Do We Need a Radical Change in Pension Provision in Ireland ?

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Incomes and Income Security of Retired Persons in Ireland

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Income security

- Income security in old age is of key importance to individuals, societies and Governments.
- The Green Paper (2007, par. 1.11) states “the overall objective of the pension system.. .. is to ensure that people have an adequate income in retirement”.

- The European Commission (2012, p. 9) state:-
- “The challenge for pension policies is to put in place a system that is financially sustainable so that the basic purpose of pension systems, namely to deliver adequate retirement incomes and to allow older people to enjoy decent living standards and economic independence, can be achieved”.

- The influential World Bank report (1994) describes Income support in old age as a ‘world wide problem, largely due to demographic ageing.

- The European Commission state that demographic ageing further aggravated by the economic and financial crisis is a “major challenge to pension systems” (European Commission, White Paper).

- The problem is that pension systems need reform and change but what reforms and how to implement them ?

Coverage

- Proposed reforms depend on issues identified.
- This paper deal with four main issues:-
- (1). Coverage;
- (2). Incomes and wealth of retired persons;
- (3). The viability of the State Pension System;
- (4). Automatic enrollment.

- Coverage is a key issue in pension systems, that is the proportion and nature of those with pension coverage.
- State pension coverage, via social insurance and means testing is very high (over 90%).
- Hence the focus is on those with supplementary or occupational pensions.
- The Recent QNHS (2016) shows a decline in occupational pension coverage between 2005 and 2015, despite various initiatives such as the introduction of PRSA’s.

Table 1 Coverage

- Occupational Pension Coverage 2005-2015

Sector	Q12005	Q42005	Q12007	Q12008	Q42009	Q42015
All sectors	51.9	55.9	55.4	56.3	51.2	46.7
Accommodation and food	20.8	23.7	19.9	22.7	17.3	13.1
Other NACE activities	34.2	34.2	29.0	30.2	27.0	23.3
Admin and support services	30.2	37.2	35.8	37.9	29.1	24.9
Wholesale and retail	35.1	39.3	38.9	36.2	29.6	26.5
Part time	26.5	29.9	28.2	31.7	23.7	22.3
Non-nationals	27.5	32.1	26.1	53.6	28.1	29.2
Self employed	44.8	48.4	45.7	45.8	36.4	22.9

Coverage

- Table (1) shows the bottom four sectors (out of 14) by occupational pension coverage:-
- Accommodation and food;
- Other NACE activities;
- Admin and support services;
- Wholesale and retail.

- These sectors are also sectors:-
- with the lowest level of pay;
- relatively high rates of employee turnover (churn)
- and seasonal employment.

- The accommodation and food sector is reported as consistently having the lowest weekly pay of 13 sectors over the period 2005-2015.
- The biggest change in pension coverage was by those described as self employed – a fall of nearly 50%.
- Self employment in construction sector increased from 25 % of those at work to over 40% in 2010 where it has remained (Wickam and Bobek, 2016, p, 44).
- Self-employment in the airline sector has also grown.
- In future years self-employment may become more important in what has been described as the 'collaborative economy' using internet platforms, for example Uber.
- These changes raise issues for retirement incomes because of income insecurity, absence of social protection, and non payment of taxes on income (De Groen and Maselli, 2016, p. 15).

What about Income?

- Coverage is a useful test of pension system effectiveness, but incomes derived from pensions is also of great importance.
- The QNHS shows sources of expected retirement income for 2015
- The Survey that the State Social welfare pension is expected to increase in importance comparing 2009 and 2015.
- In general the % of those expecting occupational pensions to be the main source of pension income is lower than the % who are members of occupational schemes.

Incomes of Retired Persons

- Actual income to retired persons is more difficult to obtain. The following reports actual income from the most recent Household Budget Survey (2009-2010) adjusted to a per capita equivalent basis.
- Table (2) shows gross income is highest for those households with a HOH aged 25-34 years.
- Median incomes show exactly the same trends.
- Households headed by a person aged 75+ showed the lowest median incomes and the second lowest if mean values are considered.

- State transfers are highest for those aged 65 and over - accounting for 70% of median income for households with a HOH aged 65-74 and 84% for households with a HOH aged greater than 75).
- The bulk of these transfer payments consist of State Social security based pensions.
- Table (2) also shows that State social security pensions and retirement pensions are similar for those with a HOH aged 65-7.
- But for those aged 75+ State Social Security pensions are a more important source of income than occupational pensions.
- Thus most retired persons are very dependent on State Social Security pensions

Table 2 Gross weekly Household Income adjusted 2009/2010

Age of HOH	N	Gross Weekly income adjusted		State transfers as % of Gross income		State Social Security pensions as % of Gross Weekly Income		Retirement Pensions as % of Gross weekly Income	
		Mean	Median	Mean	Median	Mean	Median	Mean	Median
15-24	232	345.0	297.4	32.5	27.2				
25-34	1382	608.9	512.3	15.2	8.0				
35-44	1415	608.3	473.1	15.2	9.8				
45-54	1084	586.4	436.2	14.7	10.7				
55-64	843	577.5	429.8	18.6	26.4	5.6	0	14.3	0
65-74	571	446.0	328.6	43.9	70.4	33.1	57.3	33.9	4.44
75+	364	382.1	283.8	54.1	83.9	40.8	73.6	31.7	0

Table 3 Historic changes in Income Sources

- Compared with earlier HBS surveys the relative share of occupational pensions in total incomes of retired persons has increased as shown in Table (6) below but income from State sources remain the largest source of retirement income. In particular for those households with a HOH 75+.

Sources of pension income	1987	1994/95	1999/2000	2009/2010
All state social welfare sources 65–74	43.0	37.0	47.9	43.9
All state social welfare sources 75+	44.0	40.9	48.3	54.1
Occupational pensions 65–74	15.7	20.8	23.5	33.9
Occupational pensions 75+	16.3	26.8	20.6	31.7

Table 4 Income of persons with occupational pensions

- Mean values of investment, property and other direct income are low and median values zero.

- There are consderable differences in incomes for those households who report retirement incomes (around 60% of retired households in HBS) versus those who do not.
- Typically these households have two sources of pension income.
- Mean incomes are over 25% higher than for the group as a whole and median incomes are over 40% higher.
- Table 4

Age of HOH	N	Gross Weekly income adjusted		Retirement Pensions		State Social Security pensions	
		Mean	Median	Mean	Median	Mean	Median
65-74	311	552.4	466.8	277.8	185.4	176.0	230.0
75+	364	487.5	403.7	247.5	187.0	185.4	236.7

What About Wealth ?

- The Household Finance and Consumption Survey (HFCS 2014) gives some information on assets of retired person.
- The survey of 5419 households was conducted in 2011 .
- The data shows that the retired households are most likely to own their own home.
- Median values of wealth held are larger than for other groups, but less than that for those who are self employed. Median values of debt to total assets at 3.1% is the lowest of any group, the highest being that of households classified as unemployed (48.5%).
- Mean and net wealth of retired households, although likely to have fallen considerable due to the collapse in Bank shares, is the second highest of the various groups, the highest being self employed.
- One disadvantage of this data is that it is not published on a per capita basis.
- Adjusting the data for equivalence per capita is likely to increase wealth disparities.
- Using HBS data can also give some indicators of wealth in relation to housing.
- HBS data shows that outright home ownership increases with age.
- Standard of residence, as indicated by living spaces also increases with age.

Wealth of Retired Persons

Table 1: Participation in real assets by demographic and household characteristics

	Household Main Residence (HMR)	Land	Other Real Estate Property	Self Employment Business Wealth	Vehicles	Valuables	Any Real Asset
	%	%	%	%	%	%	%
Work Status of Reference Person							
Employee and assisting relative	66.9	6.9	15.8	14.0	87.9	68.7	97.3
Self-employed	87.4	33.5	25.5	100.0	96.3	65.8	100.0
Retired	91.1	13.3	11.8	8.9	77.8	51.8	96.2
Unemployed	47.4	3.1	6.3	5.0	70.1	53.1	87.5
Other	65.2	12.1	9.3	16.8	74.3	53.2	92.3

Table 12: Gross and net wealth by demographic and household characteristics

	Median gross wealth	Mean gross wealth	Median net wealth	Mean net wealth	Share of total net wealth
	€000's	€000's	€000's	€000's	%
Work Status of Reference Person					
Employee and assisting relative	165.2	252.1	53.9	157.3	32.5
Self-employed	400.9	716.2	307.0	551.0	23.3
Retired	210.5	324.2	204.5	316.1	26.6
Unemployed	46.5	111.3	7.2	68.4	3.9
Other	143.4	251.9	94.2	205.2	13.8
Education of Reference Person					

Table 5 Wealth of Retired Households

Age of HOH	No owning home outright	% owning home outright	Rooms adjusted for adult equivalent
15-24	4	1.7	2.56
25-34	28	2.0	2.85
35-44	142	10.0	2.80
45-54	338	31.2	2.97
55-64	506	60.0	3.66
65-74	474	83.0	4.13
75+	310	85.0	4.45

In conclusion retired households are the second wealthiest group.
This pattern is underlined by examining net wealth.
The largest single source of wealth is home ownership.
Home ownership increases with age of HOH, as does living standards as indicated by the number of rooms (adjusted).
So that falling incomes in retirement are to some extent compensated by increasing wealth.

One question is whether future generations of retired persons will achieve the same net wealth.

The Viability of the State Pension System and Reform.

- Given the dependence on State Social security based pensions, the long term viability of the State pension system is vital, but several influential bodies have argued that the State pension system is not viable and needs considerable reform.
- There have been a number of proposed reforms to the State pension system.
- The OECD (2013, p. 108), for example, consider three options for reform:-
- (1). A universal basic pension scheme for the entire population;
- (2). A single means-tested pension financed out of taxes;
- (3.) A basic earnings related scheme with redistributive features.

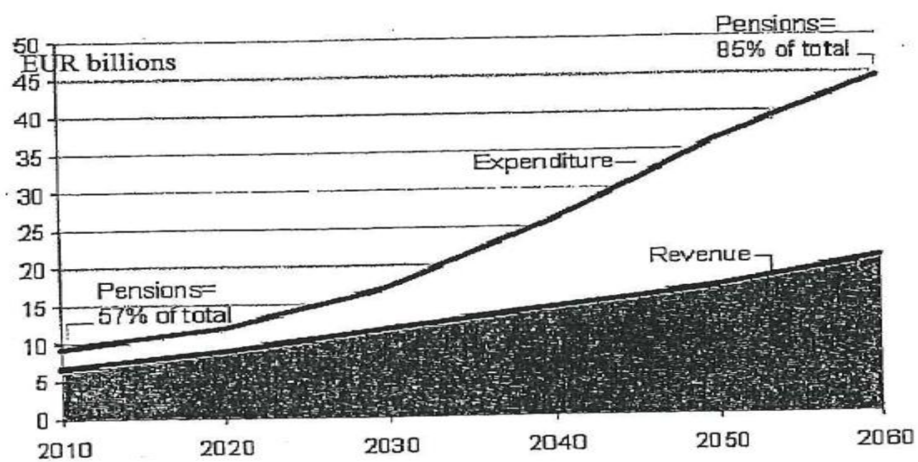
- The OECD also refer to l reforms of the existing social security based pension system, for example increasing the pensionable age from 66 to 67 by 2021 and to 68 by 2028 (OECD, 2013, p.95), but the Report, effectively considers that the only option is considerable structural reform.

- The OECD state (p. 108, Par 4.4):-
- "A definitive choice should be made **today** regarding the structure of private pensions and its interaction with the State pension, with a view to implementation in the future. Given the many years that pension reform has already been discussed in Ireland without some fundamental choices being made about the way ahead, the time is ripe now to take some fundamental decisions on the future of Irish pensions".

The Social Insurance Fund is in 'insolvent'

- One question that arises is how come the OECD reached a position that definitive choices about widespread structural reform should be made "today"?
- An important reason is that the OECD consider that the State pension system is in effect 'insolvent'.
- So that by 2066 receipts are forecast to be €23.542 billion and expenditure €49.278 billion, resulting in a deficit of €25.736 billion or 5.7% of GNP.
- Views about the non-viability of the State pension system are widely held. For example an editorial in the Irish Times (Jan. 4th 2016) states:-
- ".. .. given the unsustainability of the State pension – decisive action is required."

Long-term projections of expenditures and revenues of the Social Insurance Fund for 2010 to 2060



Source: KMPG (2012) on behalf of the Department of Social Protection.

The Social Insurance Fund (SIF)

- One problem with the OECD report is that their short run forecasts have turned out to be inaccurate.
- Rather than a forecast deficit of €2.2 billion in the Social Insurance Fund in 2016, a surplus of €217 million is forecast.
- The Social Insurance Fund is also likely to be in surplus for 2017 and 2018 as employment continues to grow, incomes rise and unemployment falls, thus offsetting the costs of increasing numbers of retired persons

- Table 6 Social Insurance Fund (SIF) Receipts and Deficit (€ million) % of GDP

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Pension Payments[1]	3546	4055	4527	4845	5007	5198	5320	5498	5641	5916	6018
SIF receipts[1]	8362	9347	9714	9226	8926	7864	7080	7632	8231	8439	8883
SIF receipts as % of GDP[2]	4.7	4.9	5.2	5.4	5.4	4.5	4.05	4.25	4.7	3.9	3.9
Surplus or Deficit[1]	649	583	-255	-2487	-2751	-1460	-2084	-1314	-542	-180 f	217 f
Actuarial review forecast (2012)[3]						-1485	-1828	-2024	-2008	-2039	-2230

Milliman projections

- More recently Milliman on behalf of the Policy Institute, have written a report on the financial sustainability of the State Pension in Ireland.
- Milliman also consider other options such as the viability of a universal State pension scheme (long been argued for by members of the PPRG and others).
- Milliman estimate forecasts of pensions payments in relation to receipts and show a growing deficit to 2065.
- They reach similar conclusions to the OECD:-
- "This projected development of the net Exchequer cost of providing pensions raises serious questions about the long term sustainability of the State pension system in its current design".

- Various options are examined.
- One option increasing PRSI rates means the employee rate would increase from 4% to 6% and the employer rate from 10.75% to 15.6% and comment "clearly these would be very substantial increases" (par. 5.46).

Some Issues:-

- The definition of pensions in payment used by Milliman is wider than that used by the Department of Social Protection and includes illness, disability and caring pensions (Milliman, p. 13).
- These payments amounted to €1.4 billion for 2014 or 25% of expenditure on State Social Security pensions.
- Milliman also state that "reliance has been placed" on the actuarial review of the Social Welfare Fund by KPMG (Milliman, p. 8).
- Hence it is of interest to examine to what extent Milliman projections change as a result of the much reduced deficit/expected surplus in the SIF.
- If the 2015 revised estimate is used the deficit falls from 2.6% (€5.57 billion) of GDP to 2.09% (€4.496 billion)
- Furthermore 2015 estimates show that 83% of PRSI receipts were used on pension expenditures rather than the assumed 65%. This reduces the deficit to 1.39% of GDP (€2.977 billion)

Table7 Milliman Projections % of GDP

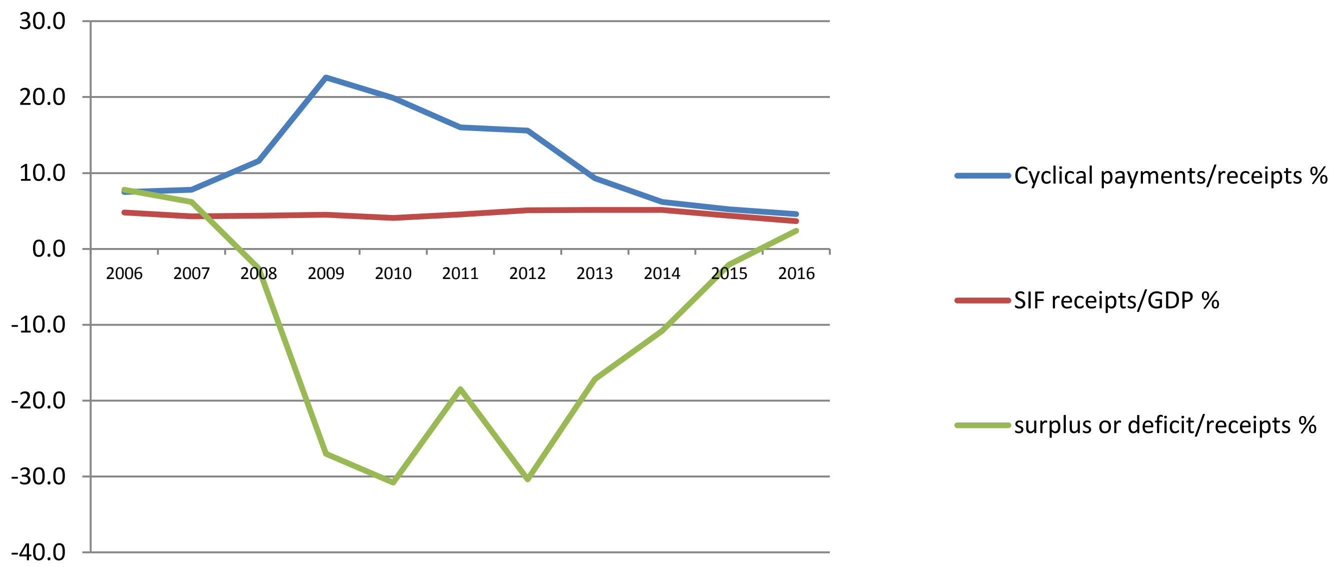
	2015	2025	2035	2045	2055	2065
Projected outgo	5.6	6.2	6.8	7.9	8.9	8.9
Projected pension-related PRSI receipts.	3.0	3.0	3.0	3.0	3.0	3.0
Deficit	2.6	3.2	3.8	4.9	5.9	5.9

	Mill. forecasts	GDP 2015 (IMF)	Estimates 2015a	Estimates 2015b
IMF forecast of GDP		€214.6 billion		
Projected outgo (as listed in Milliman pp. 12-13)				
State Pension Contributory			4.48086	4.48086
State Pension Non Contrib.			0.94162	0.94162
Widow/surviving Partner contrib.			1.42505	1.42505
Widow/surviving Partner non contrib..			0.01619	0.01619
Illness Disability, caring pensions				
Disability Allowance			1.26799	1.26799
Invalidity Pension			0.64977	0.64977
Illness Benefit			0.62163	0.62163
Carer's Allowance			0.5643	0.5643
Blind Pension			0.014115	0.014115
Total expenditures	5.6% of GDP	12.0176	9.981525	9.981525
Revenue	3.0% of GDP	6.438		
PRSI Pension Receipts estimates for 2015 8.439*0.65 (65% of actual receipts)			5.485	
PRSI receipts estimates for 2015 8.439*0.83				7.00437
Deficit	2.6% of GDP	5.5796	-5.47089	-6.99026
% of GDP		2.6	2.09	1.39

Note for 2015 estimates, pensions as counted by Milliman account for 83% of SIF expenditures not 65% as assumed by Milliman

Why was the SIF deficit Assumed to be so large

- The main reason was a failure to realize the effect of cyclical elements.
- Cyclical outlays increased in recession (job seekers allowance and redundancy payments), and receipts fell.
- The reverse happened as the economy recovered
- PRSI receipts are not stable as a % of GDP over time as assumed by OECD and Milliman.
- Furthermore changes to PRSI payments for example increasing incomes subject to PRSI will increase overall receipts as employment rises.



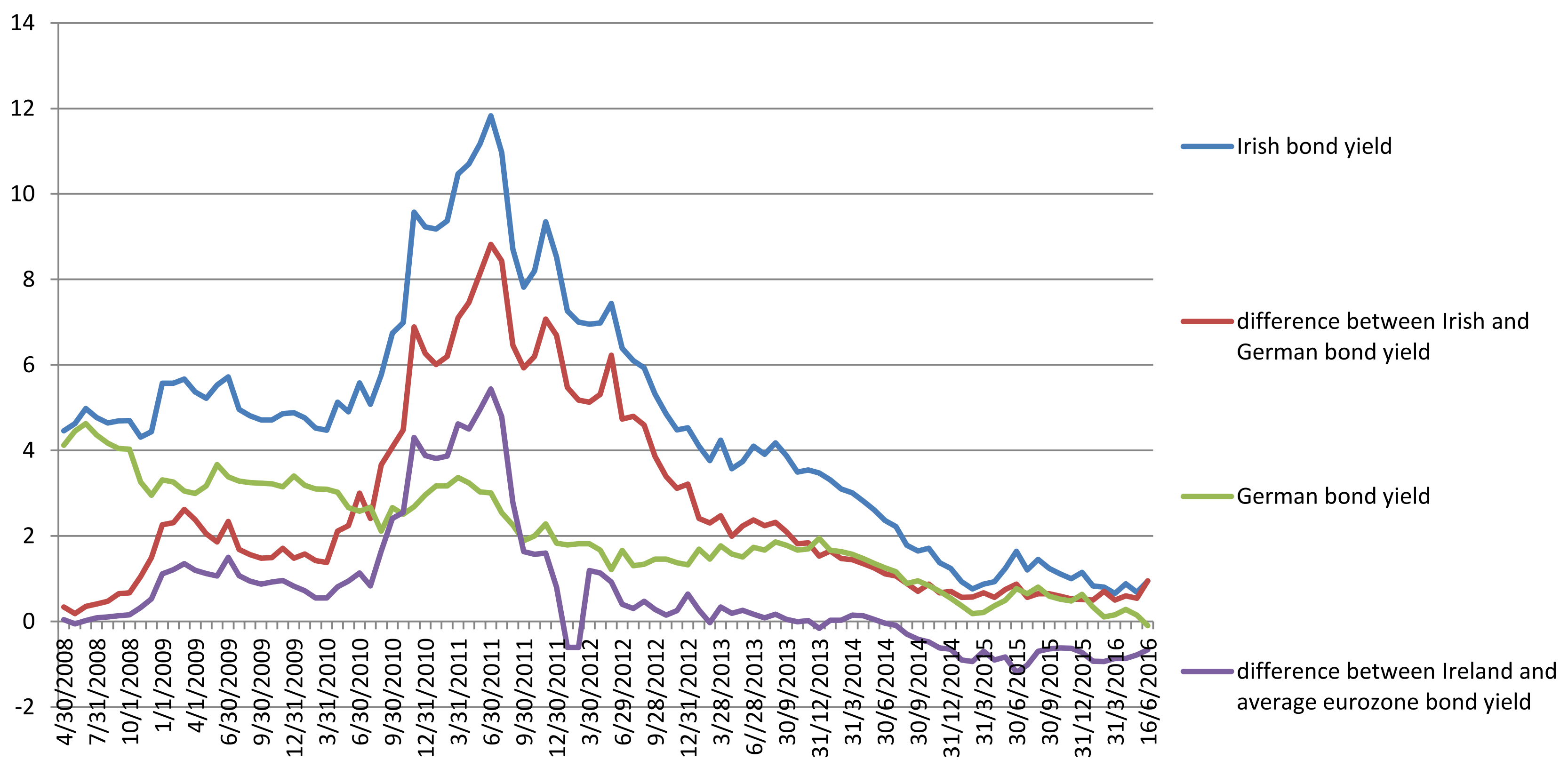
What Reforms ? Automatic Enrollment ?

- State Social Insurance Fund Payments may be secure in the short to medium term, but there is still a problem of falling coverage.
- Milliman advocate a mandatory Pillar 2 (private sector) pension scheme par. 5.40).
- This echoes proposals for in the National Pensions Framework (2010, chapter 4).
- The previous Minister for Social Protection reiterated that the Government is proceeding via the "Universal Retirement Savings Group" to "work to develop a roadmap and timeline for the introduction of a new, universal, supplementary workplace retirement saving system"
- An automatic enrollment pension scheme presents a number of problems.
- One set of problems relates to governance issues, including administrative and other costs.
- These arise from considerable information gaps between pension providers and pension scheme members, product complexity and complexity in regulation in relation to both trust based and contract based pension schemes.

Returns

- But the main issue is low real returns (net of costs/charges).
- Deflation, falling/stagnant wages, negative interest rates, and low/negative returns on government bonds (yield on 5 year German Government Bunds is -0.010%, yield on 30 year bunds is 0.62% on 16th June 2016), and historically low annuity rates, all make funded pensions systems less sustainable.
- Most Eurozone bond yields are below 1%.
- Ten year bond yield for Germany, Japan and Switzerland are negative.
- Chart (4) shows how returns on Euro denominated 10 year bonds have fallen dramatically since 2011.

Ten year Euro bond Yields



Returns

- The Automatic Enrollment example in the National Pensions Framework (2010, Table 4.1), when illustrating potential pensions, assumed a real return of 7%, net of costs.
- So that assuming a salary of Euro 30,000, 40 years contributions and an annuity rate of 22 a replacement rate of 56% could be achieved.
- The same assumptions but assuming returns of 1% and an annuity rate of 22 (25 would be more realistic) results in a replacement rate of 13.6%.
- Twenty years contributions would result in a replacement rate of 6%.
- All annuity providers and firms providing long term guaranteed and annuitized payments are potentially at risk, for example German Life Insurance companies depending on the contracts that have entered into.
- Low or negative interest rates have considerable adverse implications for all funded pension schemes.

- What about other returns ?
- Many stock markets have shown increased volatility in the period 2000 -2016 compared with the period 1970-2000
- Several major indicies are below their peak reached in the year 2000.
- Variability in stock market returns plus charges can have a considerable effect on accumulating lump sums.

Variability in stock market returns

Conclusion

- This paper shows a continuing reliance on social security based pensions.
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- Social security rates (employer and employee combined) in Ireland are amongst the lowest in the EU.
- but are used to finance multiple programs including State Insurance based pensions.

- At the same time actual and predicted pension expenditures by the EU at 7.4% for 2013 and 10.0% for 2040 are greater than both Department of Finance and Milliman projections, but are the second lowest in the EU for 2013 and ranked joint 16th for 2014 (European Commission, 2015, Table 11 1.11).

- The paper also shows considerable differences in retirement income.
- Those households reporting retirement incomes have 25% more income that the retired group as a whole using mean values and 40% higher income using median values.
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- In terms of wealth current retired households have been classified as the second wealthiest group after self employed.
- This is in particular because of house ownership.
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- It is likely that future retirees will not have the same level of retirement incomes as those currently retired.
- This is because of poor coverage, the growth of part time employment in some sectors such as retail, a switch from DB (defined benefit) type pension schemes to defined contribution (DC) schemes, the growth of individual contracts, and relatively high costs of occupational pension provision.
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- In terms of wealth outright home ownership may be more difficult for future generations to achieve.
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- Reforms to expand coverage of second tier pensions could address some issues with poor coverage of second tier pensions.
- But automatic enrollment is unlikely to provide a real solution in terms of income replacement.

- PAYG pension systems avoid many of these problems and deserve much more careful consideration.