the same consumption levels during employment and retirement. However, most studies have found that this is not the case and that consumption decreases significantly in retirement. This phenomenon is called the ‘Retirement Consumption Puzzle’, though there are specific reasons why consumption might fall in retirement (for example, the elimination of work-related expenditure).\footnote{Banks, Blundell, and Tanner's 1998 paper entitled Is there a Retirement-Savings Puzzle? was the first to put forward this puzzle, having found data that showed a steep decline in consumption during retirement. The ESRI is currently undertaking research in this area with respect to non-durable consumption (home food consumption, out-of-home consumption, leisure, alcohol, tobacco, clothes and shoes) using data from the Irish Household Budget Survey, 1987-2016 (McGuinness and Redmond, 2019). The results of this paper should provide an insight into the change in consumption patterns of citizens as they enter into retirement and will also allow us to understand these patterns with respect to factors such as household make-up and gender (McGuinness and Redmond, 2019).}

5.19 There is no consensus on how to define pension adequacy (Grech, 2013). As mentioned earlier, the NPPI (1998, p. 11) recommended a replacement rate of ‘50 per cent of gross pre-retirement income subject to a minimum of 34 per cent of average industrial earnings’ as the most basic indicator of pension adequacy. The World Bank (Whitehouse, 2012) and International Labour Organisation (2012) recommend 40 per cent and 45 per cent pre-retirement income replacement rates respectively.

5.20 The adequacy of pension income is best conceptualized around three core goals: ‘(i) poverty protection, (ii) income protection, and (iii) pension duration’, which can be measured according to risk of poverty, replacement rates, and length of retirement respectively (European Commission, 2018a, p. 22). It is generally accepted that any discussion of adequacy should take into account all sources of income, not just pensions, and it is important to emphasise that non-pension income and/or wealth may also be available to retired individuals. For example, in a study by Nivakoski (2014, p.309), supplementary pensions represented 35 per cent and 44 per cent of retired women’s and men’s total income, respectively. Furthermore, the study found that just over half of retired individuals were in receipt of a small amount of asset income (Nivakoski, 2014). Other non-pension factors will also contribute to the level of adequacy experienced in retirement, such as access to services, social
benefits or discounts, financial wealth and housing wealth (European Commission, 2018a). Consideration of household-level pension adequacy is also recommended, given the higher risk of poverty for older people living alone (European Commission, 2018a).

5.21 Contribution size is a key determinant of pension adequacy. The level of saving maintained over a working life will have substantial bearing over the pension fund accumulated. According to an analysis conducted by Collins and Hughes (2017), one in three pension savers in Ireland contribute less than 5 per cent of their earnings to their pension (i.e. employer and employee contributions combined represent less than 5 per cent of total earnings) and the median contribution rate was 8 per cent or €3,340 per annum. The Irish Association of Pension Funds (IAPF) (2015) estimate an average 5.4 per cent employee contribution to DC pension schemes, and an average 5 per cent employer contribution.

Poverty protection

5.22 The State pension has been broadly successful in achieving its objective of protection from poverty. Older adults are the age group least likely to experience poverty and deprivation (see Figure 21). Supplementary pensions function to maintain a certain level of income in retirement in order to protect living standards enjoyed during one’s working years.

<table>
<thead>
<tr>
<th>Figure 21: Poverty rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>At risk of poverty rate %</td>
</tr>
<tr>
<td>Population</td>
</tr>
<tr>
<td>Retired</td>
</tr>
<tr>
<td>Over 65s</td>
</tr>
<tr>
<td>Household 1 adult &gt;65</td>
</tr>
<tr>
<td>Household 2 adults, at least 1 &gt; 65</td>
</tr>
</tbody>
</table>

Source: CSO (2019b) based on 2018 data.

5.23 Measured in terms of relative risk of poverty (defined as 60 per cent of median equivalised income after social transfers), Ireland is one of the most successful EU Member States in protecting older age cohorts from poverty (European Commission, 2018a). This indicator includes income poverty and material deprivation. In 2016 in the EU-28, the average rate of severe material deprivation was 5.8 per cent, compared to 2.4 per cent in Ireland (European Commission, 2018a).

73 For example, a 25 year old on a salary of €46,402 and contributing 12.4% of salary (5.4% employee and 7% employer contribution) to a pension, who retires at 68, would likely achieve a 50% replacement rate including the State pension, using the Pensions Authority’s Pensions Calculator assumptions; this illustrates the need for greater levels of contributions overall (Burke and Gilhawley, 2018, p. 37).
5.24 The Roadmap commitment to benchmark the value of the State Pension contributory at 34 per cent of average earnings and to link future increases in payment to changes in inflation/wages will ensure that this poverty avoidance goal is maintained in the future.

**Income protection**

5.25 The adequacy of pension income depends on an individual’s pre-retirement income. As such, a single target replacement rate may be arbitrary, given an individual’s income varies across their life. As noted above, the NPPI (1998, p.11) suggested a ‘benchmark of 50 per cent of gross pre-retirement income subject to a minimum of 34 per cent of average industrial earnings’. Two times the State pension, means an income of over €25,000.

5.26 According to analysis of sample data from TILDA (1,864 retired individuals aged over 65), the majority of those with a supplementary pension are in receipt of a total income that replaces 50 per cent of their pre-retirement income (Nivakoski, 2014). However, 36.5 per cent of those with supplementary pensions achieve a replacement rate of less than 50 per cent (Nivakoski, 2014). Replacement rates can be limited as an indicator of pension adequacy (Nivakoski and Barrett, 2017). For example, the highest replacement rates are found in TILDA participants who are female or have the lowest education levels – this is due to the low pre-retirement income levels of these groups rather than representing greater pension income or adequacy. Consumption or income levels may be more appropriate policy targets than replacement rates when it comes to measuring pension adequacy (Nivakoski and Barrett, 2017). It is worth noting that the TILDA sample may not reflect future pensioner population, given the decrease in DB schemes.

5.27 In its Pension Adequacy Report 2018, the European Commission (2018a) discusses the relationship between home ownership and income protection in old age or retirement. The Report finds that home ownership is associated with lower risks of poverty. In the EU-28, 76 per cent of over 65s own their own home, compared with 95 per cent of over 65s in Ireland. In Ireland, tenants are at twice the level of risk of poverty than homeowners (28 per cent compared to 13 per cent, respectively) (European Commission, 2018a). The increasing average age of first-time buyers and the rising number of people living in rented accommodation has the potential to have negative implications for the income protection aspect of pension adequacy (see Figure 22 for a discussion of this issue).
Pension duration

5.28 Pension duration, or the length of time spent in retirement, is determined by age of retirement and life expectancy. The pension duration will influence the sustainability of pension income, both at a State and individual level. In 2016, the average retirement duration in Ireland was 18.6 and 22.2 years for men and women respectively and is expected to increase to 21.3 and 24.2 by 2056 (European Commission, 2018b). As life expectancy is expected to continue to rise, later retirement or longer working lives may assist reducing pension duration. Women’s longer pension duration and shorter working life duration poses a challenge to pension adequacy. This issue will be discussed further in relation to equity.

5.29 In conclusion, the State pension has evolved to a position where in general terms it is effective in ensuring poverty prevention in old age. Recent commitments contained in the Roadmap are designed to ensure that it continues to be effective in this regard. Achieving adequate supplementary pension coverage only partly addresses the objective of maintaining standards of living in retirement. To the extent that data is available it suggests that, even where saving is underway, it is not of sufficient scale or was not commenced at an early enough stage to support retirement income to fully achieve this ambition. This finding is tempered by two points: firstly, research suggests many have other sources of income in retirement outside of the pension system, though, on average, the amounts are small; secondly, the progressive nature of the income tax system combined with additional age-related

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74 Current ESRI analysis of SILC data indicates that in all households with people aged 66 and over, income from rent, interest and investments represents only 3% of gross household income while almost 75% comes from pensions.
exemptions means that, for many with smaller pension pots, income drawn from supplementary pensions will accrue little, if any, tax.

**Equity**

5.30 Research on this topic relies heavily on national survey data, which although well-established and reliable, up-to-date pension taxation data directly from the Office of the Revenue Commissioners would be preferable. A number of approaches may be taken to examine the question of equity of pension taxation. These range from a narrow analysis of pension tax relief beneficiaries to a broader life-cycle approach that incorporates the three pillar pension system, social insurance and older age income tax policies. A question also arises as to the appropriate level at which the analysis should be undertaken; individual, household, cross-sectional or longitudinal, as well as how to measure the material impact of pension taxation for individuals/households.

*Income Level Distribution of Tax Relief on Contributions (Vertical Equity)*

5.31 Low pension coverage or the lack of material incentive (during the working life) to contribute to a pension among low income deciles is often cited as an indicator of inequity in pension taxation. However, it is important that there is policy clarity around desired replacement rates and coverage levels. For incomes below €18,000, where effective tax rates are low, the State pension replaces over 70 per cent of pre-retirement income arguably reducing the need for a supplementary pension depending on the replacement rate policy goal.

5.32 Analysis of the income distribution of individuals making pension contributions in 2019 has been made available by Revenue in their paper “Statistics and Insights from the First Year of Real-Time Payroll Reporting (PAYE Modernisation)”. Estimates of the distribution of the tax cost by income range, associated with these contributions, should be possible once self-assessment tax returns for 2019 are filed and a full picture of taxpayer income levels has been determined.

5.33 According to analysis of the SILC data, it is estimated that the majority (71 per cent) of individuals with supplementary pension savings pay income tax at the higher rate (and therefore receive tax relief on their contributions at this higher rate) (Collins and Hughes, 2017). Higher rate tax payers also contribute more of their income to their pension than standard rate payers. However, using the current tax rates and tax bands that apply for 2020 it should be noted that the higher rate applies to incomes over €35,300 for a single person or €44,300 for married couples with one earner and these incomes are not generally considered to be ‘high incomes’. Middle to higher income earners constitute the main group of beneficiaries of tax relief on pension contributions by number; according to SILC 2017, half of those in receipt of relief on contributions fall between income levels of €39,000-€72,000 (See Figure 19 for more detail and assumptions relied on).

5.34 Using the ESRI’s SWITCH (Simulating Welfare and Income Tax Changes), which models national survey data, the ESRI (Doorley et al., 2018) analyses the distribution of gains from tax relief on pension contributions and simulates the impact of changes to the tax treatment of pension contributions. They

estimate disposable income gains made by those contributing to a pension by modelling the effect of non-taxation versus taxation of contributions. According to their modelling, upper income deciles benefit most, with the top four income deciles gaining between 3 and 4.5 per cent in disposable household income due to this tax relief. By comparison, middle earners gain 1 - 2 per cent with the bottom decile not gaining at all. 76

5.35 As part of this exercise and to examine the distributional impact of changes to the level of tax relief on pension contributions, the ESRI simulated a standardised rate of relief of 20 per cent and 30 per cent as well as reducing the annual contribution limit from €115,000 to €75,000. Standardising tax relief to 30 per cent results in a reduction in the level of gains for incomes in the upper deciles, having less of a negative impact on lower and middle income deciles. Standardising tax relief to 20 per cent reduces the level of gains for all income deciles, though higher income deciles lose more than lower deciles. Reducing the annual contribution limit has little effect other than a slightly negative impact on the top three income deciles.

5.36 Whereas the ESRI work focused on disposable income impacts, Collins and Hughes (2017) focused on allocating the proportion of the value of the relief by income decile. Both approaches are plotted in Figure 23 where the skew towards upper deciles is clear – and is starker when applying the Collins and Hughes methodology.

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76 Whelan and Hally (2018) suggest that a married household with one income below €20,000 gains no benefit (with a -3% net effective tax relief), due to USC imposed on retirement income. They also suggest that existing pension taxation is regressive and disincentivises pension saving for lower income groups (below €20,000) (Whelan and Hally, 2018).
The research on equity cited above does not include analysis of tax paid on pension income and, therefore, does not take account of the deferred taxation element of the EET system. Behavioural impacts of changes to pension taxation are also not accounted for. As discussed earlier, contribution levels of those with a supplementary pension already appear low, with small pension pots the norm – and changes to tax relief may result in even lower levels of contribution.

**Figure 24: Value-for-money and the Social Insurance Fund**

**Review of the Social Insurance Fund**

The social insurance system operates through the Social Insurance Fund (SIF) and contributions (PRSI) are paid into the Fund to finance a range of contributory social insurance benefits including pensions. As part of the Actuarial Review of the SIF, based on an end 2015 position, a value-for-money (VFM) analysis was conducted on PRSI contributions. VFM was measured on the basis of setting the present value of projected benefits (in this case the Contributory State Pension) in terms of the present value of PRSI contributions (both employer and employee) and comparing the scores over different income levels.

The chart below relies on the same approach to estimate the average weekly pension that accumulated contributions would purchase in a hypothetical defined contribution pension scheme. This is the pension a contributor might expect to receive if they invested all of their and their employer’s cumulative PRSI contributions in a defined contribution pension scheme and at retirement purchased a pension with the accumulated value of the invested contributions.

The chart highlights the value of a flat-rate benefit such as the State Pension to those on lower incomes. Based on a defined set of assumptions (see below), the contributions of an individual on a wage equivalent to National Average Earnings (NAE) would not be sufficient to purchase an annuity equivalent to that of the State Pension. On the other hand, the contributions of an individual on a wage of three times NAE would be sufficient to purchase an annuity equivalent to in excess of two times the State Pension.

![Graph of value-for-money analysis](image)

*Source: KPMG (2017). The VFM Methodology is set out in the SIF Review. The chart above is adapted from Table 11.3 and assumes full PRSI Class A contribution history with contributions from the age of 25 to 66; the data relates to 2015.*

**Broader/Systemic Conceptualisation of Equity**

Ireland’s income tax and social protection systems are important factors in assessing equity of treatment. The distributional impact of pensions should ‘consider the progressivity of the system as a
whole, rather than that of each element’ (Barr and Diamond, 2009, p. 7). According to the Commission on Taxation (2009, p. 3):

Equity should be considered in the context of the overall tax system. A lack of progressivity in one area of the system may be compensated for by having a high degree of progressivity in other areas, or by focused direct expenditure - which is financed from tax revenues.

5.39 As highlighted in Figure 24, the Actuarial Review of the Social Insurance Fund (KPMG, 2017) finds that the social insurance system is highly redistributive. Notwithstanding the fact that PRSI contributions provide for a range of benefits (such as income supports for people of working age and dental benefits), the State pension, as a flat-rate benefit, offers greater value-for-money for lower incomes than higher incomes, where the latter ‘get less back than they pay in’ (KPMG, 2017, p. 7).

Figure 25: Tax wedge Ireland versus OECD average

Source: OECD, 2018b.

5.40 Ireland’s highly progressive income tax system (incorporating USC) means that comparatively less income tax is paid at lower income levels (Figure 25 compares Ireland with the OECD average). This progressivity is amplified in retirement with an additional range of age-related concessions existing for older age cohorts.

Gender

5.41 Gender is largely underrepresented in pension research in Ireland (Maher, 2018) and much of the existing data on pensions is not disaggregated by gender.

Women and pension coverage

5.42 The proportion of women with a supplementary pension (51 per cent) is slightly higher than that for men (50 per cent) and has only marginally fluctuated over the past decade (Figure 26 CSO, Labour Force Survey 2020). According to research using TILDA data, male retirees’ average income is 58 per cent higher than women’s, with mean weekly pension incomes of €397 compared to €252 respectively (Nivakoski and Barrett, 2012). However, according to separate research by Aviva (2017), women are less likely than men to make retirement plans, and less likely to be saving regularly for retirement than men.

Figure 26: LFS Data on pension coverage

5.43 However, the key drivers of pension coverage and adequacy for women relate to labour market factors – the combination of reduced working hours and breaks in employment due to caring duties can have significant implications for women’s duration of working life and lifetime earnings. This, therefore limits the capacity to maximise the size of the final pension fund for women who do contribute to a supplementary pension.

Women and employment

5.44 Compared to men, women have lower levels of labour market participation and they are more likely to be engaged in home duties or part-time employment. These are all factors which contribute to lower levels of pension coverage and adequacy. According to CSO (2019) data from Q3 2019, although evident from as early as age 20, from age 35 – 44 years onwards, the labour force participation rate gap between men and women widens more significantly: 92 per cent compared to 78 per cent respectively and persists at around a 10 - 20 per cent gap until retirement age. In addition, for the same quarter, a greater number and proportion of women than men were in part-time employment: 31 per cent compared to 11 per cent respectively (CSO, 2019a). Part-time work is associated with lower levels of pension coverage; in 2019, just one in four part-time workers reported having a supplementary pension compared to over half of full-time workers (CSO, 2020). Apart from lower pay, associated with working part-time rather than full-time, women are also over-represented in lower paid categories of employment such as human health and social work, administration and sales and customer service according to data from Q3 2019 (CSO, 2019a).

5.45 In Q3 2019, 16 per cent of women (aged over 15) compared to just 1 per cent of men described their principle economic status as ‘engaged with home duties’ (CSO, 2019a). Women represent 94 per cent of those whose primary role is in home duties, however the volume of women in this category decreased between Q2 2015 and Q3 2019 from 459,600 to 312,600 with a parallel increase in the number of men in this role (CSO, 2019a). While it is possible, it is unlikely, that persons engaged in home duties may at the same time contribute to a personal pension. Therefore, it can be assumed that the individual’s pension fund would be in receipt of fewer contributions than if the person had been in employment.

5.46 Given the over-representation of women in part-time employment (see Figure 27), affordability may likely explain low pension coverage. As a result, incentives targeted to lower income groups may help encourage greater levels of retirement saving among women (see international examples in Figure 31). The availability of occupational schemes in the sectors in which women are over-represented will also play an important role and Automatic Enrolment has the potential to address this issue.

![Figure 27: Principle economic status by gender](source: CSO (2019): Labour Force Survey (Q3 2019, persons > 15y)).
Some respondents to the Group’s public consultation suggest the provision of tax credits to individuals’ pension pots during breaks in employment for caring duties, or the sharing of pension contribution tax relief between partners during this time. In the UK, non-taxpayers can benefit from tax relief if their pension scheme has a ‘relief at source’ arrangement, whereby their pension scheme contributions receive standard tax rate relief (Thurley et al., 2018). This type of tax relief for employees that are non-income tax payers (i.e. their income is too low to be liable for tax) would disproportionately benefit women, who are over-represented among low income groups.

Figure 28: Women and Automatic Enrolment

In the UK, Automatic Enrolment has proved hugely successful in increasing the level of coverage for women – in 2013, 50% of women in employment had no pension, which by 2017 had reduced to 29%. The introduction of such a system here should have a similar outcome.

However, a number of considerations arise as a result of women’s labour market activity. Firstly, women will likely be over-represented in the population of workers not included in Automatic Enrolment. Analysis by the ESRI indicates that, on the basis of the enrolment criteria of employees without pension coverage, aged 23 to 60 and earning €20,000 a year, around 254,000 women would be auto-enrolled. However, this would equate to a lower proportion of women than men being enrolled: 43.5% compared to 56.5%. This is partly explained by the fact that while women have lower pension coverage than men in the private sector, a greater proportion of female employees work in the public sector, where supplementary pension coverage is much higher than in the private sector. If a lower income threshold was set at €14,000 the proportion of women who would be auto-enrolled would increase to 48.4%, demonstrating the over-representation of women at lower income levels. Secondly, for women who are automatically enrolled and subsequently have a break in employment due to caring duties, consideration must be given to how the accumulation of pension savings could be best protected and how to minimise reduced contributions over the lifetime.


The ESRI and the Pensions Council considered this area under their Joint Research Programme on Gender, Pensions and Income in Ireland. This research showed that:

Average total weekly pension income in 2010 was €280 for women and €433 for men, implying a raw gender pension gap of approximately 35 per cent. No consistent evidence of a gender state pension gap was found. For occupational and private pensions, higher levels of female educational attainment are found to reduce the gender pension gap throughout the pension income distribution.

A number of reasons were put forward with a principal factor contributing to the gap being the lower relative years of work experience among women.

77 Where schemes operate a ‘net pay’ arrangement, this facility is not available.
PAYE, Self-Employed and Proprietary Directors (Horizontal Equity)

5.49 Employment-type plays a role in how pension related tax relief applies. As detailed earlier, the tax treatment of employee contributions differs to employer contributions. While employee contributions are subject to a limit based on a percentage of annual earnings up to a maximum of €115,000, employer contributions are not subject to such limitations. Employer contributions to trust-based occupational pensions are also exempt from BIK, PRSI and USC.

5.50 For the individual in a position to influence the allocation of remuneration, the ability to make employer rather than employee contributions to their pension represents considerable material benefit to them (and concurrent cost to the Exchequer). Incorporated self-employed individuals have the potential to determine whether or not their remuneration is in the form of employer contributions to their own pension scheme (if trust-based); unlike unincorporated self-employed or indeed PAYE workers whose contributions will be subject to limitations.

5.51 An example of this differential treatment is illustrated in Figure 29 in terms of costs to the Exchequer. When an individual contributes €1,000 to a trust-based pension in the form of an employee contribution they receive tax relief at their marginal rate, but pay PRSI and USC on the amount of income contributed. This represents a cost of €289 in revenue forgone to the Exchequer. In contrast, the individual who receives an equal contribution in their name in the form of an employer contribution costs the Exchequer €567, benefitting from relief from USC, employer and employee PRSI, and income tax.

| Figure 29: Contrasting tax treatment of employer and employee contributions of €1,000 |
|-----------------------------------------------|-----------------------------|
| **High rate** | **Employer contribution** | **Employee contribution** |
| **€567** | **€289** |
| **Standard rate** | **€357** | **€161** |

Source: Burke and Gilhawley (2018)

5.52 There is a disparity arising in relation to the tax treatment of pension contributions, depending on whether the contribution is made by an employer or employee. Unincorporated self-employed and PAYE workers are subject to age-related restrictions on the amount of tax-free contributions that can be made to their supplementary pension, whilst incorporated self-employed persons are in a position to make contributions to their supplementary pension in the form of employer contributions and therefore are not subject to this limitation. This has been discussed in Chapter 3. A change in treatment, such as further limiting relief on employee contributions, could further exacerbate this perceived imbalance.
5.53 Public service employees continue to accrue DB pension benefits. Public service pension entitlements are generally unfunded operating on a PAYG basis, though public service employees make mandatory contributions and additional superannuation contributions towards their pension. As such, no explicit employer contributions are made annually. However, public service employees accrue retirement benefits and an actuarial assessment is required to value the retirement benefits accruing. The value of this ‘implicit’ employer contribution is generally presented as a percentage of salary.

5.54 The Public Service Benchmarking Body (2007) and Department of Public Expenditure and Reform (2017) have attempted to assess and quantify the implicit employer contribution for public service employees. It should be noted that the terms and conditions of employment for public servants are not homogenous. Further assumptions have to be made in an attempt to identify a generally applicable level of implicit employer contribution. The average implicit employer contribution was estimated at 20 per cent by the Public Service Benchmarking Body (2007) and 29 per cent by Department of Public Expenditure and Reform (2017) (for pre-2013 entrants).

5.55 These implicit contributions are not taxed. According to the ESRI (Doorley et al., 2018), the cost of tax relief of these implicit contributions (on the basis that they represent a benefit-in-kind) is estimated at €778m in 2017. This is based on an implicit contribution rate of 20 per cent less employee contributions (this is lower than both approaches noted in the previous paragraph). An estimate for this implicit contribution is not included in the cost of tax relief set out in paragraph 4.43.

5.56 The OECD (2018b, p. 46) notes:

Public pay-as-you-go (PAYG) pension arrangements are generally subject to the “EET” tax regime. […] In most OECD countries, employees’ social security contributions are deductible from income, the (implicit or explicit) internal rate of return of the PAYG scheme is exempt from personal income tax, and pension benefits are taxed as income.

5.57 The OECD (2018a, p. 17) further notes that:

Countries may want to treat savings, whether through PAYG or funded pension arrangements, equally, in particular when these are part of the mandatory system.

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80 It should be noted that the analyses cited in this section excludes does not factor the former ‘Pension Related Deduction’ now known as ‘Additional Superannuation Contribution’.

81 Department of Public Expenditure and Reform (2017) covers this issue in detail, highlighting the differences between various categories of public service employees and different entry dates. It is notable that the implicit employer contribution for new entrants after 2013 falls significantly to 9% due to the different benefit structure which applies to these members under the Single Public Service Pension Scheme. As at end 2019, new entrants after 2013 constituted 41% of public servants.

82 This point is made on the basis that the cost of the BIK exemption for funded schemes is generally included in estimates of the cost of the tax expenditure on pensions. As discussed in paragraph 3.68, as drawdown is taxed at the marginal rate, applying BIK would involve taxing the same income twice.
Any alteration in the tax treatment of explicit contributions made by employees and employers would result in horizontal inequity if not paralleled with regard to the State’s implicit contributions.

**Automatic Enrolment**

Action 3.13 of the Roadmap (Government of Ireland, 2018, p. 27) provides that the review of the cost of tax incentives is to be undertaken ‘to inform decisions relating to financial incentives for retirement savings and underpin the development of the automatic enrolment system’. The design and rollout of Automatic Enrolment is not a matter for the IDPRTG and this Chapter provides only one input into the design of the Automatic Enrolment system. It is, however, useful to set out some points which have emerged from the work of the IDPRTG that are worthy of consideration.

**Background to Automatic Enrolment proposal and State Financial Incentive**

In August 2018, the Government published a ‘Strawman’ proposal for an Automatic Enrolment retirement savings system in Ireland (Department of Employment Affairs and Social Protection, 2018). The Strawman was not to be read as a confirmation of what form Automatic Enrolment would ultimately take, but as a high-level draft intended to generate and prompt discussion. In terms of a State financial incentive, the Strawman proposal gave an illustrative example that the State could contribute €1 for every €3 contributed by the individual to their pension fund. This approach to designing the State incentive and its interaction with the existing marginal rate of tax relief scheme for supplementary pensions was one of the most complex issues identified in the consultation process. The IDPRTG observed that the Strawman proposals are particular to those at whom Automatic Enrolment is aimed i.e. those currently without retirement savings; largely low and middle income earners. As the Strawman proposals do not relate to provisions for current pension savers, it did not take a position on reforming the current system of tax relief for pension contributions.

Under any Automatic Enrolment system, the State is committed to supporting employees by financially incentivising retirement saving. While the Government made a number of design decisions for the Automatic Enrolment system in October 2019, the issue of financial incentives is one of the areas where work was to continue so as to develop proposals for Government to consider. As discussed in detail above, the current system of tax relief for private pension contributions provides incentives that differ depending on income levels. Given that the incentive is delivered through marginal tax rates, workers on lower incomes are provided with more limited or no incentives for saving for their retirement. The financial incentive provided under Automatic Enrolment should operate in a way that best supports the policy objective of Automatic Enrolment, to improve income adequacy in retirement

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83 For illustrative purposes, the Strawman lays out a ‘Saver’s Bonus’ system of State backed incentives that gives €1 for every €3 saved. As the Strawman proposes a contribution rate of 6% for the employee, the rate from the State would equate to a 2% contribution rate. When the 6% employer contribution rate is added in, the total contribution rate would be 14%. Employee contributions would be made as a percentage of gross earnings but deducted from after-tax income. To help manage the costs of the new system, the Strawman proposes that the State contributions be subject to a cap. For Automatic Enrolment members, the matching contribution approach could replace the current tax relief system on pension contributions. The matching contribution approach represents a contribution rate of 25% and is more advantageous than the standard income tax rate of 20% but less beneficial than the marginal income tax rate of 40%.
in particular for those on lower incomes. It should also seek to promote long-term saving amongst the target population. A proposed State contribution could be combined with a cap to provide an incentive that is more income-neutral (i.e. the incentives are the same for all income levels) than alternative approaches. In addition, the employer is obliged under the proposals for Automatic Enrolment to make a financial contribution matching that of the employee up to a specified level. This is in contrast to current situations where employers, while they must provide for a PRSA, are not actually obliged to contribute to an employee’s PRSA. Currently, employers who have established occupational pension schemes are obliged to make a ‘meaningful’ contribution to their members’ pensions, however no stated minimum contribution is obliged.

**Challenges in Designing a State Financial Incentive for Automatic Enrolment**

5.62 In designing an appropriate State financial incentive to encourage participation in Automatic Enrolment, consideration has to be given to the functioning of the current system of tax relief, and relief for pension contributions in particular. In addition, consideration will need to be given to both the value of state support along with the method of calculating the incentive. Options could include: making no change and applying the current incentive structure to Automatic Enrolment, though noting the issues above in relation to low income workers; continuing with the current tax relief system for those who are not a part of the Automatic Enrolment system and providing matching contributions only to those who participate in the Automatic Enrolment system; or designing a new incentive that would apply equally to all pension savers.

5.63 The existence of two separate regimes of financial incentive being offered by the State (Automatic Enrolment and outside Automatic Enrolment) may create significant differences that incentivise employees to move from one system to another (all else remaining equal) and increase complexity for all stakeholders. This could create an incentive for higher rate income tax payers to opt-out of Automatic Enrolment in favour of tax relief in the ‘traditional’ private pensions system. Conversely, it could see lower rate income taxpayers, who are currently saving for retirement, incentivised to leave their ‘traditional’ private pensions in favour of Automatic Enrolment. Maximising one’s position under both schemes depends not only on contribution rules but also taxation treatment on drawdown. In other words, an individual has to assess under which system they would be better-off over the full life-cycle – this is a complex calculation requiring a number of key assumptions.

5.64 Furthermore, the working population is not static. Individuals enrolled in Automatic Enrolment at the start of their career when they are on lower rates of pay might initially benefit from a 25 per cent State contribution, as illustrated under the Strawman, compared to the existing 20 per cent standard rate tax relief. However, as they progress in their employment and reach the higher rate tax bracket as their salaries increase, they could then lose out on the greater level of incentive afforded through the current supplementary pensions system (i.e. tax relief at the current higher rate of 40 per cent). In this regard affected individuals could choose to leave the Automatic Enrolment system and start saving

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84 Standardising the level of incentive for pension saving for all income levels was previously proposed as a way to restructure the pensions system in the National Pensions Framework (2010, p. 17) on the basis that it would ‘promote simplicity and equity and ensure that similar options are available to all groups of employees’.

through the supplementary pension system, resulting in members having two sets of funds. This could increase associated costs, thereby diminishing the amount that their funds might realise at maturity. Finally, it is likely that many workers will either have existing pension savings or will move between employers who have existing pension schemes and employers who are enrolled in Automatic Enrolment. Ideally, in-line with a pot follows member approach, individuals should be able to transfer savings with ease between both systems.

This presence of arbitrage and the mobility of workers between Automatic Enrolment and non-Automatic Enrolment schemes could compromise the overall coherency of the pensions system and result in increased complexity for members who may struggle to compare the pros and cons of the different systems available to them. Given that benefits would vary according to whether a person is liable to income tax at the marginal rate or not, clear communication of which system is more advantageous would be difficult. This could generate an increased need for advice to determine which system the employee should be part of, thereby increasing the costs to the employee. Compliance difficulties might also develop as two parallel systems could make it more difficult to determine who must be enrolled. The loss of potential members for the Automatic Enrolment system could also potentially jeopardise the ability of providers to maximise economies of scale in Automatic Enrolment. Separately this could substantially increase the State’s current expenditure on tax relief on pension contributions.

<table>
<thead>
<tr>
<th>Country</th>
<th>Detail</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Australia</strong></td>
<td>Before July 2017, low income earners were disadvantaged by a 15 per cent flat tax rate on pension contributions, meaning that individuals below the income tax threshold would pay tax on contributions to pensions even though their income would otherwise not have been taxed. Since July 2017, the Low Income Superannuation Tax Offset was introduced to address this disincentive for low income groups and refund the tax paid on contributions for those earning less than $37,000. Superannuation account holder spouses with low income can also avail of a tax off-set for post-tax contributions (Australian Government, the Treasury, 2018).</td>
</tr>
<tr>
<td><strong>United States</strong></td>
<td>The Retirement Savings Contribution Credit, known as the Saver’s Credit, took effect from 2002 and aims to encourage low and middle income earners to save for retirement. The incentive is in the form of a tax credit, allowing those eligible, to reduce their tax liability. The rate of tax credit reduces as income increases. The tax credit is non-refundable, so for example, a single person earning up to $19k USD adjusted gross income is eligible for a 50% tax credit, up to a maximum credit amount of $2k USD (Internal Revenue Service, 2019). If a single person with income of $19k USD...</td>
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</tbody>
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86 For example, a single person earning up to $19k USD adjusted gross income is eligible for a 50% tax credit, up to a maximum credit amount of $2k USD (Internal Revenue Service, 2019). If a single person with income of $19k USD...
individuals must be liable for income tax, which arguably makes it less of an incentive to low income earners. (Southworth and Gist, 2008)

An additional incentive encourages people aged over 50 to pay ‘catch up’ contributions to their pension, by extending an additional annual tax credit for contributions to 401k-type savings (Rutledge et al., 2016). Workers aged over 50 can contribute an extra $6,000 per annum in addition to the standard $18,000 limit. Evidence points to increased contributions but the incentive is not effective in encouraging low income earners to save more, with the already high-saving workers most responsive to the incentive (Rutledge et al., 2016).

| United Kingdom (EET) | Tax relief applies at the individual’s marginal tax rate. However, employees who do not pay income tax, because they earn below the income tax threshold but who earn at or above the automatic enrolment threshold, are still eligible to receive tax relief. This is only available if the employee’s pension scheme operates a ‘relief at source’ arrangement, whereby the scheme assumes a flat rate tax relief of 20 per cent on behalf of the employee and then claims the relief from HM Revenue and Customs. In such cases, tax relief is provided at 20 per cent on the first £2,880 paid into a pension scheme. However, tax relief is not available to employees who are members of schemes that operate ‘net pay’ arrangements and do not pay income tax. |

5.66 The potential for arbitrage could be addressed by ensuring that the tax benefits provided under Automatic Enrolment are harmonised across the entire supplementary pension system. However, this could only be achieved by either reducing the current tax relief regime to a lower standard rate of relief or the levelling-up of the Automatic Enrolment provision to equate to the marginal rate of taxation. Either of these approaches would address any potential concerns that incentives are being provided inequitably. However, both approaches would be problematic. While levelling-up would be costly to the Exchequer, a reduction in tax reliefs to some set standard rate, while representing a saving to the Exchequer, could potentially discourage higher tax payers from contributing to pension funds and thus reduce their level of saving. Finally, both in the case of standardising tax relief or introducing matching contributions at a rate lower than the marginal rate, many higher paid employees could in effect retain their current tax savings by switching to a salary sacrifice/employer contribution arrangement.

5.67 On the other hand, if there were no changes to the tax relief regime there could be concerns that the incentives are being provided inequitably as the proposed matching contribution approach would be lower than that currently available to higher rate taxpayers (25 per cent under matching contributions versus 40 per cent marginal tax rate relief). There might also be a perception that the addition of a new method of incentive could perpetuate inequities within the system. Equally, there are those who would argue that the current system of tax relief is working well for those who are saving and that the

 contributes $2k USD towards a pension, they are eligible for $1k USD Saver’s Credit (i.e. 50% of their contribution), while a single person with income of $19,001 USD is eligible for a 20% tax credit, so if they contribute $2k USD they receive $400 USD Saver’s Credit (Internal Revenue Service, 2019).

87 Further information is available at: https://www.gov.uk/tax-on-your-private-pension/pension-tax-relief.

88 The Commission on Taxation (2009) explores the potential option of tax relief at source.
matching contribution approach might undermine the current system of private pensions if there was a levelling-down of support from the State. If this was to happen, people currently saving for their retirement might be disincentivised to continue contributing to pension savings.

5.68 The treatment of income derived from an Automatic Enrolment saving fund in terms of tax on exit is also to be determined and represents a further challenge in designing the system. Employee contributions to Automatic Enrolment under the Strawman proposal could be deducted from ‘after tax’ income and if this was to be the case, a decision would have to be made on whether employer contributions would be subject to BIK. It is likely that, in common with the existing position, returns on savings would be tax-free. The resultant pot of savings will be a combination of pre-tax and after-tax savings. Finally, if an individual has pension savings from another scheme or arrangement, they could be faced with two separate tax regimes in retirement.

5.69 To conclude, the introduction of an Automatic Enrolment system should address the gap in coverage highlighted in this report and materially improve income adequacy in retirement in the future. The Government has made a clear commitment to making a contribution to the individual member’s retirement savings. However, designing financial incentives for such a system is complex. Compared to marginal tax relief, a matching contribution by the State, depending on the design, is likely to be more beneficial in relative terms to those on lower incomes. It would be more easily understood than marginal tax relief. However, as discussed earlier, to the extent that inertia is a driver of inadequate savings, it could be argued that enrolment in a pension in itself could be sufficient in increasing coverage and that the matching contribution paid by employers would be a sufficient financial incentive to remain enrolled.

5.70 Unless aligned, operating two incentive systems in parallel may have significant drawbacks in terms of equity, complexity and labour market mobility. Extending the existing marginal relief scheme (without modification) to Automatic Enrolment savers risks excluding some of these savers from receiving any State support. Replacing the existing system of marginal relief with a matching contributions approach, as well as being complex, could risk reducing current levels of savings and raises significant issues of equity vis-à-vis PAYG schemes.
Conclusions

The Group has agreed the following conclusions:

**Measuring Success: Coverage & Adequacy**

- Though the State pension provides a basic and effective protection against pensioner poverty, it is not designed or intended to secure a high level of pension adequacy. Current policy aims to achieve a 50 per cent replacement rate of pre-retirement income for individuals in retirement, subject to a floor of 34 per cent of average earnings (provided by the State pension). This implies that the purpose of the supplementary pension system is to incentivise those on incomes above two times the State pension to provide for additional retirement income (this, in part, explains a coverage target of 70 per cent). The Department of Social Protection is currently reviewing the suitability of such a one-size-fits-all approach to replacement rates.

- Supplementary pension coverage continues to be below the policy target of 70 per cent, with the most recent data indicating that the current level is around 57 per cent of those in employment aged 30 to 65. There is limited data available on pension adequacy but to the extent that it is available it suggests that for many, even those with pensions, they will likely experience a material fall versus pre-retirement living standards. It is also challenging to determine whether, and to what extent, this represents a failure in existing saving incentives and the extent to which relief is afforded to savings that would be made anyway (deadweight). Clearly, for those who do not pay income tax there is no tax incentive. For those eligible for relief on contributions, other reasons such as affordability may explain some of the lack of coverage. However, research also indicates that tax incentives are poorly understood. International experience demonstrates that inertia is a key driver for the low take-up of supplementary pensions and that the introduction of mandatory or quasi-mandatory enrolment systems can quickly lead to significantly higher coverage rates. Finally, limiting the existing incentive framework could result in behavioural changes that reduce pension coverage or the quantum of pension saving.

**Equity**

- Evaluating equity in the distribution of tax expenditures on pensions depends on how broadly or narrowly equity is defined. In a narrow sense, tax relief is regressive by nature - only those who pay tax qualify. Given the particular design of the Irish pension tax regime, including recent changes to limit reliefs at the higher end, middle income earners are the main beneficiaries of the current system of pension tax relief while a lesser incentive is available to lower income groups;

- However, a broader definition of equity, factoring in the social insurance system (including the State pension) is necessary. This illustrates the scale and effectiveness of social transfers in the Irish system. The flat rate State pension represents far greater value to those with lower incomes;
The OECD’s work on the design of financial incentives has highlighted that financial incentives may need to be different for different population groups.

**Automatic Enrolment**

- Automatic enrolment has the potential to address both the coverage and adequacy gaps set out here. Designing financial incentives for such a system is undoubtedly complex. A matching contribution by the State, depending on the design, could be more beneficial in relative terms to those on lower incomes. It may also be more easily understood than marginal tax relief;

- Unless aligned, the operation of two incentive systems in parallel may raise potential difficulties in terms of arbitrage between the current system and the Automatic Enrolment system. In this regard the Automatic Enrolment Programme Board (AEPB) will consider proposals for Government in relation to the design of an appropriate incentive structure for Automatic Enrolment which will primarily target lower earners. This will take into account measures that could mitigate arbitrage between the two systems.
6. Review of the Approved Retirement Fund

6.1 The accumulation phase of pension policy has been the primary focus of policy makers and other stakeholders over the past decades. As our population ages and DC becomes more prevalent, an increasing amount of individuals will face significant financial choices before, at the point of, and during retirement. In turn, an increased scale of savings will be channelled into decumulation products – currently into Approved Retirement Funds (ARFs) or annuities. It is timely, now, to review the ARF product.

6.2 The introduction of Automatic Enrolment will also require an assessment of appropriate drawdown options including the identification of a potential default approach for such members. The availability of lump sum cash drawdown, annuities, and a flexible drawdown product will be considered in this context. These are the choices facing existing DC savers. Ensuring the ARF or a revised drawdown product is fit-for-purpose will aid consideration of the drawdown approach under Automatic Enrolment.

Objective and Background

6.3 The ARF was introduced by Finance Act 1999, to improve the flexibility of pension drawdown, with its legal basis established in Section 784A of the TCA. It now allows DC scheme members and owners of personal pension products to manage the proceeds of their own pension fund after retirement. Up to then, having taken a tax-free lump sum, the only option available at retirement was to purchase an annuity. The ARF provides flexibility and an alternative income stream to an annuity in retirement.

6.4 Access was initially restricted to Proprietary Directors of occupational pension schemes (DB and DC), individuals making contributions to RAC’s after 6 April 1999 and those making contributions before that with agreement of the pension provider. However, over time access has been extended to all DC savings. Combining increased accessibility with the perceived deterioration in value-for-money from annuities, ARFs have become the drawdown product of choice for most DC savers. Initially conceived as a product for high-net-worth individuals, it has evolved into a mass market product. Though there have been a number of minor changes to ARF rules over the years, it remains generally structured as initiated. However, given its current wider use, the IDPRTG is of the view that material reforms are warranted.

6.5 The Group is of the view that the ARF should be replaced by a combination of drawdown within occupational schemes, where available, and a re-designed PRSA product. The basis for the recommendation is set out later in this Chapter. Given that the Group has been tasked with reviewing the ARF product, the sections below serve to both review the ARF product and recommend reforms.

\[\text{When the introduction of Automatic Enrolment was proposed in the National Pensions Framework in 2010 it explicitly stated in relation to Automatic Enrolment design that ‘access to Approved Retirement Funds will be provided’ (Department of Social and Family Affairs, 2010. p. iii).}\]

\[\text{DC savers, who are members of occupational schemes or who own a BOB, are required to use the remainder of their pension pot to buy an annuity if they opt for taking a tax-free lump sum calculated by reference to salary and service. They may choose that option if such a lump sum is of higher value than the alternative of taking 25% of their total pension pot as a tax-free lump sum (see Chapter 3 – lump sum rules - for further details).}\]
For the most part, these reforms would apply equally to the ARF product or to the revised landscape of a whole-of-life PRSA product and in-scheme drawdown. However, it is important to note that it is envisaged that any proposed ARF reforms would be prospective.

6.6 Chapter 6 is set out as follows:

- Overview of submissions to the IDPRTG public consultation;
- Outline of current ARF rules and data on existing ARF use;
- Contrasting the ARF option with the annuity, including international comparisons;
- Discussion of the proposal to replace the ARF with a whole-of-life product and the potential for in-scheme drawdown;
- Dialogue around reforms to the ARF product structure with suggestions for improving the regulatory approach. Conclusions apply whether the Group’s proposal to replace the ARF with a whole-of-life PRSA is accepted or whether the ARF is retained.

Actions Addressed

6.7 Chapter 6 addresses Action 3.14 of the Roadmap for Pensions Reform 2018-2023 (Government of Ireland, 2018, p. 27).

<table>
<thead>
<tr>
<th>Action</th>
<th>Detail</th>
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<tbody>
<tr>
<td>3.14</td>
<td>Undertake a broad review of the utilisation of the ARF option and consider whether regulatory oversight of this product is fit for purpose. This will include a review of ARF criteria set out in tax legislation including specified minimum income requirements. It will also include identifying measures to address any provider/consumer protection gap and the potential to facilitate group ARF products or in-scheme drawdown.</td>
</tr>
</tbody>
</table>

Consultation General Feedback

6.8 Submissions received as part of the IDPRTG consultation process highlighted a significant consensus on the need for reform of the ARF. While there were variations within submissions as to what such reforms would look like, a number of common themes emerged:

- One was the need for greater freedom and flexibility in choosing the most appropriate post-retirement product or combination of products;
- In relation to the effectiveness of current consumer protection arrangements, many would like to see improved regulation of ARF products, including making charges more transparent and ensuring good quality advice is available before, at the point of, and during retirement;
The majority of respondents agree that the rules and rationale underpinning the Approved Minimum Retirement Fund (AMRF) should be reviewed, with many suggesting abolishing the AMRF altogether, given the current level of the State Pension (Contributory) which renders the requirement redundant for many;

- Many support the idea of in-scheme drawdown subject to conditions and on an opt-in basis;
- There were a variety of views on the current deemed/imputed distribution regime, with many responses suggesting amendments to the rates or ages at which various rates apply;
- There was significant support for improving data collection.

Existing ARF Landscape

**Introduction**

6.9 ARFs can be described as funds with earmarked assets with a particular tax status. The performance of an ARF depends on the performance of the assets it is invested in. The key differences between an ARF and its main competitor, an annuity, is that an ARF does not guarantee a stable and predictable income for life, exposing savers to income volatility and longevity risk (i.e. running out of money before they die). Also, unlike an annuity, the ARF option allows an individual to pass on any unused capital as an inheritance without any clawback of pension tax relief.

6.10 From a tax perspective, an ARF operates as a destination into which pension fund assets can be transferred at the point of retirement without incurring a charge to income tax. ARF returns are not taxed but any amount drawn down is subject to income tax, USC and PRSI (where the individual is below the age of 66). There is also an annual imputed or notional distribution in place against which any actual drawdowns are off-set. Tax may also apply where an ARF is inherited.

6.11 Figure 31 shows how availability of the ARF was extended over the years.

<table>
<thead>
<tr>
<th>Year</th>
<th>Available To:</th>
</tr>
</thead>
<tbody>
<tr>
<td>FA 1999</td>
<td>Proprietary Directors and individuals making contributions to RACs after April 1999 and those making contributions to RACs before that date with agreement of the pension provider</td>
</tr>
<tr>
<td>2000</td>
<td>Extended to AVCs</td>
</tr>
<tr>
<td>2003</td>
<td>Extended to PRSAs</td>
</tr>
<tr>
<td>2011</td>
<td>Extended to all members of DC Occupational Pension Schemes</td>
</tr>
<tr>
<td>2016</td>
<td>Extended to all BOBs</td>
</tr>
</tbody>
</table>

ARFs are personal investment accounts into which certain individuals can, in certain circumstances, transfer part of their retirement fund, at retirement, instead of using those funds to purchase an annuity.

This is in contrast with pension annuities, which do not incur a PRSI charge.
6.12 Section 784A of the TCA defines the ARF as a fund ‘which is managed by a qualifying fund manager (QFM) and which complies with certain conditions’. While practitioners must advise the Office of the Revenue Commissioners of their intention to act as a QFM, there is no approval process in place to become a QFM. An ARF is held by a QFM in the name of the individual who is beneficially entitled to the assets in the fund. Accordingly, as ARFs do not fall within the definition of an occupational pension or a PRSA, they are not regulated by the Pensions Authority and can be treated differently depending on the setting (for example, differences in treatment in the case of bankruptcy and PRSI charges on drawdown if under 66 years of age).

6.13 The Office of the Revenue Commissioners and the Pensions Authority jointly approve PRSAs. In contrast with a PRSA where investment requirements, calculation of charges, and reporting and disclosure obligations are set out in the Pensions Act (1990), the ARF is defined in tax law. The relevant provisions in the TCA set out some general design features of the ARF but do not include those product specifics.

**AMRF Requirement**

6.14 Motivated by a concern that savers would outlive their ARF funds, ARF rules dictate that as a safeguard an individual must have a minimum guaranteed level of pension income (‘specified income’) actually in payment for life at the time the ARF option is exercised, currently €12,700. Where an individual cannot meet the minimum specified income test for ARF access, and does not wish to purchase an annuity with his or her pension pot, an AMRF must be chosen, into which a ‘set aside’ amount must be invested. An AMRF is, in effect, a special type of ARF, the purpose of which is to ensure a capital or income ‘safety net’ throughout the latter period of retirement for individuals whose pension income is below the specified income limit.

6.15 As stated above, where the minimum specified income test is not met and an individual does not wish to purchase an annuity, then the AMRF must be chosen, into which a ‘set aside’ amount must be invested. The maximum ‘set aside’ amount is €63,500 or the remaining pension fund balance if lower, after taking the permissible tax-free retirement lump sum. The funds in an AMRF can be used at any

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93 The TCA defines a QFM as one of the following: Bank, Building Society, Trustee Savings Bank, Post Office Savings Bank, Credit Union, Collective Investment Undertaking, Life Assurance Company, Stockbroker, and certain Authorised Investment Intermediaries.

94 Section 784A sets out a list of entities that can act as a QFM and they must inform the Revenue Commissioners to do so.

95 It is important to note that the TCA (Section 784A(1)(b)) provides that ‘references to an approved retirement fund shall be construed as a reference to assets in an approved retirement fund which are managed for an individual by a qualifying fund manager and which are beneficially owned by the individual’.

96 While none of the insolvency processes require an individual to hand over her/his investment in a pension scheme (described as a pension pot), an ARF is not a pension pot in this context nor is a vested PRSA and may be taken into account in the arrangements.

97 Office of the Revenue Commissioners approval of PRSA products under Section 787K TCA 1997.

98 Grant of approval of a PRSA product and code of conduct under Section 94 Pensions Act 1990.
Any funds remaining, after the transfer to an AMRF, may be invested in an ARF. Up to 4 per cent of the value of the assets in an AMRF can be drawn down in any year, subject to taxation at the AMRF owner’s marginal tax rate. Other than the maximum 4 per cent withdrawal from the AMRF each year, the capital in the AMRF cannot be accessed until the owner reaches 75 years of age (unless the owner wishes to purchase an annuity or the owner satisfies the guaranteed pension income requirement before then), at which point the AMRF becomes an ARF with unrestricted access to the funds, subject to taxation on drawdown.

The basic conditions around access to an ARF and the requirements to invest in an AMRF have not, in effect, changed since the introduction of the flexible option regime in 1999. There is no clear relationship between some of the conditions and requirements for investing in an ARF/AMRF. Increases in the State pension now mean the AMRF requirement is not binding in the case where an individual has reached State pension age and is entitled to the full State pension (though this is a large proportion of State pension recipients, about one-third are not entitled to the maximum rate).

**EET Regime & Imputed Distributions**

As discussed in Chapter 4, Ireland’s tax incentive model (EET) relies on taxing pension drawdown (albeit at lower effective rates than income at working age). This tax deferral model relies on individuals having taxable income in retirement. The OECD (2018a, p. 13) advocated as part of its policy guidelines that:

Countries where pension benefits and withdrawals are tax exempt may consider restricting the choice of the post-retirement product when granting financial incentives. [...] If however withdrawals are tax exempt, there is no financial disincentive for withdrawing early or taking a lump sum. [...] To counter this, policy makers could restrict the choice of when and how to withdraw the money; take back part or all of the financial incentives when individuals take a lump sum or withdraw early; or promote selected post-retirement products that are more in line with the objective of people having a retirement income.

In 2005, an internal review of tax relief for pension provision was conducted by the Department of Finance, in conjunction with the Office of the Revenue Commissioners, as part of a broad review of tax relief schemes. The Review found among other things, that the ARF option was not being used as intended, to fund an income stream in retirement, but as a form of wealth and estate planning (it should

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99 In Finance Act 2011 (Section 19(2)), the specified income limit of €12,700 and the AMRF maximum ‘set-aside’ amount of €63,500 were increased significantly to €18,000 and €119,800, respectively, based on a multiple of the State Pension (Contributory). These increases were subsequently rescinded by Finance Act 2013 (Section 17(2)) as it was decided that there were insufficient transitional arrangements in place for the magnitude of the changes introduced in Finance Act 2011.

100 Budget 2006 Review of Tax Schemes – Volume III Internal Review of certain tax schemes (Section G).
be noted that at this stage ARF access was restricted to proprietary directors and individuals contributing to RACs) (Department of Finance, 2006). On foot of the 2005 review, changes were introduced in Budget and Finance Act 2006.

6.20 To ensure that the ARF was being used as intended, and in an effort to limit its attractiveness as a vehicle for indefinite deferral of tax, the imputed distribution regime was introduced. It came into effect from 2007 and applies to ARF owners who are 60 years or over for the whole of a tax year. It was phased in - from 2007 to 2009: 1 per cent in 2007; 2 per cent in 2008; and 3 per cent from 2009. The rate applicable in 2010 and 2011 was 5 per cent. The notional amount is taxed at the ARF owner's marginal income tax rate. Funds actually drawn down by an ARF owner are credited against the imputed distribution in that year to arrive at a net imputed amount, if any, for the year. In respect of ARFs with values of over €2 million, Finance Acts 2011 and 2012 increased the rate of the notional distribution to 5 per cent, and 6 per cent respectively. To reduce the risk that individuals in the age group of 60 to 70 years might outlive their ARF funds, Finance Act 2014 reduced the 5 per cent rate to 4 per cent for ARF owners under the age of 70, where the value of assets in their ARF is €2 million or less. ARF owners are taxed on an imputed distribution, and therefore are not under any obligation to actually draw down funds (anecdotally, it is understood that individuals generally draw down an actual amount at least equal to the level of the imputed distribution, as otherwise they would effectively be paying tax twice on the same amount when eventually drawn down).

Analysis of ARF Data

6.21 There is limited data available on ARFs. Though QFMIs are required to make tax returns in relation to imputed distributions, this information is not available in a consolidated fashion from the Office of the Revenue Commissioners. The Office of the Revenue Commissioners estimates that there are circa 70,000 ARFs and just over 40,000 AMRFs as of the end of 2019, containing assets valued at €12.5 billion and €2.5 billion respectively. It should also be noted separately that there are currently tens of billions of pension savings in DC schemes and products. Accounting for lump sum payments and some proportion of annuity purchases, a large proportion of these savings are likely to be channelled into ARFs.

6.22 Market facing evidence and some sample data suggest that the median ARF fund size is small in relative terms (particularly for insured ARFs). This, coupled with the large number of AMRFs, suggests a considerable volume of low value ARFs. In terms of asset allocation, there is little if any data available. Again, current information suggests a substantial allocation to cash deposits and other low-risk / low-return assets.

6.23 Reflecting the poor quality of available data, the Group’s consultation paper sought stakeholder views on improving data collection. There was general support for such an approach but many responses
cautioned against unduly onerous and costly requirements which would invariably lead to higher costs for consumers.\textsuperscript{101}

\textit{Conclusions:}

- ARF providers (or in the event that the ARF is replaced by a combination of in-scheme drawdown and a re-designed PRSA) and PRSA providers should be required to make annual data returns to the relevant regulatory authorities. Returns should include, \textit{inter alia}, ARF numbers, drawdown levels and distribution, asset allocation and fees.

\section*{Taxable Cash, ARF, or Annuity}

At retirement, savers are entitled to a tax-free lump sum from their pension savings, the scale of which depends on the nature of their pension (see discussion in 4.28 – 4.31). DC occupational pension schemes and BOBs both offer the choice of a tax-free lump sum at the highest of up to 25 per cent of the accumulated fund or up to 1.5 times the individual’s final salary depending on service, subject to an overall limit of €200,000. On the other hand, PRSAs and RACs can only offer a tax-free lump sum of up to 25 per cent of the accumulated fund. The options available to an individual having taken a tax-free lump sum are to withdraw additional cash which is taxable, invest in an ARF, or invest in an annuity.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{annuity_costs.png}
\caption{Trend in Annuity Costs}
\end{figure}

\textit{This data was sourced from Insurance Ireland and is meant to be indicative of the increase in annuity costs over recent times.}

\textsuperscript{101} There is a trade-off regarding the collection of data for analytical and policy-making purposes and on the other hand increasing the regulatory and administrative burden.
6.25 Figure 33 shows that the availability of the ARF is dependent on the pension arrangement in place.\textsuperscript{102} Once the ARF option is chosen, an individual must take the tax-free lump sum in the form of up to 25 per cent of the fund subject to a lifetime limit of €200,000.

<table>
<thead>
<tr>
<th>Pension Type</th>
<th>Tax-Free Lump Sum Available</th>
<th>ARF</th>
<th>Annuity</th>
</tr>
</thead>
<tbody>
<tr>
<td>DB Scheme</td>
<td>1.5 x Final Salary (Based on Service)*</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>DB (Proprietary Director)</td>
<td>1.5 x Final Salary (Based on Service)*</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>DC Scheme</td>
<td>1.5 x Final Salary (Based on Service)*</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>BOB</td>
<td>1.5 x Final Salary (Based on Service)*</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>PRSA</td>
<td>Up to 25% of Accumulated Fund</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>RAC</td>
<td>Up to 25% of Accumulated Fund</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

*Minimum 20 years’ service

An annuity is a contract with a life insurance company that will pay a guaranteed, regular income for life in return for a capital sum from an individual’s retirement fund. While longstanding studies suggest that individuals should prefer annuities to ARFs, that is not the case - termed the ‘annuity puzzle’.\textsuperscript{103} Notwithstanding that purchasing an annuity eliminates, for the purchaser, longevity and investment risk, it is likely that the objective of maximising one’s tax-free lump sum, the perceived poor value of annuities and a bequest motive tips the balance of consumer decisions in favour of ARFs.

6.27 Figure 34 which is taken from a Review of the Irish Annuities Market (Indecon, 2007) sets out a qualitative comparison between ARF and annuity from a consumer perspective.

\textsuperscript{102} Chapter 3 recommends that the link between lump sum calculation (salary and service or 25% of fund) and drawdown product should be broken. This would allow those who choose a salary and service based lump sum to access an ARF.

\textsuperscript{103} The ‘annuity puzzle’ is a phenomenon that has been widely studied by economists. This interest was spurred by Yaari (1965) in his paper Uncertain Lifetime, Life Insurance, and the Theory of the Consumer, in which he demonstrated that it is rational for people to turn their wealth into lifetime income – that is, annuitise.
6.28 Annuities have been an active market in Ireland and the UK for a long time. However, as life expectancy has increased, what used to be a short-to-medium term product of 7 or 8 years is now a long-term product of 20 years or more. From the provider’s point of view, this has greatly increased the risk and, therefore, has increased costs. From the retiree’s point of view, it is worth considering whether it is practical to insure against all significant risk over such a long period. It is unlikely that such insurance can ever be provided at an attractive price.

6.29 There have been suggestions that some of the issues surrounding annuities could be addressed by product innovation. Discussions around new products have generally explored two approaches – impaired life annuities and some type of deferred annuity product. Impaired life annuities are annuity products that offer better rates to customers with lower life expectancy, but by definition, the numbers qualifying for such annuities are not large. A deferred annuity product provides an income that would start at a later age, say 80. A retiree would use part of his or her retirement benefits to secure such a deferred income and would use the balance on an ARF-basis to provide income until that time. While there is no technical reason why such products could not be available today, they are not being widely offered at present due to the current low level of demand.

6.30 In assessing drawdown, the OECD (2018b, p. 31) noted that:

Individuals find it difficult to smooth their consumption post retirement – there is evidence from Australia that retirees underspend because they are afraid of exhausting their savings.

Some longevity protection can be added to DC systems – the OECD Roadmap for the Good Design of DC Pension Plans recommends a combination of programmed withdrawals with a deferred life annuity as a default option for the pay-out phase – but payments must necessarily be lower if they have to last over a longer period.
The Group is of the view that annuities continue to serve a purpose and represent a viable option for pension savers. Communicating the value of an annuity is challenging but important, and this is discussed further below. Deferred annuities are a logically attractive option but are not currently being offered by the market. It is likely that for deferred annuities to become a viable option for consumers, they would need to be mandated by government as either a default option or as a condition of accessing an ARF (e.g. an AMRF alternative).

Conclusions:

- Annuities continue to serve a purpose and any revised regulatory and advice requirements should include highlighting the merits of annuities in providing guaranteed income for life.

International Drawdown Approaches

Figure 35 sets out pre and post retirement regimes in a number of countries. Similar to Ireland, most of these countries provide an option of purchasing an annuity at retirement. This shows that in the current climate, as in Ireland, annuity purchases are declining globally. The range of post-retirement products vary from country to country with some, for example the UK and New Zealand, providing an option of taking the full fund while others provide specific drawdown products to ensure an income stream in retirement.

<table>
<thead>
<tr>
<th>Country</th>
<th>Decumulation Options</th>
</tr>
</thead>
</table>
| UK (EET)    | ‘Pension Freedoms’ were introduced in the UK in 2015 and saw a relaxation in pension drawdown rules for those aged 55 years and over (Cumbo, 2019). At the same time, a free and impartial government service called ‘Pension Wise’ was established, provided by the Pensions Advisory Service in partnership with Citizens Advice (Pensions Advisory Service, 2019). Pension Wise gives guidance on DC pensions over the phone or face-to-face (Pensions Advisory Service, 2019). Prior to this change, tax restrictions ensured that the majority of the 400,000 people retiring each year bought an annuity, sold by insurers, to secure their retirement income for life (Cumbo, 2019).

In 2019, the Financial Conduct Authority (FCA, 2019) carried out a review of the new regime, which showed that from April 2015 to March 2019, over 1.8 million DC pension pots were accessed. From April 2018 to March 2019:

- Just over 645,000 pension plans were accessed to buy an annuity, move into drawdown or take a first cash withdrawal in 2018/19.
- There were 74,000 annuity purchases, which have continued to decline steadily as a proportion of all pension withdrawals.
- 4 in 10 of all the pension pots accessed had a value of less than £10,000.
- Over 350,000 pension pots were fully withdrawn at the first time of access; 90% of which were less than £30,000 in value.
- 48% of plans were accessed without regulated advice or guidance being taken by the plan holder. 37% of plans were accessed by plan holders who took regulated advice and 15% by plan holders who did not take advice but received Pension Wise guidance.

The Report shows that following pension freedoms, there has been a substantial shift away from annuities towards drawdown without advice (FCA, 2019). 48 per cent of plans were accessed without advice compared to 5 per cent before the freedoms.

Her Majesty’s Revenue & Customs (HMRC, 2019) data indicate that the number of individuals taking flexible drawdowns from pensions and their values are growing significantly from 159,000 and £1,770m in Q2 2016 (the first period of compulsory reporting) to 336,000 individuals with a total value of £2.75bn in Q2 2019. The number of payments went from 296,000 to 760,000 in the same periods. This shows that on average individuals are drawing down on more than one occasion.104

| Australia (TTE) | Australia requires compulsory contributions by employers to a private pension fund (superannuation) (OECD, 2008b). Retirees have the option to withdraw their savings as cash (all at once or in stages), to invest in a retirement income stream, to leave their money in their superannuation fund for a time, or they can combine options (OECD, 2008b). The retirement income stream option is available through account-based pensions (similar to ARFs) and annuities (Australian Securities & Investment Commission (ASIC), 2019). Account-based pensions are dominant. They have a minimum annual withdrawal requirement, which is age-dependent (ASIC, 2019).

The Australian Government is developing legislation to facilitate trustees of superannuation funds in providing pre-selected Comprehensive Income Products for Retirement (CIPR) to help guide members at retirement and improve outcomes for retirees; including through increased private retirement incomes, increased consumer choice, and better protection against longevity and other risks (Australian Government, 2016). The Government has also committed to introducing a ‘retirement income covenant’; this will codify requirements and obligations for superannuation trustees to improve retirement outcomes for individuals (Australian Government, 2018). |

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104 On 4 March 2020, the outgoing chief executive of the Financial Conduct Authority, Andrew Bailey said the general view at the regulator was pension freedoms had been “rushed through too quickly”. This was in reference to the fact that 370 firms have left the defined benefit transfer sector over the past two years, totalling 12 per cent of the entire market. He added that “we have a large investigation ongoing surrounding a large number of other firms where we believe there looks like there was mis-selling.” https://www.ftadviser.com/regulation/2020/03/04/370-firms-have-left-db-market-bailey-tells-mps/
### NZ (TTE)
An Automatic Enrolment pension system, known as ‘Kiwisaver’, was introduced in New Zealand in 2007. Upon becoming eligible, usually at age 65, members can take their savings as a lump sum to spend or invest elsewhere, for example, in term deposit or savings accounts. They also have the option of leaving their money in their Kiwisaver, with some accounts allowing for regular withdrawals or larger periodic withdrawals. These may be subject to minimum amounts depending on the provider’s requirements. Like Australia and Ireland, the annuities market in New Zealand appears to be very small (Rusconi, 2008).

### US (EET)
Two major forms of US DC plans are the 401(k), predominantly offered through employers, and the Individual Retirement Accounts (IRAs) which are mainly used for personal contributions or distributions from employer-sponsored plans (Phipps, 2019). There are tax penalties for early withdrawal and required minimum withdrawals apply from age 70½ or 72 even if you haven’t retired.\(^{105}\)

To remove a potential barrier to the use of deferred annuities, in 2014, the US softened rules around minimum withdrawal requirements for IRAs and 401(k)s in certain circumstances by allowing the lesser of $135,000 or 25 per cent of the fund to be put into a deferred annuity (called a qualified longevity annuity contract or QLAC) without the minimum withdrawal applying (Internal Revenue Service, 2019).

### Canada (EET)
Capital Accumulation Plans (CAPs), which facilitate tax assisted savings for retirement, have various decumulation products available to them, from annuities to life income funds (LIFs) and registered retirement income funds (RRIFs). These permit flexibility but do not guarantee an income for life (Laurentian Bank, 2019). Minimum withdrawals are required each year and the balance can continue to grow tax-free until withdrawn. In some cases, maximum withdrawals are specified (Laurentian Bank, 2019). Transfers to individually registered decumulation products offered by financial service providers and insurers are considerably more popular than annuities due to spending flexibility, broad investment choice, and savers retention of ownership of unspent capital (Laurentian Bank, 2019). Some DC schemes and other CAPs offer retirees a group RRIF/LIF through the scheme service provider but these are independent from the scheme (Laurentian Bank, 2019).

### 6.33
International decumulation options clearly show the decreasing popularity of annuitisation in response to low nominal annuity rates caused by historically low bond yields and increasing life expectancy. Policy makers have responded with flexible drawdown solutions which purport to offer better value,

\(^{105}\) Setting Every Community Up for Retirement Enhancement (SECURE) Act December 20, 2019 introduced changes, so if an individual’s 70th birthday is July 1, 2019 or later, s/he does not have to take withdrawals until s/he reaches age 72. [https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-required-minimum-distributions-rmds](https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-required-minimum-distributions-rmds)
but entail their own challenges as retirement cash flow decisions are left, to some degree, with the individual.

A New Approach to Drawdown: In-Scheme Drawdown & Whole-of-Life PRSA
Before assessing possible amendments to the ARF, the Group proposes that the ARF be replaced by a combination of in-scheme drawdown (on an optional basis) and a whole-of-life PRSA product.

Conclusions:

- The ARF option should be replaced by a combination of in-scheme drawdown and a re-designed PRSA product which operates as a whole-of-life product

In-Scheme Drawdown & Group ARFs

6.34 Action 3.14 of the Roadmap requires the Group to assess ‘the potential to facilitate group ARF products or in-scheme drawdown’. It is widely accepted, as reflected in consultation responses, that DC pension savers can face difficult decisions at the point of retirement. This challenge can be compounded where active occupational pension scheme trustees, who have guided or assisted members through the accumulation phase, play no role in decumulation decisions. Accordingly, individuals face making important financial decisions without support. This transition, from a pension scheme to an ARF, can result in needless costs with no provision for a default choice or for a fiduciary function.

6.35 It has been suggested that for the benefit of members, schemes and trustees should be given the option to remain engaged and involved with a member post-retirement. More generally, it is argued that having a trust-based arrangement available for drawdown could reduce costs for individual savers as schemes take advantage of economies of scale and potentially, in the case of in-scheme drawdown, eliminate the need for savers to sell-down assets and transition to an ARF. It is important to remember that any additional role for schemes or trustees, in supporting individuals managing their retirement funds, brings increased responsibilities and the nature of risks differ to those in the accumulation phase. Schemes should have the option, rather than an obligation, to provide such services.

6.36 Providing for drawdown or decumulation within a pension scheme could be achieved in various ways requiring trivial-to-substantive legislative change. A minimalist solution would be to add IORP to the definition of QFM. At the other end of the spectrum, provision could be made for schemes to pool risk in drawdown (this is a complex initiative and was not considered in detail by the Group). The

106 An alternative approach would be to amend the QFM regime. As part of our consultation process, Construction Executive Retirement Savings (CERS) put forward a more detailed version of an amended QFM regime, which would involve legislative changes and Pensions Authority regulation.
Group is supportive of providing for in-scheme drawdown where this activity is regulated, and appropriate rules are in place to cover, for example, the segregation of assets, scheme wind-up, and other issues.

6.37 In-scheme drawdown is clearly not an option for individuals with personal pension products. If, as proposed above, in-scheme drawdown is provided for on an opt-in basis, an additional cohort will also be precluded from availing of in-scheme drawdown. A potential solution would be to provide for the establishment of trust-based drawdown-only schemes, or ‘Group ARFs’. Such an approach would build on the Master Trust infrastructure currently being developed by the Pensions Authority (2018c; 2019a).

6.38 The Pensions Council has argued a number of times\(^{107}\) that providing for the availability of ‘Group ARFs’ could help lead to better outcomes for individuals in a number of ways including: by reducing charges for consumers achieved through economies of scale; allowing scheme members the benefit of independent scheme trustees’ support and oversight, and their ability to invest in quality-assured default options (also meaning less need for individual advice); providing consumers with access to investment options which are not normally available to individuals; facilitating improved communication with scheme members.

Conclusions:

- Legislative amendments should be considered to enable flexible in-scheme drawdown. The parameters for such an approach will be progressed by the Department of Social Protection and the Pensions Authority.
- Proposals should be advanced in parallel to allow for the provision of what is termed ‘Group ARFs’. The detail for such an approach will be progressed by the Department of Social Protection and the Pensions Authority.

Whole-of-Life PRSA

6.39 The Group is also of the view that the ARF should be replaced by a re-designed, whole-of-life PRSA product. The following is a non-exhaustive list of the benefits of this approach:

- Simplifies the pension landscape without losing functionality;
- Deals with the challenge of multiple provider types by setting out product related rules that would apply in addition to sector-specific rules;
- Should eliminate transaction costs in transitioning from accumulation to decumulation and avoid unnecessary / unwanted de-risking or liquidation of assets;

\(^{107}\) For example, the Pensions Council’s submission to the Pensions Authority Consultation on Pensions Reform (The Pensions Council, 2016b).
Chapter 6: Review of the Approved Retirement Fund

- The concept of drawdown from PRSA already exists in the form of the Vested PRSA.
- Would re-centre drawdown product rules in pension and financial regulatory legislation while ensuring tax legislation focuses on taxation (for example, removing the Qualifying Fund Manager designation from the Taxes Consolidation Act);
- The PRSA is already identified explicitly in consumer protection legislation and guidance (for example, it is covered by the Central Bank’s Consumer Protection Code 2012 and is listed in Section 2 of the Investment Intermediaries Act 1995, thus ensuring it is an eligible instrument for the Investor Compensation Scheme);
- There is a more comprehensive product approval process in place for the PRSA;
- The additional requirements imposed on providers will improve data capture;
- Potentially provides an appropriately regulated destination for Automatic Enrolment savings.

There are also some potential risks and challenges:

- Existing assets destined for ARFs may not be PRSA compatible;
- The charging and investment rules currently applying to the PRSA may not be appropriate to an ARF.

Conclusions:

- IDPRTG members will advance technical proposals regarding the replacement of the ARF with a whole-of-life PRSA product.

Reform of the Product Design

6.40 This section of the review will examine particular features of the ARF product design and potential reforms to the product or a whole-of-life replacement product.

ARF Access

6.41 DB scheme members who are not proprietary directors are the only remaining group prohibited from accessing an ARF. A number of respondents to the consultation process suggested that ARF access should be extended to all. However, providing such access to all DB schemes is fraught with challenges. The collective nature of DB schemes and the cash-flow, valuation / asset sale, and solvency considerations introduce a level of complexity and risk which, in the view of the Group, outweigh the merit in ensuring consistency of benefit across all beneficiaries. Accordingly, no change is proposed.

AMRF Requirement

6.42 With the current level of the State pension contributory, for the majority of people, once they reach the age at which they can access the State pension entitlement, the ARMF requirement has become
redundant (the State pension now exceeds the specified income requirement).\textsuperscript{108} In such cases where there is an AMRF in place, it then becomes an ARF. In any event, there is no link between the capital sum required to be transferred to an AMRF and the specified income requirement. Consideration must be given either to reforming the AMRF requirement to ensure it achieves its initial objective or to proposing its abolition.

6.43 Options for reforming the AMRF requirement include re-calibrating the current regime by adjusting the specified income requirement and the age limit, introducing a maximum annual drawdown level, or requiring ARF investors to purchase a deferred annuity for a specified amount. The OECD (2018b, p. 171) recently recommended that:

A combination of programmed withdrawals, offering flexibility during the first years in retirement, with a deferred life annuity starting payments at the age of e.g. 85, offering protection against the tail risk of longevity, could be considered as an appropriate default post-retirement product.

6.44 The IDPRTG consultation paper sought the views of respondents on the need to replace or reform the AMRF. Most responses focused on the need to abolish the AMRF requirement with few responses focusing on an alternative mechanism. However, there was some support for the annual drawdown limit. There were few suggestions requiring savers to purchase an annuity, deferred or otherwise, even though a deferred annuity would appear, on the face of it, to effectively address concerns surrounding longevity risk.

6.45 Reflecting the earlier discussion on the evolution of the ARF into a mass market product, and the large volume of smaller ARFs, there is a weaker basis for requiring savers to defer what could be a significant proportion or a majority of their funds until they reach the age of 75. Any recommendation to remove the AMRF requirement should be linked to the broader question of the need for, and role of, financial advice at retirement. This issue is addressed in more detail below, but an effective regime of retirement and post-retirement advice might achieve the policy objective which gave rise to the AMRF – assisting retirees in avoiding outliving their savings.

Conclusions:

- On the basis that reforms in relation to regulation and advice are accepted, progressed and executed, the AMRF should be abolished.

\textsuperscript{108} Additional reforms to the State pension, including the commitment in the Roadmap to maintain a link with average earnings, further strengthens the State pension as a basic income support for individuals in retirement. 2020 SPC rate is €12,912 p.a.
Transition for Existing AMRFs

6.46 An AMRF automatically becomes an ARF where the individual turns 75, is in receipt of the specified income amount, or dies. As such, a transition for existing AMRFs to become ARFs on the removal of the AMRF requirement should generally be seamless and no specific arrangements are required to be put in place. In practice, the primary impact is the inclusion of AMRF funds within the imputed distribution requirements. At present, AMRFs are not included in the imputed distribution regime. While this may not suit those who are trying to defer drawdown as long as possible for estate planning purposes, it is less likely to be of significant impact to others, particularly those who do not have a minimum guaranteed income.

Phased Retirement

6.47 Some responses to the Group’s public consultation suggested allowing additional flexibility in terms of drawing pension benefits at and around retirement. As work patterns evolve, retirement will, for many, cease to be a point in time but rather something that happens over a period of time. Amending pension and tax rules to reflect this makes sense and is consistent with Strand 6 of the Roadmap ‘Supporting Fuller Working Lives’. The UK, for example, has introduced a number of reforms in this area such as the Uncrystallised Funds Pension Lump Sum (UFPLS) which provides for a quarter of all drawdown amounts to be taken tax-free with the remaining three quarters taxed at an individual’s marginal rate. UFPLS is a way of taking cash lump sums from a pension without purchasing a product.

6.48 Having reflected on the issue, the Group is of the view that while this is an area worthy of consideration in the future, no immediate changes are being recommended. The ARF product offers significant flexibility in itself and when combined with the earlier recommendation in this report to allow those who choose a salary and service based lump sum to access the ARF, it further enhances this flexibility.

Drawdown Process / Imputed Distribution

6.49 Imputed distribution arrangements were introduced in Finance Act 2006 to require withdrawals from ARFs so that they would be used as intended – to fund an income stream in retirement. This requirement also applies to vested PRSAs. Interestingly, as discussed in Figure 36, work carried out in 2017 by Nivakoski and Barrett of the ESRI shows no evidence of decumulation of wealth generally in retirement. However, it is also stated that due to imperfect data, further work is needed in this area.
Basic economic theory assumes that people accumulate wealth during working years and then draw on these assets to finance consumption in retirement. However, international research has found very little evidence of wealth decumulation in older age. In contrast, wealth accumulation has been found to continue in retirement years, especially among wealthier households with high post-retirement incomes. The explanations put forward include the desire to leave an inheritance, precautionary saving, biases affecting decision-making and a high proportion of wealth held in illiquid forms. Some exceptions to these general findings on decumulation include the following examples from previous studies: decumulation of financial wealth in the case of health shocks, and of housing wealth among the over 80s.

The ESRI’s research examines the evolution of wealth among older Irish households. They investigate financial assets and housing wealth holdings, using data gathered by TILDA from households aged 66 years or older. They find that, in any given survey year, wealth holdings are negatively related to age which might suggest decumulation. However, this is a cohort effect: those born in later years are more likely to have financial asset holdings and are wealthier. When wealth is examined over time (from 2010 to 2016), tracking the same households, generally no evidence of decumulation is found. Examination of specific wealth types reveals that for the retired population as a whole, saving/deposit account balances accumulate over time, while housing wealth decumulates among single households aged 85 and over. Differences in the paths of financial asset evolution are found for sub-groups of the population: households experiencing negative health shocks decumulate financial wealth, while households with supplementary pension income accumulate financial wealth. While these results suggest that fears over rapid asset decumulation among retirees might be misplaced, it should be noted that the data is imperfect and so further work is needed.

Source: Nivakoski and Barrett, 2017

Designing an imputed distribution regime involves compromising between two competing objectives: on the one hand ensuring the integrity of the EET tax incentive system by requiring income drawdown and on the other hand ensuring against ‘bomb-out’ risk. Changes in life expectancy, increased investment risk aversion related to ageing and rules around drawdown ages must be factored in.

Perhaps because savers understand this in a general sense, the OECD has noted, drawing on the example of Australia, that where individuals control the level of drawdown or where this is dictated by law, there is a concern that ‘individuals are self-insuring against longevity risk at a high cost when measured in terms of foregone income’ (OECD, 2018b, p. 166).
6.51 Some consultation responses included concerns that the requirement to draw down 4 percent of an ARF could be detrimental and increase an individual’s exposure to ‘bomb-out’ risk, which is the risk of the fund running out. In a discussion of the topic, the Society of Actuaries in Ireland (2015) suggested (based on a number of assumptions) that the current regime could be requiring an inappropriately high level of drawdown in earlier years. The corollary of such an assessment is that drawdown requirements at later ages are too low. Figure 37 sets out a number of approaches to mandatory drawdown, though it should be noted that these results are highly sensitive to assumptions around life expectancy and investment return.

6.52 Sun & Webb (2012)\textsuperscript{110} assess various approaches to managing the rate of wealth decumulation in retirement. Compared against an optimal drawdown design, common alternatives such as decumulating over the household’s life expectancy, spending the investment income only or consuming a fixed 4 percent of initial wealth, underperform this model and in the order listed. However, the OECD 2018 Pensions Outlook state that ‘accumulation and pay-out phases need to be internally coherent. For example, flexibility in the pay-out phase may not make sense when participation is mandatory or financially incentivised’.

6.53 The attractiveness of the current imputed distribution regime is its simplicity. Having considered these issues the Group is of the view that the imputed distribution regime should be retained and that further work in this area should be considered.

**ARF Treatment on Death**

6.54 The position regarding IT and CT on the death of the ARF holder, and on the subsequent death of the spouse/civil partner into whose ARF the original ARF was transferred, is summarised in Figure 38 (usual CAT tax-free thresholds apply).\textsuperscript{111} Any payment, or imputed payment, from an ARF following

\textsuperscript{110} This is referenced in, and in part underpins, the analysis in OECD (2018).

\textsuperscript{111} Current CAT Thresholds for inheritances/gifts taken on or after 09/10/2019: A-€335,000; B-€32,500; C-€16,250.
the death of the ARF owner is a distribution and is taxable as such and the distribution is treated as income of the ARF owner for the year of assessment in which he or she dies.

Figure 38: Tax treatment of ARF on death

<table>
<thead>
<tr>
<th>Beneficiary</th>
<th>Death of Holder</th>
<th>Death of Spouse/Civil Partner</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Income Tax</td>
<td>CAT</td>
</tr>
<tr>
<td>Spouse/Civil Partner</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Child under 21</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Child 21 or over</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Other</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>


6.55 As seen in Figure 38, benefits payable from AMRFs/ARFs can be passed to a spouse or civil partner without payment of CAT or IT (a tax rate of 30 per cent applies subsequently on the death of the spouse or civil partner). Benefits payable to a child under 21 are subject to CAT but not to IT. Benefits payable to a child over 21, either from the original ARF or subsequent to a transfer to a spouse/civil partner, are subject to income tax at the rate of 30 per cent (which is a ring-fenced final liability tax).

6.56 Funds within an ARF represent tax relieved funds and these funds are also accumulated on a tax-free basis. There are few grounds for this concessionary inheritance treatment of ARFs, in that benefits payable to a child attract either IT or CAT as opposed to both. This acts as a disincentive to drawdown in retirement and, in doing so, undermines the integrity of the EET tax regime. The Group is of the view that this CAT treatment should be amended to ensure that both IT and CAT apply to ARFs where ARF proceeds are inherited by a child. This will encourage the deployment of tax incentivised pension savings as intended; to provide an income in retirement.

Conclusions:

- ARF assets should be treated for inheritance tax purposes in the same way as other assets where inherited by anyone other than the individual’s spouse or civil partner. Both Income Tax and Capital Acquisitions Tax should apply.

Regulation & Advice

6.57 The ARF (and AMRF) is a construct of tax law. A QFM, the permitted provider of an ARF, is also defined in the TCA. Once an entity applying to be a QFM falls within the legislative definition it qualifies
as a QFM. Though such entities are financial service providers, and regulated by the Central Bank of Ireland, there is no approval process for QFMs.

6.58 Although the products in which most ARF holders invest are typically sold by regulated entities (entities generally regulated by the Central Bank of Ireland), ARFs may also hold unregulated assets (e.g. property). The ARF itself is not a regulated product and it is not specifically referenced in the Central Bank’s Consumer Protection Code 2012 (Central Bank of Ireland, 2015).112

6.59 Retirement planning involves a process of forecasting cash flows and balancing risks. The majority of consumers are not well equipped to decide appropriate levels of drawdown and how to factor financial risks, life expectancy and health issues into this decision. Market facing evidence suggests that people overestimate the level of a reliable rate of return and under estimate their life expectancy. Insofar as ARFs require ongoing decisions (especially with regard to the appropriate amount of income to draw down and larger encashments to meet medical or care costs) there is no direct provision in the event of cognitive decline.

6.60 To summarise, ARFs tend to invest in products sold by regulated providers. However, financial services legislation and regulation only make limited specific reference to ARFs. Given the unique nature of ARFs, the scale of the sums involved, and the complexity of decisions facing consumers, there is a strong case for more explicit regulatory treatment of ARFs.

Advice

6.61 The need for independent financial advice in the lead up to, at the point of, and during retirement is widely accepted. Improving the availability of appropriate advice for pension savers received significant support in consultation responses. The lack of harmonisation among products, particularly with respect to taxation treatment, further complicates these choices. Most people do not have the financial knowledge or experience to effectively manage these challenges.

6.62 Currently, a consumer is not required to obtain advice before investing in an ARF; it is up to the individual to seek advice including appropriate information needed to make an informed decision. Many ARF providers advocate that consumers do seek independent financial advice (particularly in relation to retirement needs) and resources are provided on an ad hoc basis to assist them in finding financial advisers/brokers. Providers can, and generally do, offer information guides with generic advice, and sometimes useful tools such as pension and risk calculators. However, unless an individual is already somewhat informed, this information can often be confusing, misunderstood or ignored. On the other hand, some providers will offer investment strategy advice and manage the fund on behalf of the consumer.

6.63 The complexity of decisions required, emphasises the critical importance of having easily accessible, independent, clear, and focused information available prior (ideally well in advance) to making a

112 Investment and insurance intermediaries involved in the sale of ARFs are subject to the Central Bank’s conduct of business regulations and the ARF is explicitly referenced in the Central Bank’s Minimum Competency Code (from 2006 onwards – the latest version is from 2017) which sets out minimum professional standards for persons providing certain financial services.
decision which could have tax, legal or other financial implications. The means of providing this information, whether it should be mandatory, the cost and how it is paid for, all need to be addressed. In particular, the scale of small ARFs suggests that the cost of appropriate financial advice would appear disproportionately high to many. Financial literacy levels may also limit the effectiveness of advice. Requiring a decumulation product provider to incorporate a default option for savers could address some of these problems. However, what this default option would be and who would take responsibility for designing it brings with it challenges of its own. Advice requirements in the forthcoming PEPP product is mandatory and provided at three key stages. As discussed, a broadly similar approach could be taken in relation to ARFs.

6.64 Advice is not just necessary at the point of purchase but also during retirement. It is evident that the ARF advice landscape is deficient and can create negative outcomes for some consumers. By way of illustration, Figure 39 sets out how advice requirements are addressed in the recent PEPP proposal. While the PEPP Regulation includes provision for advice at pre-retirement and at retirement, it does not provide for on-going advice during decumulation.

Figure 39: PEPP advice requirements

Advice Requirements and PEPP

To explore what a future advice landscape could look like, we consider how the provision of advice applies in the new Pan-European Personal Pension Product (PEPP). Advice under PEPP is mandatory and is required to be given by PEPP providers/distributors at three key stages:

1. Prior to the conclusion of the PEPP contract;
2. Prior to switching PEPP providers;
3. During the pre-retirement phase and at decumulation.

‘Advice’ in this context means the provision of a personal recommendation to a PEPP customer. This advice should take into account:

- The long-term retirement nature of the product, the individual demands/needs of the saver (based on information provided by the saver);
- The limited redeemability of the product;
- The savers risk tolerance and ability to bear losses (having asked the saver about their knowledge and experience in the investment field relevant to the PEPP offered/demanded, their financial situation and their investment objectives).

This advice should also inform the saver about the features of investment options, the level of capital protection and the types of out payments. It should also be objective and provided in a comprehensible

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113 In 2017, the European Commission published a proposal for a Pan-European Personal Pension Product (PEPP). The aim of the proposal is to lay the foundations for a safer, more cost-efficient and transparent market in affordable and voluntary personal pension savings that can be managed on a pan-European scale. It is expected that the first PEPPs will come to market by 2022.
form. The provision of this advice may be automated or semi-automated but this does not diminish the responsibilities of the PEPP provider or PEPP distributor with respect to the above.

At the decumulation phase, a PEPP provider/distributor should offer the PEPP saver personal retirement planning on the suitable use of the capital accumulated in the PEPP based on:

- The value of the capital accumulated in the PEPP;
- The total amount of other accrued retirement entitlements;
- The long-term retirement-related demands and needs of the PEPP saver.

The retirement planning should also include a personal recommendation to the PEPP saver on his/her optimal form of out payments, unless only one form of out payment is provided. If a lump sum payment is not in-line with the retirement-related needs of the PEPP saver, the advice shall be accompanied by a warning to that end. Notably, the right to advice at the decumulation phase can be waived by the consumer.

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**Charging**

6.65 Market information suggests that individuals may not fully understand the nature and source of charges applying to them and so may needlessly hold multiple ARFs. Disclosure rules can sometimes be confusing and ARFs also fall outside the scope of the EU Regulation on Packaged Retail Investment and Insurance Products (PRIIPs), 2014.\(^\text{114}\)

6.66 A number of previous reports have addressed pension charges generally, including the *Green Paper on Pensions* in 2007 and the *Report on Pension Charges in Ireland* in 2012 (Department of Social and Family Affairs, 2007; Department of Social Protection, 2012). The 2007 report highlighted the lack of detailed information on the cost of providing funded supplementary pension arrangements in a voluntary regime in Ireland. The 2012 report noted the lack of a culture of clear and transparent information provision to the consumer, which also impacts on competitiveness in the market.

6.67 The Pensions Council (2016a) subsequently published its report on ARF Charges which was limited to ARFs provided by insurers. Comparing charges for twenty-three ARF products offered by six different life assurance companies identified a wide variation in charges associated with ARF products, which in some cases would reduce or even eliminate the investment return earned by the ARF (The Pensions Council, 2016a). In highlighting the disparity in charging, the report noted the value of shopping around but also noted that the pricing information contained in the report is not normally available to consumers or to intermediaries who provide advice on ARF choices (The Pensions Council, 2016a).

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\(^\text{114}\) Packaged retail investment and insurance-based products are a category of financial assets provided to consumers in the EU as an alternative to savings accounts. Regulations were put into place as of 2018 for new calculation methodologies and transparency requirements for investment products across the EU.
6.68 The IDPRTG recommends that the ARF product should be replaced by a reconstituted, whole-of-life PRSA. The current PRSA design includes charging caps and the applicability of such charging caps in the context of a whole-of-life product would have to be considered should the ARF be replaced by the PRSA.

**Investor Protection**

6.69 The Investor Compensation Scheme (ICS) protects clients of an investment firm that goes out of business and provides compensation of 90 per cent of the net loss, up to a maximum amount of €20,000. It covers PRSAs\(^\text{115}\) but only applies to ARFs on a case-by-case basis. An ARF is not a defined investment instrument within the scope of the ICS and any compensation obligation would need to be considered on a case-by-case basis by an Administrator, appointed in accordance with the provisions of the Act, to validate claims received from clients of the relevant failed firm. To ensure that ARF holders are afforded the same investment protections as holders of PRSAs it is proposed that ARF products are explicitly added to the list of investment instruments eligible for compensation under the ICS. Accordingly, should the Group’s recommendation to replace the ARF with a re-designed PRSA be accepted, such a measure would not be necessary.

**Conclusions:**

- Replacing the ARF with a whole-of-life PRSA brings the ARF explicitly within the remit of the Consumer Protection Code. The IDPRTG should engage with the Central Bank of Ireland to advance proposals to improve the regulatory and advice framework as it applies to decumulation and a whole-of-life PRSA. This would address requirements on the nature and frequency of advice, disclosure requirements, and the applicability of existing PRSA charging caps.
- The ARF should be explicitly captured within Investor Compensation Scheme covered products in the event it is not replaced by a whole-of-life PRSA.

\(^{115}\) The investment instruments eligible for compensation under the ICS are set out in Section 2 of the Investment Intermediaries Act 1995 (IIA) and Schedule 1 Part 3 of the European Union (Markets in Financial Instruments) Regulations, 2017 (MiFID II). Section 2 of the IIA (1995) includes PRSAs which are therefore within-scope, subject to all other elements of the compensation obligation being satisfied in accordance with the Act.
7. Next Steps

Following publication of this Report it is intended to proceed as follows:

- IDPRTG will draft and agree an implementation plan to progress specific reform initiatives and conclusions in a structured, coherent manner;
- Commence implementation of those measures that can be easily accomplished;
- Consider and draft further engagement measures around more complex actions;
- Commence implementation of remaining measures.

These measures will be carried out in tandem with other pension-related developments currently in the pipeline:

- Automatic Enrolment framework design which is being progressed by the Department of Social Protection (DSP), with input from the Department of Business, Enterprise and Innovation (DBEI), Department of Public Expenditure and Reform (DPER) and the Department of Finance (DFIN).
- Transposition of IORP II by DSP which will introduce additional governance and regulatory standards.
8. Table of Conclusions

<table>
<thead>
<tr>
<th>Reforming &amp; Simplifying the Existing Supplementary Pension Landscape</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Revenue will review and update the Pensions Manual to reflect any changes introduced on foot of the Pensions Roadmap process.</td>
</tr>
<tr>
<td>2 BOBs and RACs should cease to be available as Third Pillar pension saving products on a prospective basis. The PRSA should operate as the sole personal pension product.</td>
</tr>
<tr>
<td>3 Existing BOBs and RACs should be allowed to run-off over time, retaining their existing product features, terms, and conditions. The proposed changes to the PRSA set out in Chapter 3 should facilitate transfers from BOBs.</td>
</tr>
<tr>
<td>4 In order to facilitate the prospective cessation of BOBs, the provision in the TCA banning transfers to PRSAs for scheme members with more than 15 years qualifying service should be removed.</td>
</tr>
<tr>
<td>5 In order to facilitate the prospective cessation of BOBs, Section 122(2) of the Pensions (Amendment) Act 2002, should be commenced in order to permit existing BOB holders to transfer to PRSAs.</td>
</tr>
<tr>
<td>6 Direct transfers from existing RACs to occupational pension schemes should be provided for.</td>
</tr>
<tr>
<td>7 Allowing discounts to be offered in the case of bulk transfers from schemes to PRSAs should be provided for.</td>
</tr>
<tr>
<td>8 Ring-fencing of lump sum benefits within a PRSA to allow for a salary and service based lump sum for the portion of assets related to a transfer in from an occupational scheme should be provided for.</td>
</tr>
<tr>
<td>9 The Pensions Authority will reconsider the requirements in relation to the provision of Certificates of Benefit Comparison, in particular in relation to transfers to PRSAs from DC arrangements, and make recommendations to the Department of Social Protection for legislative change where necessary.</td>
</tr>
<tr>
<td>10 In view of the recommendation to eliminate RACs on a prospective basis, the ability to avail of life cover, in-line with that which is currently provided for in Section 785 of the TCA with respect to RACs, should be retained. This could be provided for either on a standalone basis or as part of a PRSA.</td>
</tr>
<tr>
<td>11 As far as possible, and consistent with the objective of rationalisation and simplification, the transposition of the PEPP Regulation should aim to align with existing PRSA legislation. Any</td>
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</tbody>
</table>
State Support for Supplementary Pension Saving

1 Adequate and timely data is a pre-requisite for policy analysis. Supplementary pension policy, and pension provision more generally, is a key area of policy both in terms of Exchequer-impact and the well-being of the population. Further consideration is required in the area of pensions to specify and collect the necessary data to support policy analysis.

2 Like the majority of OECD and EU countries, Ireland has adopted an EET system of pension taxation. Such systems involve a long-run net cost which varies as a regime matures. The objective of this system of pension taxation is to encourage individuals to provide for later life and secure adequacy of income in retirement. Combining the scope and success of the State pension with a recognition that fiscal support for pension saving should be capped at a certain level of income, the focus of tax incentives for supplementary pension saving is on encouraging those on low-to-middle incomes to save for their retirement.

3 Due to limited data availability on some features of the pension regime in Ireland, accurately calculating the total cost of all tax reliefs is a challenge. However, it is clear that a net tax advantage exists for pension savers, as pension savings accumulate on a tax-free basis and effective tax rates are lower in retirement than pre-retirement. This benefit is highest, on a proportionate basis, at middle income levels with those on higher incomes also benefiting.

Measuring Success: Coverage & Adequacy

1 Though the State pension provides a basic and effective protection against pensioner poverty, it is not designed or intended to secure a high level of pension adequacy. Current policy aims to achieve a 50 per cent replacement rate of pre-retirement income for individuals in retirement, subject to a floor of 34 per cent of average earnings (provided by the State pension). This implies that the purpose of the supplementary pension system is to incentivise those on incomes above two times the State pension to provide for additional retirement income (this, in part, explains a coverage target of 70 per cent). The Department of Social Protection is currently reviewing the suitability of such a one-size-fits-all approach to replacement rates.

2 Supplementary pension coverage continues to be below the policy target of 70 per cent, with the most recent data indicating that the current level is around 57 per cent of those in employment aged 30 to 65. There is limited data available on pension adequacy but to the extent that it is available it suggests that for many, even those with pensions, they will likely experience a material fall versus pre-retirement living standards. It is also challenging to
determine whether, and to what extent, this represents a failure in existing saving incentives and the extent to which relief is afforded to savings that would be made anyway (deadweight). Clearly, for those who do not pay income tax there is no tax incentive. For those eligible for relief on contributions, other reasons such as affordability may explain some of the lack of coverage. However, research also indicates that tax incentives are poorly understood. International experience demonstrates that inertia is a key driver for the low take-up of supplementary pensions and that the introduction of mandatory or quasi-mandatory enrolment systems can quickly lead to significantly higher coverage rates. Finally, limiting the existing incentive framework could result in behavioural changes that reduce pension coverage or the quantum of pension saving.

3 Evaluating equity in the distribution of tax expenditures on pensions depends on how broadly or narrowly equity is defined. In a narrow sense, tax relief is regressive by nature - only those who pay tax qualify. Given the particular design of the Irish pension tax regime, including recent changes to limit reliefs at the higher end, middle income earners are the main beneficiaries of the current system of pension tax relief while a lower incentive is offered to lower income groups.

4 A broader definition of equity, factoring in the social insurance system (including the State pension) is necessary. This illustrates the scale and effectiveness of social transfers in the Irish system. The flat rate State pension represents far greater value to those with lower incomes.

5 The OECD’s work on the design of financial incentives has highlighted that financial incentives may need to be different for different population groups.

6 Automatic enrolment has the potential to address both the coverage and adequacy gaps set out here. Designing financial incentives for such a system is undoubtedly complex. A matching contribution by the State, depending on the design, could be more beneficial in relative terms to those on lower incomes. It may also be more easily understood than marginal tax relief.

7 Unless aligned, the operation of two incentive systems in parallel may raise potential difficulties in terms of arbitrage between the current system and the Automatic Enrolment system. In this regard the Automatic Enrolment Programme Board (AEPB) will consider proposals for Government in relation to the design of an appropriate incentive structure for Automatic Enrolment which will primarily target lower earners. This will take into account measures that could mitigate arbitrage between the two systems.

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**Review of the Approved Retirement Fund**

1 ARF providers (or in the event that the ARF is replaced by a combination of in-scheme drawdown and a re-designed PRSA product), and PRSA providers should be required to make annual returns to the relevant regulatory authorities. Returns should include, *inter alia*, data on ARF numbers, drawdown levels and distribution, asset allocation and fees.
<p>| | |</p>
<table>
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<tbody>
<tr>
<td>2</td>
<td>Annuities continue to serve a purpose and any revised regulatory and advice requirements should include highlighting the merits of annuities in providing guaranteed income for life.</td>
</tr>
<tr>
<td>3</td>
<td>The ‘ARF option’ should be replaced by a combination of in-scheme drawdown and a re-designed PRSA product that operates as a whole-of-life product.</td>
</tr>
<tr>
<td>4</td>
<td>Legislative amendments should be considered to enable flexible in-scheme drawdown. The parameters for such an approach will be progressed by the Department of Social Protection and the Pensions Authority.</td>
</tr>
<tr>
<td>5</td>
<td>Proposals should be advanced in parallel to allow for the provision of what is termed ‘Group ARFs’. The parameters for such an approach will be progressed by the Department of Social Protection and the Pensions Authority.</td>
</tr>
<tr>
<td>6</td>
<td>IDPRTG members will advance technical proposals regarding the replacement of the ARF with a whole-of-life PRSA product.</td>
</tr>
<tr>
<td>7</td>
<td>On the basis that reforms in relation to regulation and advice are accepted, progressed and executed, the AMRF should be abolished.</td>
</tr>
<tr>
<td>8</td>
<td>ARF assets should be treated for inheritance tax purposes in the same way as other assets where inherited by anyone other than the individual’s spouse. Both Income Tax and Capital Acquisitions Tax should apply.</td>
</tr>
<tr>
<td>9</td>
<td>Replacing the ARF with a whole-of-life PRSA brings the ARF explicitly within the remit of the Consumer Protection Code. As part of this process the IDPRTG should engage with the Central Bank of Ireland to advance proposals to improve the regulatory and advice framework as it applies to decumulation and a whole-of-life PRSA. This would address requirements on the nature and frequency of advice, disclosure requirements, and the applicability of existing PRSA charging caps.</td>
</tr>
<tr>
<td>10</td>
<td>The ARF should be explicitly captured within Investment Compensation Scheme covered products in the event it is not replaced by a whole-of-life PRSA.</td>
</tr>
</tbody>
</table>
9. Bibliography


95. Pensions Authority. (2019a). *Pensions Authority response to consultation on obligations for trustees of defined contribution (DC) master trusts*. Available at:


10. **Appendix 1**

**IDPRTG Terms of Reference**

1. **Context**

The Interdepartmental Pensions Reform & Taxation Group was established following a recommendation by the Pensions Authority to the Minister for Employment Affairs and Social Protection on foot of a national consultation process. The work of the group will primarily derive from the Roadmap for Pensions Reform 2018 – 2023 which sets out a number of tasks for the Group and timelines for completion.

2. **Membership**

The Group will be chaired by the Department of Finance and will include members from the following organisations:

   a. The Department of Employment Affairs and Social Protection
   b. The Department of Public Expenditure & Reform
   c. The Office of the Revenue Commissioners
   d. The Pensions Authority

As the tasks set out in the Roadmap are time-bound, sub groups will be established to ensure efficient and effective delivery on particular assignments. Where relevant or required, other organisations may be invited to attend meetings or join sub-groups on an ad-hoc basis.

3. **Reporting**

It is important that the Group has clearly defined reporting structures. It is envisaged that reporting in the first instance will be to the Minister for Finance, and Public Expenditure and Reform on a periodic basis. Updates will also be provided to the Minister for Employment Affairs and Social Protection.

4. **Responsibilities**

In line the Roadmap for Pensions Reform 2018 - 2023, published by Government in February 2018, the group will examine a number of defined areas under the IDPRTG allocated tasks. Those tasks are listed in date order in Appendix 1. The work of the group will not be limited to the areas defined in Appendix 1 and can be added to with the agreement of the Group over time but the initial focus will be on the Roadmap requirements.

5. **Review**

The terms of reference will be reviewed as required or within 12 months and amended if necessary.
### Relevant Extracts from the Roadmap for Pensions Reform 2018 – 2023

<table>
<thead>
<tr>
<th>Task Number</th>
<th>Action</th>
<th>Owner</th>
<th>Due Date Year</th>
<th>Due Date Quarter</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.2</td>
<td>A new process will be developed to require all new and existing schemes gain ‘authorised status’ from the Pensions Authority in order to carry out activities and to obtain tax relief. This process will require trustees to demonstrate compliance with new fitness and probity requirements and governance obligations (see below).</td>
<td>DEASP, PA, DFIN, RC</td>
<td>2018</td>
<td>Q2</td>
</tr>
<tr>
<td>3.13</td>
<td>Review the cost of funded supplementary pensions to the Exchequer. To inform decisions related to financial incentives for retirement savings and underpin the development of the automatic enrolment system (See Strand 2), this will include an assessment of the economic and social benefits delivered and an evaluation of equity in the distribution of tax expenditure on pensions.</td>
<td>IDPRTG</td>
<td>2018</td>
<td>Q3</td>
</tr>
<tr>
<td>3.11</td>
<td>The Interdepartmental Pensions Reform and Taxation Group will identify and progress measures to improve the harmonisation of rules to eliminate anomalies in the treatment of different retirement arrangements including taxation treatment.</td>
<td>IDPRTG</td>
<td>2018</td>
<td>Q4</td>
</tr>
<tr>
<td>3.14</td>
<td>Undertake a broad review of the utilisation of the Approved Retirement Fund (ARF) option and consider whether regulatory oversight of this product is fit for purpose. This will include a review of ARF criteria set out in tax legislation including specified minimum income requirements. It will also include identifying measures to address any provider/consumer protection gap and the potential to facilitate group ARF products or in-scheme drawdown.</td>
<td>IDPRTG</td>
<td>2018</td>
<td>Q4</td>
</tr>
<tr>
<td>6.6</td>
<td>The Interdepartmental Pensions Reform and Taxation Group (see Action 3.11) will review the legislation governing the various ages at which pensions can be drawn down together with any apparent anomalies arising in the treatment of different retirement arrangements with a view to a standardised upper age limit.</td>
<td>IDPRTG</td>
<td>2018</td>
<td>Q4</td>
</tr>
<tr>
<td>3.12</td>
<td>Identify the options and develop recommendations to coherently rationalise the number of individual pension vehicles which exist at present.</td>
<td>IDPRTG</td>
<td>2020</td>
<td>Q2</td>
</tr>
</tbody>
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### 11. Appendix 2

#### Public Consultation Questions

<table>
<thead>
<tr>
<th>Section A – Simplification &amp; Reform</th>
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<tbody>
<tr>
<td>Reduction in Pension Saving Vehicles</td>
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<tr>
<td>A1.</td>
</tr>
<tr>
<td>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?</td>
</tr>
<tr>
<td>A2.</td>
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<tr>
<td>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?</td>
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<tr>
<td>A3.</td>
</tr>
<tr>
<td>What changes would you recommend to the design of the PRSA product?</td>
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<tr>
<td>A4.</td>
</tr>
<tr>
<td>In terms of pension vehicle rationalisation, what impact could the introduction of the pan-European Personal Pension Product (PEPP) have?</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Harmonisation of Rules</th>
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<tbody>
<tr>
<td>A5.</td>
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<tr>
<td>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?</td>
</tr>
<tr>
<td>A6.</td>
</tr>
<tr>
<td>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?</td>
</tr>
<tr>
<td>A7.</td>
</tr>
<tr>
<td>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?</td>
</tr>
<tr>
<td>A8.</td>
</tr>
<tr>
<td>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?</td>
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<tr>
<td>A9.</td>
</tr>
</tbody>
</table>

### 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? |
| 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? |
| B3. | What adjustments, if any, could be made to marginal relief to best support the rollout of automatic enrolment? |
| 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? |
| B5. | In evaluating equity in the distribution of the economic and social benefits from this tax expenditure, what factors should be considered? |
| B6. | Should changes be made to the existing tax treatment of pensions in any of the following stages?  
- Tax treatment of employee contributions  
- Tax treatment of employer contributions  
- Tax treatment of growth in pension funds  
- Tax treatment of drawdown of pension  
If so, what kind of changes should be introduced and for what reasons? |

### Section C – Approved Retirement Funds

<p>| C1. | What, if any, limitations are appropriate for pension savers when drawing down benefits in retirement? Should the current suite of retirement savings drawdown |</p>
<table>
<thead>
<tr>
<th>Options</th>
<th>Description</th>
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<tbody>
<tr>
<td>C2.</td>
<td>What, if any, changes need to be made to ARF access, and why?</td>
</tr>
<tr>
<td>C3.</td>
<td>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 set-aside amount and should it vary? If so how? Should the conversion age of 75 be adjusted?</td>
</tr>
<tr>
<td>C4.</td>
<td>Are the current imputed distribution requirements appropriate? What changes, if any, would be appropriate?</td>
</tr>
<tr>
<td>C5.</td>
<td>To improve data capture and to facilitate the assessment of retirement outcomes, what additional returns should be required of Qualifying Fund Managers (QFMs)?</td>
</tr>
<tr>
<td>C6.</td>
<td>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?</td>
</tr>
<tr>
<td>C7.</td>
<td>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?</td>
</tr>
<tr>
<td>C8.</td>
<td>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?</td>
</tr>
</tbody>
</table>
# 12. Appendix 3

## Table of Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ARF</td>
<td>Approved Retirement Fund</td>
</tr>
<tr>
<td>AMRF</td>
<td>Approved Minimum Retirement Fund</td>
</tr>
<tr>
<td>AVC</td>
<td>Additional Voluntary Contribution</td>
</tr>
<tr>
<td>BIK</td>
<td>Benefit-in-Kind</td>
</tr>
<tr>
<td>BOB</td>
<td>Buy-Out Bond</td>
</tr>
<tr>
<td>CAT</td>
<td>Capital Acquisitions Tax</td>
</tr>
<tr>
<td>CBC</td>
<td>Certification of Benefit Comparison</td>
</tr>
<tr>
<td>CGT</td>
<td>Capital Gains Tax</td>
</tr>
<tr>
<td>CT</td>
<td>Corporation Tax</td>
</tr>
<tr>
<td>DB</td>
<td>Defined Benefit</td>
</tr>
<tr>
<td>DC</td>
<td>Defined Contribution</td>
</tr>
<tr>
<td>DIRT</td>
<td>Deposit Interest Retention Tax</td>
</tr>
<tr>
<td>EEE</td>
<td>Exempt, Exempt, Exempt</td>
</tr>
<tr>
<td>EET</td>
<td>Exempt, Exempt, Taxed</td>
</tr>
<tr>
<td>FTB</td>
<td>First-Time Buyers</td>
</tr>
<tr>
<td>IAPF</td>
<td>Irish Association of Pension Funds</td>
</tr>
<tr>
<td>ICS</td>
<td>Investor Compensation Scheme</td>
</tr>
<tr>
<td>IDPRTG</td>
<td>Interdepartmental Pensions Reform and Taxation Group</td>
</tr>
<tr>
<td>IIA</td>
<td>Investment Intermediaries Act</td>
</tr>
<tr>
<td>IORP II</td>
<td>Institutions for Occupational Retirement Provision II</td>
</tr>
<tr>
<td>IT</td>
<td>Income Tax</td>
</tr>
<tr>
<td>MiFID</td>
<td>Markets in Financial Instruments Directive</td>
</tr>
<tr>
<td>NAE</td>
<td>National Average Earnings</td>
</tr>
<tr>
<td>NPPI</td>
<td>National Pensions Policy Initiative</td>
</tr>
<tr>
<td>NRA</td>
<td>Normal Retirement Age</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Description</td>
</tr>
<tr>
<td>--------------</td>
<td>-------------</td>
</tr>
<tr>
<td>NPF</td>
<td>National Pensions Framework</td>
</tr>
<tr>
<td>PAYE</td>
<td>Pay-as-you-Earn</td>
</tr>
<tr>
<td>PAYG</td>
<td>Pay-as-you-Go</td>
</tr>
<tr>
<td>PEPP</td>
<td>Pan-European Personal Pension Product</td>
</tr>
<tr>
<td>PFT</td>
<td>Personal Fund Threshold</td>
</tr>
<tr>
<td>PRIIPs</td>
<td>Packaged Retail Investment and Insurance Products</td>
</tr>
<tr>
<td>PRSA</td>
<td>Personal Retirement Savings Account</td>
</tr>
<tr>
<td>PRSI</td>
<td>Pay-Related Social Insurance</td>
</tr>
<tr>
<td>QFM</td>
<td>Qualifying Fund Manager</td>
</tr>
<tr>
<td>QNHS</td>
<td>Quarterly National Household Survey</td>
</tr>
<tr>
<td>RAC</td>
<td>Retirement Annuity Contract</td>
</tr>
<tr>
<td>SFT</td>
<td>Standard Fund Threshold</td>
</tr>
<tr>
<td>SIF</td>
<td>Social Insurance Fund</td>
</tr>
<tr>
<td>SILC</td>
<td>Survey on Income and Living Conditions</td>
</tr>
<tr>
<td>SSAPS</td>
<td>Small Self-Administered Pension Scheme</td>
</tr>
<tr>
<td>SWITCH</td>
<td>Simulating Welfare and Income Tax Changes</td>
</tr>
<tr>
<td>TCA</td>
<td>Taxes Consolidation Act 1997 (as amended by subsequent Acts)</td>
</tr>
<tr>
<td>TILDA</td>
<td>The Irish Longitudinal Study on Ageing</td>
</tr>
<tr>
<td>TET</td>
<td>Taxed, Exempt, Taxed</td>
</tr>
<tr>
<td>TTE</td>
<td>Taxed, Taxed, Exempt</td>
</tr>
<tr>
<td>USC</td>
<td>Universal Social Charge</td>
</tr>
<tr>
<td>VAT</td>
<td>Value-Added Tax</td>
</tr>
<tr>
<td>VFM</td>
<td>Value-for-Money</td>
</tr>
</tbody>
</table>
## 13. Appendix 4

### Glossary of Terms

| **Approved Retirement Fund (ARF)** | An ARF is a post-retirement investment contract into which the proceeds of any defined contribution scheme, additional voluntary contributions, PRSA, RAC, buy-out bond (where the benefits from a defined benefit or defined contribution scheme were transferred into a buy-out bond) or in the case of a 5% Director other retirement benefits that are not taken in the form of a lump sum or pension on retirement. Certain qualifying conditions must be met to be eligible to take out an ARF. |
| **Approved Minimum Retirement Fund (AMRF)** | An AMRF is a post-retirement investment contract where an individual re-invests a minimum of €63,500 of their pension fund until they reach 75 years. An AMRF must be taken out where, on retirement, an individual does not have a guaranteed annual income for life of €12,700. |
| **Additional Voluntary Contributions (AVCs)** | AVCs are contributions that can be made in addition to normal contributions to an occupational pension scheme in order to increase retirement benefits. AVCs also benefit from tax relief, subject to certain limits. |
| **Buy-Out Bond (BOB)** | A BOB is an insurance policy or bond into which the cash value of pension rights in funded occupational pension schemes may be transferred in certain circumstances, including where such schemes are wound up. |
| **Decumulation/Drawdown** | Pension Decumulation or Drawdown is the way in which individuals access their pension funds in retirement. |
| **Drawdown Age** | **Maximum Drawdown Age**: The age from which an individual must begin drawdown of their retirement benefits. This age differs depending on the pension product.  

**Minimum Drawdown Age**: The age from which early retirement benefits can be accessed. This age differs depending on the pension product. |
| **Exempt, Exempt, Taxed (EET)** | This refers to the tax treatment of pensions savings in Ireland - contributions are exempt from income tax (subject to age and
### Imputed Distribution or Notional Distribution
This is an assumed minimum withdrawal for tax purposes from an ARF or vested PRSA. Tax is levied on this amount as if it had been drawn down. Actual distributions made during the year normally may be deducted from the imputed distribution to arrive at a net imputed distribution (if any).

### In-Scheme Drawdown
In-scheme drawdown is where an occupational scheme member remains invested in their pension scheme after retirement, rather than transferring their fund into another vehicle such as an ARF, or purchasing an annuity.

### Interdepartmental Pensions Reform and Taxation Group
The Interdepartmental Pensions Reform and Taxation Group (IDPRGT) was established under the Roadmap for Pensions Reform: 2018 – 2023. The Group is chaired by the Department of Finance and comprises representatives from the Revenue Commissioners, Department of Public Expenditure and Reform, Department of Social Protection, and the Pensions Authority. The Group was tasked with a number of actions in the Roadmap.

### Master Trust
A master trust is a funded occupational pension scheme the members of which are the employees of unrelated employers.

### Normal Retirement Age
Normal retirement age is the age at which you can retire and take your full benefits under an occupational pension scheme. It can also refer to the age you expect to retire under a personal pension or PRSA arrangement.

### Occupational Pension Schemes
Occupational Pension Schemes are the basis of the Second Pillar. They are employer-provided and exist in both the public and private sectors. They can be either defined benefit (DB) or defined contribution (DC).

### Old-Age Dependency Ratio
The old-age dependency ratio is defined as the number of the population aged 65 and over as a share of the population in the 15 to 64 age cohort.

### Pan-European Personal Pension Product (PEPP)
In 2017, the European Commission published a proposal for a Pan-European Personal Pension Product (PEPP). The aim of the proposal is to lay the foundations for a safer, more cost-efficient and transparent market in affordable and voluntary personal
pension savings that can be managed on a pan-European scale. It is expected that the first PEPPs will come to market by 2022.

<table>
<thead>
<tr>
<th>Pension Arrangement Type</th>
<th>Definition: A pension arrangement can be either a Defined Benefit or a Defined Contribution arrangement.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Defined Benefit</td>
<td><em>Defined Benefit (DB):</em> A DB pension arrangement has specific rules setting out benefit entitlements under various circumstances (retirement, death etc.). Benefits are usually expressed in terms of ‘pensionable salary’ and years of service. Almost all public service schemes and some funded occupational schemes are defined benefit.</td>
</tr>
<tr>
<td>Defined Contribution</td>
<td><em>Defined Contribution (DC):</em> A DC pension arrangement operates such that the benefits at retirement or leaving service depend on the value of the investment fund accumulated for the member. There is no guarantee of any minimum benefit. Many funded private sector occupational schemes and all personal pensions (PRSAs, BOBs, and RACs) are defined contribution.</td>
</tr>
</tbody>
</table>
| Personal Retirement Savings Account (PRSA) | *Definition:* A Personal Retirement Savings Account is a contract between an individual and an authorised PRSA provider (such as an insurer, credit institution or investment firm) in the form of an investment account. It is a long-term personal retirement account designed to enable an individual to save for retirement in a flexible manner. It is structured as an individual contract-based DC product. There are two types of PRSAs – a Standard and Non-Standard PRSA. The difference between the two is that Standard PRSA charges are capped at 5 per cent of PRSA contributions paid and 1 per cent per annum of PRSA assets. Non-Standard PRSAs have no such caps on charges. The other main difference is that standard PRSAs can only invest in pooled funds (also known as managed funds), whereas non-standard products have a wider investment choice.  
*Vested PRSA:* A vested PRSA is a PRSA from which retirement benefits have commenced. |
| Pillars                  | *First Pillar:* State Pension  
*Second Pillar:* Trust-based or insurance-provided occupational schemes |
### Qualifying Fund Manager (QFM)
A QFM is a financial institution authorised to operate ARFs or AMRFs. QFMs can include banks, building societies, credit unions, collective investments undertakings such as unit trusts, stockbrokers, and life assurance, companies who have notified Revenue of their intention to act as a QFM.

### Replacement Rate
Replacement Rates are defined as the percentage of an individual's pre-retirement income that is replaced by their retirement income. Replacement rates generally look at gross income but net income may also be considered. Current Government policy continues to recommend a replacement rate of ‘50 per cent of gross pre-retirement income subject to a minimum of 34 per cent of average industrial earnings’. The Department of Social Protection is examining the area of appropriate replacement rates, recognising that a one-size-fits-all approach to replacement rates might not be optimal.

### Retirement Annuity Contract
A Retirement Annuity Contract (also known as a personal pension) is a Third Pillar product. They are specifically Revenue approved insurance policies taken out by an individual with an insurance company.

*Trust RAC:* A Trust RAC is a group trust version of the individual RAC, established by a body representing the majority of individuals engaged in the State in a particular occupation.

### Small Self-Administered Pension Scheme (SSAPS)
A SSAPS is a Second Pillar occupational scheme. It is a self-administered scheme with 12 members or less designed primarily for 20% directors. Due to the absence of ‘arms’ length’ from pension trustees and members, in order to safeguard against SSAPS being used for tax avoidance and due to potential conflicts of interest, additional requirements need to be met in order for such schemes to achieve exempt status from Revenue. In practice, the overwhelming majority of SSAPS are one member arrangements. SSAPS have typically been associated with owner managers and proprietary directors.

### Standard Fund Threshold (SFT)
The SFT is the limit or ceiling on the total capital value of tax-relieved pension benefits that an individual can draw down in his or
her lifetime from all of that individual’s pension arrangements. The SFT was introduced in December, 2005 and is currently €2 million.

| Supplementary Pension System | The supplementary pension system is comprised of Second Pillar trust-based occupational schemes and Third Pillar contract-based personal pension products. It is considered supplementary as it is additional to the State pension system. |
| Whole-of-Life Product | A pension savings vehicle that can provide for both the accumulation and decumulation of pension savings within the one product. |