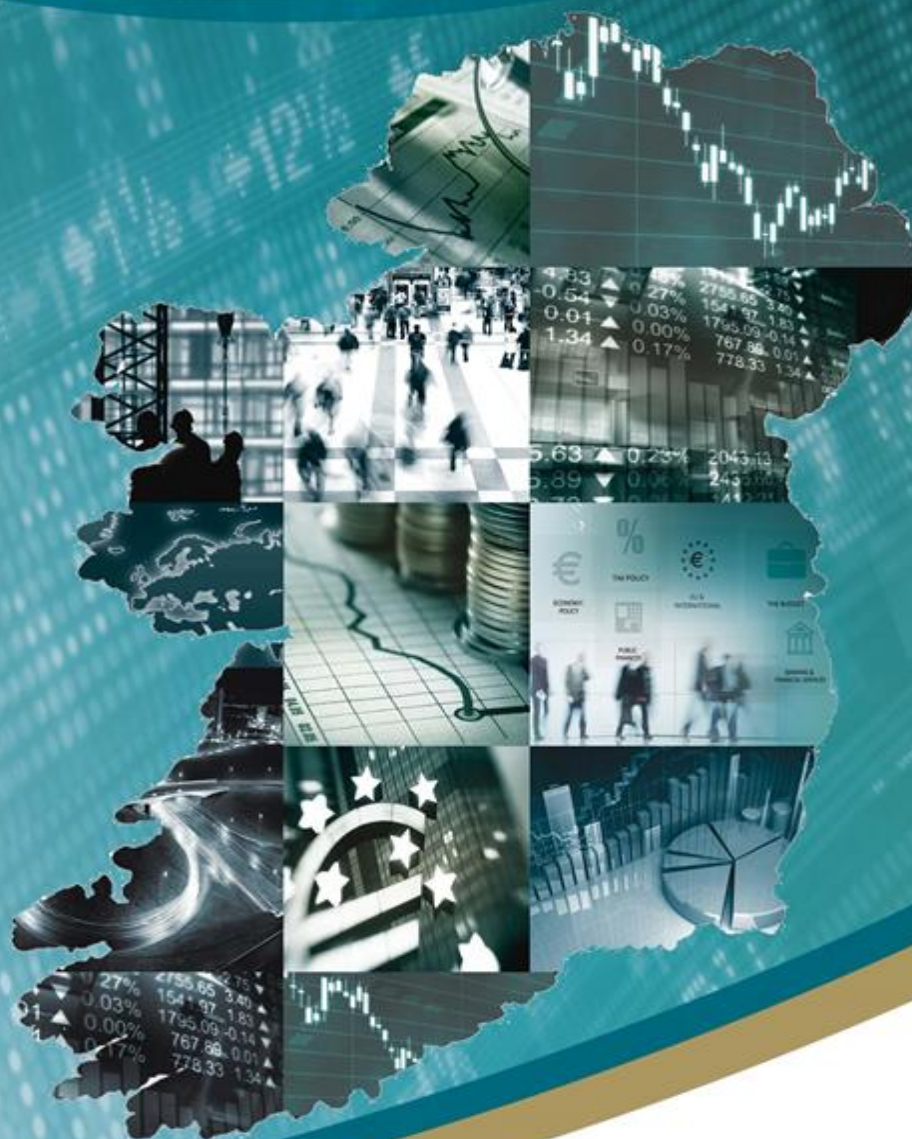


Consultation on Supplementary Pensions Reform: Roadmap for Pensions Reform 2018-2023



Note: This document has been drafted for consultation purposes only. It is intended to elicit views from stakeholders on a range of issues and is in no way indicative of policy direction. No decisions have been made in relation to any aspect addressed in this Consultation Paper.



An Roinn Airgeadais
Department of Finance

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Introduction

Note: This document has been drafted for consultation purposes only. It is intended to elicit views from stakeholders on a range of issues and is in no way indicative of policy direction. No decisions have been made in relation to any aspect addressed in this Consultation Paper.

The [*Roadmap for Pensions Reform 2018 – 2023*](#) sets out a comprehensive plan with specific actions and implementation timelines to overhaul our pension system.

The Interdepartmental Pensions Reform and Taxation Group¹ (IDPRTG), which is responsible for implementing a number of those actions, is providing an opportunity for interested parties to input into the process. Parties can submit responses to this consultation and thereby have their views and concerns considered.

This Consultation Paper is set out under three main sections: Section A – Simplification & Reform; Section B – Costs; and Section C – Approved Retirement Funds (ARFs). Under each section there is a short background note followed by a number of questions pertaining to the specific action.

This consultation process does not specifically address the Government's proposed introduction of an automatic enrolment supplementary retirement savings system as set out in Strand 2 of the *Roadmap for Pensions Reform 2018-2023*. As provided for in the Roadmap, views on the design and operation of an automatic enrolment system will be the subject of a separate consultation process by the Department of Employment Affairs and Social Protection.

The Roadmap actions being considered under this consultation process are:

- Actions 3.11, 3.12 and 6.6 (Section A) identifying measures to simplify pensions, tackle inconsistencies within the supplementary pensions system, and reduce the current number of pension savings vehicles;
- Action 3.13 (Section B) reviewing the cost of supplementary pension to the Exchequer; and
- Action 3.14 (Section C) undertaking a broad review of the utilisation of the ARF option.

The IDPRTG agreed to produce one Consultation Paper covering the actions allocated to it under the Roadmap rather than to consult separately on each action. In order to give stakeholders sufficient time to consider all issues, the consultation process covered by this document will run until **5pm Friday, 19 October 2018** (any submissions received after this

¹ The IDPRTG is chaired by the Department of Finance and includes representatives from this Department as well as from the Department of Public Expenditure & Reform, the Department of Employment Affairs & Social Protection, Revenue and the Pensions Authority.

date may not be considered). The Group expects to report to the Minister for Finance on the actions addressed in this Consultation Paper by year end.

The final section in this document sets out details of the consultation process itself, how to make a submission, and Freedom of Information requirements.

The IDPRTG now invites interested parties to make a submission on all or any of the outlined reform areas in the format set out on page 16 of this document.

Section A – Simplification & Reform

Section A relates to three actions in the Roadmap: 3.11; 3.12; 6.6. These actions concern the identification of inconsistencies within the supplementary pension system, the harmonisation of rules, and reducing the number of pension vehicles.

Ease of understanding and confidence in the pension system are critical in encouraging people to save adequately for their retirement. The complexity of the pension landscape in Ireland may make it difficult for individuals to understand, compare and choose a pension product that suits their needs.

Action 3.11 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.

Action 3.12 Identify the options and develop recommendations to coherently rationalise the number of individual pension vehicles which exist at present.

Action 6.6 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.

In order to progress this work, the IDPRTG has identified the following core areas for consideration of any potential reform:

Product Types

The personal pension landscape broadly provides for three separate contract pension savings vehicles specifically designed to provide retirement benefits. These are Personal Retirement Savings Accounts (PRSAs), Buy-out-Bonds² (BoBs) and Retirement Annuity Contracts (RACs).

When PRSAs were introduced in 2002, it was envisaged that the product would replace both BoBs and RACs over time. However, in practice this has not taken place.

Following a public consultation in 2016 on Reform and Simplification of Supplementary Funded Private Pensions, the Pensions Authority recommended that the number of different types of pension vehicles be reduced to simplify the personal pensions landscape.

Prospectively ceasing BoBs and RACs would provide for a simplified Defined Contribution (DC) contract landscape resulting in PRSAs being the single³ option for new contract based arrangements.

To ensure a smooth transition to a simplified DC landscape, careful consideration must be given to addressing transferability issues among the existing contract options and also with DC occupational schemes.

² Buy-out-Bonds are also known as 'Personal Retirement Bonds'.

³ European Commission proposal COM (2017) 343, for a Regulation on a pan-European Personal Pension Product (PEPP), may result in an additional contract option with an EU wide portability feature to the DC contract landscape.

Finally, the European Commission has published a proposal for a pan-European Personal Pension product, 'PEPP', which has the potential to add a further personal pension product to the domestic landscape.

Standardised Age Treatments

There is no mandatory retirement age in Ireland. However, the normal retirement age (NRA) set down by employers for occupational scheme members is typically between 60 and 70 years.

With regard to personal pensions, PRSA and RAC holders can access benefits at any age between 60 and 75 without any requirement to cease economic activity. Rules around access to benefits from BOBs reflect the rules of occupational schemes. While DC occupational pension funds are generally available from age 50 for those in early retirement, not all personal pensions can be accessed from that age.

For example, a PRSA held by an employed person can be accessed once s/he retires after the age of 50. However, a self-employed unincorporated individual can only access benefits in a PRSA or RAC from age 60.

Tax Treatment of Contributions

The most significant difference in the tax treatment of trust and contract pension vehicles is seen when comparing the tax treatment of employer contributions to occupational pension schemes and employer contributions to private contracts such as PRSAs.

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. 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 although it is only where the combined employer and employee contributions exceed the relevant age and earnings related limits that a BIK charge will arise.

Drawdown Conditionality including Death Benefits ⁴

1. Retirement Lump Sums⁵: Another notable difference between the tax treatment of trust and contract pension schemes relates to the calculation of the tax-free portion of the retirement lump sum.

Members of DC occupational schemes can take a retirement lump sum, calculated by reference to length of service and final remuneration⁶ with compulsory annuity purchase, or

⁴ ARF considerations to be addressed in ARF review - Section C in this document.

⁵ The cumulative amount of retirement lump sum that can be taken tax free for all pension vehicles is subject to a lifetime limit of €200,000, beyond which tax is payable in two stages. The portion between €200,001 and €500,000 is taxed at the standard rate of income tax. Any portion in excess of €500,000 is taxable at the marginal rate of income tax. The tax-free amount of €200,000 is a lifetime limit and encompasses all retirement lump sums paid to an individual from 7 Dec 2005.

⁶ To a maximum of 1.5 times final remuneration.

they can take 25% of the fund value as a retirement lump sum and reinvest the balance in an ARF.

PRSAs and RACs allow for a maximum lump sum of 25% of the fund value with the options, for example, 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. Thus, in the context of individual arrangements, one-member DC occupational pension schemes are more flexible than PRSAs and RACs because they facilitate accessing the higher lump sum under either the ARF option or the traditional annuity option.

2. Death Benefits: Different pension schemes can apply different rules to the payment of 'death-in-service' benefits. In DC schemes 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. With PRSAs and RACs 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 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.

CONSULTATION QUESTIONS

Reduction of Pension Savings Vehicles

- A1. Do you agree that PRSAs, BoBs and RACs largely fulfil the same function for a consumer and that it would be beneficial to simplify the DC contract landscape by prospectively ceasing BoBs and RACs? If not, why?
- A2. What, if any, positive or negative consequences would you foresee from the prospective cessation of BoBs and RACs? What changes would be required to the legislation governing PRSAs? What transitional measures would be required?
- A3. What changes would you recommend to the design of the PRSA product?
- A4. In terms of pension vehicle rationalisation, what impact could the introduction of the pan-European Personal Pension Product (PEPP) have?

Harmonisation of Rules

- A5. In what ways would consumers benefit or be disadvantaged by the standardisation of minimum and maximum drawdown ages across occupational schemes and personal pension products?
- A6. Would harmonising the treatment of employer contributions to occupational schemes and PRSAs be beneficial? How would this be best achieved? Would it result in a shift from single member schemes (and possibly SSAPS?) to PRSAs? How would any change impact the funding incentives for employees/employers?
- A7. Would harmonising the calculation method for maximum tax-free portion of the retirement lump sum across DC occupational schemes and personal pension products be beneficial? How would this be best achieved? Would it result in a shift away from single member schemes?
- A8. Should the rules around the tax treatment of death-in-service benefits between DC occupational schemes and personal pension products be harmonised? How would this be best achieved?
- A9. Are there constructive changes that could be made to eliminate inconsistencies in the treatment of DC and DB scheme members?

Section B – Costs to the Exchequer

Section B relates to one action in the Roadmap: 3.13. This action concerns reviewing the cost of supplementary pension to the Exchequer.

The State encourages individuals to save for retirement by offering tax incentives when saving for a pension. However, participation rates in supplementary pensions remain low among low and middle income earners, motivating the introduction of an automatic enrolment system (see Strand 2 of the *Roadmap for Pensions Reform 2018-2023*). In this context, it is important to review how well existing financial incentives for pension savings are working.

Action 3.13 provides for a review of 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.

Background

Ireland's taxation treatment of pensions involves an 'EET' (exempt, exempt, taxation) system whereby (subject to various limitations, see below) contributions to pensions are tax exempt, pension fund growth is exempt from income or capital gains tax and pension fund benefits are taxed at an individual's marginal tax rate when they are drawn down.

By its nature, marginal tax relief on contributions has limited effectiveness at lower income levels. Having said that, Ireland's highly progressive income tax system results in, for example, a single individual entering the higher income tax bracket at €34,550, a level which is below average earnings. At these moderate income levels, marginal relief represents a significant financial incentive for pension savings.

According to the report on Tax Expenditures for the Tax Strategy Group, the cost of tax relief on private pensions is estimated to have been €2.4 billion in 2014⁷. These costs (i.e. tax forgone) include tax reliefs associated with employee and employer contributions, exemption of employers' contributions to occupational schemes from employee BIK taxation, the tax exemptions for contributions to RACs and PRSAs, and tentative figures for exemption of investment income and gains of approved superannuation funds and of tax free portions of retirement lump sums.

Despite existing tax incentives in place to encourage pension saving, supplementary pension coverage in Ireland remains at below 50% (reducing to circa 35% when the private sector is considered in isolation). To address this low coverage rate, the *Roadmap for Pensions Reform 2018-2023* proposes the introduction of a new Automatic Enrolment Supplementary Retirement Savings System, for workers without a workplace pension.

⁷ http://www.budget.gov.ie/Budgets/2017/Documents/Tax_Expenditures_Report%202016_final.pdf

Contributions

Employee contributions to supplementary pensions are exempt from income tax, but are liable for PSRI and USC (since 2011). Tax relief is given at the individual's marginal income tax rate. Two main limitations apply in relation to tax relief on such contributions: employee contributions are subject to age-related limits restricting the proportion of remuneration that can be contributed to a pension scheme. In addition, there is an upper limit of €115,000 on the amount of earnings that may be taken into account for the tax relief purposes, which applies whether an employee is contributing to a single pension product or to multiple pension products.

Employer contributions to their employees' occupational scheme are not subject to the age-related percentage limits nor the overall earnings cap. Employees are not liable for Benefit in Kind (BIK) on employer contributions to an occupational pension scheme, but if 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, and it is only where the combined employer and employee contributions exceed the relevant age and earnings related limits that a BIK charge will arise.

Growth in Pension Funds

The investment income and capital gains of a pension scheme are exempt from income and capital gains tax.

Benefits

In simple terms, taxation rules allow scheme members or individuals, subject to certain conditions, to take a tax free retirement lump sum from their fund; and then further provides for the taxation of the remaining pension entitlements.

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.⁸ Under RACs and PRSAs, or where a DC member wishes to avail of an Approved Retirement Fund, 25% 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-free⁹, the portion of a lump 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 and subject to USC.

All other income from supplementary pensions is taxable and subject to USC¹⁰. Current rules also prescribe a maximum benefit that an individual can receive from a Revenue approved

⁸ 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.

⁹ As advised in Footnote 4, 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.

¹⁰ ARF distributions are not treated as pension income but they are taxable and subject to USC.

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”.¹¹ A maximum allowable pension fund at retirement for tax purposes (known as the Standard Fund Threshold – SFT) was introduced in Budget and Finance Act 2006. The SFT is €2 million and applies to both occupational pension funds and personal pension products. Its objective is to address the problem of pension overfunding and excessive pension accrual. 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.

As part of this review, and to inform the development of an automatic enrolment retirement savings system in Ireland, the IDPRTG would like to gain stakeholder perspectives on financial incentives for supplementary pensions and puts forward the following questions for consideration.

¹¹ However, it is possible to qualify for this maximum benefit over a shorter period under what is known as the “uplifted scale”. Under this approach an individual can, starting not less than 10 years from normal retirement age, fund for the maximum benefit of two-thirds of final remuneration.

CONSULTATION QUESTIONS

- 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 roll-out 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

Section C relates to one action in the Roadmap: 3.14. This action provides an undertaking for a broad review of the utilisation of the ARF option.

Access to ARFs has been liberalised over time since their initial introduction in 1999. Given current market conditions and a perception that poor value is received when purchasing an annuity, ARFs have become the preferred means of drawing retirement benefits for the vast majority of DC savers. It is therefore important to ensure that the ARF option is fit for purpose and meets the needs of consumers of varying profiles.

Action 3.14 provides for the undertaking of a broad review of the utilisation of the ARF option and to 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.

Background

ARFs are post-retirement investment vehicles in which individuals can invest the proceeds of their pension fund in retirement and draw down amounts as needed. ARFs were introduced in Finance Act 1999 as an alternative to the purchase of an annuity and to provide more flexibility and control regarding drawdown. The ARF option allows the retiree to take up to 25% of the maturing retirement fund as a tax-free lump sum and to transfer the balance to an ARF or take the balance as a taxable cash amount, subject to certain conditions.

An individual who is under the age of 75 at the time of exercising an ARF option and does not meet the requirement of having a minimum guaranteed pension income for life of €12,700 per annum, is required to set aside an amount of €63,500 (or the remainder of the pension fund if less than €63,500 after taking a retirement lump sum). This condition is met by investing the amount in an Approved Minimum Retirement Fund (AMRF) or by purchasing an annuity.

The purpose of the AMRF is to ensure that an individual who does not have the minimum guaranteed pension income for life, has a capital nest egg to provide for the latter years of retirement. An AMRF owner can draw down up to 4% of the value of the fund assets once annually, until he or she meets the guaranteed pension income requirement or attains the age of 75, at which point the AMRF automatically becomes an ARF and any remaining funds can be drawn down at the owner's discretion.

ARFs (and vested PRSAs – that is, a PRSA which has commenced to pay benefits) are subject to an annual imputed distribution requirement which varies between 4% and 6% of the value of the assets in the ARF and/or vested PRSA, depending on the individual's age and the overall size of the fund.

Charges & Regulation

The challenges facing those considering the purchase of an ARF include decisions about investment risk, longevity and health uncertainty, investment charges and taxation. The potential for longer term cognitive decline may make these challenges even more difficult. Also, many people facing these complex decisions may have relatively little financial or investment experience.

As the *Roadmap for Pensions Reform 2018-2023* notes, the Pensions Authority has expressed the view that the lack of regulation at the point where the consumer must choose a drawdown option for their funds, is not in the best interests of consumers. Separately, research by the Pensions Council¹² has identified a wide variation in the charges associated with ARF products which in some cases reduces or even eliminates the investment return.

In-Scheme Drawdown / Group ARFs

There is a perception that drawdown outcomes could be improved if scheme trustees were involved or if other mechanisms were in place to aggregate drawdown product purchase. As the *Roadmap for Pensions Reform 2018-2023* notes, the Pensions Council has observed that as ARF packaged products are currently only open to consumers on an individual basis as personal contracts rather than on a group basis, this likely results in a substantial inequality in information and in bargaining power between providers on the one hand and the individual consumer on the other.

¹² The Pensions Council found that a member would save €11,720 for an ARF investment of €150,000, over 10 years by choosing the ARF product with the lowest charges over the period and holding it for the full 10 years. Report relates to charges levied on ARFs provided by life assurance companies. See <http://www.pensionscouncil.ie/en/Council-Opinions>

CONSULTATION QUESTIONS

- C1. What, if any, limitations are appropriate for pension savers when drawing down benefits in retirement? Should the current suite of retirement savings drawdown options be changed in any way? For example, should savers be required to defer a portion of pension drawdown for a defined period?
- C2. What, if any, changes need to be made to ARF access, and why?
- C3. Given the narrowing gap between State pensions and the AMRF income threshold, what is an appropriate minimum level of required income where an AMRF would not be necessary and should this amount be indexed? What is an appropriate set-aside amount and should it vary? If so how? Should the conversion age of 75 be adjusted?
- C4. Are the current imputed distribution requirements appropriate? What changes, if any, would be appropriate?
- C5. To improve data capture and to facilitate the assessment of retirement outcomes, what additional returns should be required of Qualifying Fund Managers (QFMs)?
- C6. Are current consumer protection arrangements in relation to ARFs effective? How might consumer protection requirements be improved? Is there a role for maximum or standard charges?
- C7. How can ARF owners be adequately informed and supported to make the decision that best suits their needs through retirement, especially given that ARFs require ongoing management? Is there a role for mandatory advice? How can access to good quality affordable advice be facilitated/provided for?
- C8. How might in-scheme drawdown and group ARFs be facilitated? What additional requirements should be placed on schemes that want to provide in-scheme drawdown to ensure they have the capacity and capability to do so?

The Consultation Process

Consultation Period

The consultation period will run **to 5pm Friday 19 October 2018**. Any submissions received after this date may not be considered.

Note: This document has been drafted for consultation purposes only. It is intended to elicit views from stakeholders on a range of issues and is in no way indicative of policy direction. No decisions have been made in relation to any aspect addressed in this Consultation Paper.

How to Respond

The preferred means of response is by e-mail to: IDPRTGconsultation@finance.gov.ie

Alternatively, you may respond by post to:

Public Consultation on Pensions Reform
Interdepartmental Pensions Reform and Taxation Group
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2, D02 R583

Please include contact details if you are responding by post.

When responding, please indicate whether you are contributing to the consultation process as a professional adviser, representative body, corporate body or member of the public. Please also specify which question you are addressing in each response.

Freedom of Information

Responses to this consultation are subject to the provisions of the Freedom of Information Acts. Parties should also note that responses to the consultation may be published on the Department of Finance website.

After the Consultation

Responses received during the consultation process will be considered when finalising the policy choices for each of the pension areas outlined in this consultation document.



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