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**4<sup>th</sup> November 2018**

**Re: Consultation process for an Automatic Enrolment Retirement Savings System for Ireland**

Dear Sir,

I attach, for your consideration, IAIM's response to this consultation process.

The Irish Association of Investment Managers (IAIM) represents the major investment managers operating in Ireland. The services our members provide, primarily portfolio construction and asset management, are critical to individual and institutional savers and investors alike, allowing them to achieve their financial goals and meet their responsibilities.

Our response and recommendations are geared to be of assistance in formulating policy in relation to pension reform in Ireland.

Yours sincerely

Regina Breheny  
CEO

## 1. Introduction

IAIM is pleased to get the opportunity to participate in this consultation.

We welcome the government's commitment to a) retain the State pension as the bedrock of the pension system and b) maintain that pension at 34% of average wages over the long term. We strongly support the introduction of an auto-enrolment retirement savings system that will be simple and cost effective, will provide choice and portability and is administered to a high standard of governance. We agree that the existing supplementary pension system should be simplified, and, in the process, inconsistencies eliminated, and product rules harmonised.

Both of these initiatives should improve understanding, trust and confidence in the system and should help to achieve the objective of expanding supplementary pension coverage. We believe that this is in the best interest of consumers, pension providers and the State.

However, coverage is only one aspect of pension provision sustainability. An effective DC system in the long term will be largely measured in terms of pension adequacy which is primarily determined by contribution rates that are heavily influenced by tax incentives provided by the State. It is important not to put impediments in the way of employees increasing contribution rates above any proposed restrictions.

In general, we believe that:

- the overriding principle should be to give pension savers choice. Independent advice is essential to guide this choice;
- every effort should be made to include as many of the 860,000 employees that are not currently saving for retirement;
- in terms of structure and design, the existing life and pensions infrastructure should be utilised as much as possible. The Pensions Board dictates governance and the Life & Pensions industry is highly regulated;
- technology, both in terms of communication and a secure administration portal, should be used extensively in the design of the CPA.

## 2. Administrative Arrangements and Organisational Approach

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

The concept of a universal, low cost web portal is attractive and in terms of rationale the establishment of a CPA is sound. In particular it would probably be the better model to deal with smaller employers and will provide a centralised system that would make the process of "pot follows the member" more efficient.

However, we would be concerned that a CPA would add to an already complicated pension system and could involve significant cost. Experience in other countries such as the UK, New Zealand and Sweden is that the cost of developing the full range of infrastructure from scratch is high, for example the NZ hub has cost over €300m. Existing pension providers already have systems in place and employers who are willing to promote pension coverage can currently liaise with providers and remit premiums to them via “straight through” processing.

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

The primary strength is the availability of a low-cost centralised web portal that facilitates timely remittance of premiums to pension providers particularly for smaller employers.

The primary weakness is the potential cost of building an infrastructure to duplicate what already exists within the marketplace. Also, the potential cost structure has nothing built in to pay for independent advice for pension savers, indicating that the CPA may be more focused on coverage than on adequacy.

The CPA should be responsible for:

- Sourcing, selecting and de-selecting providers of AE products
- Establishing minimum standards for service delivery and product features
- Acting as an awareness, information and education provider
- Operating a web-based portal, which provides access to AE services for employers and employees and operates the carousel.
- Monitoring compliance with the provisions of auto-enrolment by employers

Pensions Providers should be responsible for:

- Collecting and investing contributions
- Account administration both before and after retirement
- Communication with members
- Providing their own portal which help members manage their own pension pots.

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

The existing low coverage of pension provision is due to membership being voluntary as opposed to compulsory, not due to the lack of technological infrastructure.

The existing portals on the market are impressive and in partnership with employers will cater for a contribution and remittance system. Existing providers were able to cater for the government bonus during the SSIA initiative and should be able to allocate the governmental contribution without complication. The DC model operated by existing providers is already subject to a high level of governance and regulation, it does not require oversight from a CPA.

If pension providers, employers and payroll systems work together, the necessary functionality should be readily available by the implementation date. The SuperStream system in Australia works on this basis. This could be a more cost-effective and lower-risk option for the State.

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

The set up and development costs should be funded from the government as a strategic investment spend given the very long-term nature of the payback. If the aim is to keep fund charges as low as possible for members while being commercially

viable for providers, it doesn't make sense to fund setup/development costs from members or providers.

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

Yes.

The main providers in the pensions industry have the in-house expertise, systems and premium collection processes to manage this increased take up.

This model of re-using the existing private sector infrastructure follows international best practice and has been used in the UK, New Zealand and Australia. It is the quickest and least risky way for the government to tackle the growing shortfall in retirement savings.

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

Yes.

It is appropriate for the CPA to limit the number. The size of the Irish market is relatively small, and it is not unreasonable to assume that pension pots will be relatively small and hence the need for economies of scale in order to reduce costs.

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

The suggested number of Registered Providers at 4 is not unreasonable. However, the size of the Irish market will determine the number of providers that will satisfy a competitive tender requiring operational scale.

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

An alternative (assuming the CPA is a given) is simply to set a given threshold standard of service, capital, etc and allow a market approach to determine the numbers involved. However, for the system to be sustainable, fragmentation needs to be avoided.

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

There should be a single form of governance within the auto-enrolment world to ensure consistency of communication for all members. Allowing a variety of types of products forms would lead to confusion and unnecessary complexity amongst members and make it difficult to sell the system as an easy to use.

Master Trusts would achieve economies of scale and will offer a standardised industry approved solution with one overall scheme for those who wish to follow the Strawman.

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

If the member does not choose a fund, it would be appropriate to allocate them to a default fund. If the number of providers is limited to four, then the CPA could distribute the default among all providers at an equal rate.

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

The set up and development costs of the CPA should be funded from the government as a strategic investment, given the very long-term nature of the payback.

On the face of it 0.5% is adequate as a bundled annual management charge assuming that the investment content is passive, or predominantly passive and that advice is not required. This is likely to be a competitive tool for providers. However, a 2017 review of AE in the UK concluded that 0.75% remained the appropriate rate despite the large scale in the UK system. Allowing for some diseconomies of scale relative to the UK we would suggest 75-100bps as a plausible range for maximum fees.

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

The initial tender period should be for 10 years with a review after five. Any tender loss at that time should be only in respect of future members on the carousel. Existing business should remain as transfer can be very complicated. Members can of course move at their own discretion.

At the five-year stage, the CPA could review and makes suggestions for systems improvements if necessary. This process would also allow the CPA to compare the four providers and give the other three a five- year time frame to catch up with the number one provider.

Any provider that falls short of service levels standards, rating and/or solvency levels etc could be sanctioned and could lose all new funds subject to some fair and transparent regulatory process if they were in breach of minimum thresholds (i.e. be removed from the carousel).

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

The timelines are aggressive but achievable with the right approach of maximising the re-use of the technology and systems of commercial providers.

A critical piece will be the length of time it takes to get the CPA up and running.

The terms of the AE system should be implemented through legislation so that a change of government would not affect the end date.

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

The proposed employee choice model removes the responsibility from employers to make a decision about the pension provider. However, given the potential levels of inertia, employer selection is probably preferable but there should be no compulsion on the employee to accept that Provider

### **3. Structure**

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

Affordability should be taken into account, but it is worthwhile suggesting that if an employee cannot afford to contribute, the employer and government contributions should still be made.

A person who works multiple employments which in aggregate reach the minimum threshold should be opted-in by all the employers into the auto-enrolment scheme. This could be monitored via Revenue who would details of all employments and notify employers of the need to opt an employee into the system.

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

We believe that a threshold of €25,000 would be more appropriate as the State pension will provide greater than 50% on earnings below this. As employers will not have visibility of all employees' earnings the onus may rest with Revenue and CPA working in partnership to notify employers when they should opt-in certain employees.

***17. Do you agree with the proposal to review the earnings threshold on a 5 yearly basis? If not, what adjustment process would you propose?***

The earnings threshold should be reviewed annually as part of the budgetary process. This is consistent with nearly every other parameter affecting the taxation and social welfare system, for example, the state pension, income tax bands, minimum wages etc

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

No.

Any employee of any age eager to join the AE system should be encouraged to do so. The ethos of saving for retirement needs to be part of every adults working life experience. There should be no upper limit as there is no legal retirement date and working lives may be extended in the future reflecting a healthier outlook and a more flexible work experience.

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

There should be no age thresholds. Should eligibility not be based on ability to contribute as opposed to age?

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

Yes.

The purpose of the criteria are to set broad ranges where it is likely that membership of the pension scheme is desirable. Given the diverse nature of careers and life paths the criteria will only be broadly applicable and will not guarantee a 100% match between those who should be saving for a pension and those automatically included and employees themselves should have the final say.

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

As employment patterns change there will be an increasing need for a flexible pension system which can cater for a more diverse workforce including one where individuals have multiple sources of employment income at the one time.

If someone has more than one job, then subject to the qualifying criteria, they should have one pension in the auto enrolment system covering all of the employments. Logically this should be taken out via their main source of employment.

Applying the earnings criteria to the combined income will be administratively challenging for the Central Processing Authority. However, we suggest by working with the Revenue that this could and should be done. In particular the introduction of Real Time Reporting (RTR) in Ireland will modernise the Pay As You Earn (PAYE) system, and mean that employers will be required to report pay, tax and other deductions, at the same time as they run their payroll. This should greatly assist the facilitation of AE entitlements where the employee holds more than one source of employment income.

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

In Ireland just 30% of self-employed people have a supplementary pension. Raising this will be a key challenge for policy makers in the years ahead.

Given the diverse range of self-employment it is likely to prove impractical to compel self-employed persons to join the AE system. However, a targeted campaign aimed at the self-employed professions may be successful in boosting pension uptake on a voluntary basis. This would allow self-employed persons benefit from the product innovation and economies of scale which are likely to coincide with the launch of AE. In theory, there is no reason why the self-employed should not be compulsorily participating, the contribution could be remitted annually based on the annual tax return, as is the current system.

The Department of Social Protection have signalled their intention to undertake a campaign to raise awareness of the impact of “bogus self-employment” which results in contractors forfeiting entitlements such as holiday pay, sick pay, the national minimum wage, redundancy pay, as well as unemployment and other benefits. As the AE system is rolled out employer, pension contributions is an additional benefit to which contractors may be entitled to if they can demonstrate that they should be treated as employees.

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

The launch of AE is a once in a generation opportunity to make major improvements to the operation of the pension system in Ireland. Allowing people who are not part of the paid workforce participate would further strengthen its image as a revolution in Irish pension provision.

Carers and homeworkers may have periods of employment during which times they enrolled in the AE retirement savings system. They may want to continue to make retirement savings during their time out of the workforce benefitting from the state top-up. This should be facilitated, and contributions should get the same incentives from the State as employees contributions receive, up to a reasonable limit.

In the UK non-earners can contribute up to £2,880 and receive tax relief of 20% even though they are not actually paying income tax. In the case of Tax Relief at Source (TRS) on qualifying mortgages in the Irish tax system, there is no current requirement

on the recipient to actually be in receipt of taxable income in order to continue to receive the benefit.

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

Enrolment in the AE retirement savings system should be automatic for all eligible members on commencing of employment. Currently many employers only enrol employees after completion of their probation period. Eliminating the waiting period would further improve the attractiveness and effectiveness of the system.

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

The interaction of the existing pension system and the AE retirement savings system is a critical issue. The current tax relief system is more beneficial for higher paid earners. It makes no sense for these pension savers or for the employers to switch to an AE system as this could have a negative impact on pension adequacy.

Both systems will co-exist for the foreseeable future which means that there will be many employers participating in both. Many members on changing employment will find themselves moving from a traditional scheme to the new system and vice-versa. Some members may have two concurrent employments; one of which is pensioned in a traditional scheme and one of which is part of the new system.

Unless transfer between the systems is allowed members will not be able to consolidate their pension benefits in one place. The objective of a 'pot follows member' system will not be achieved.

#### **4. Employer and Employee Contribution Rates**

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

Australia and the U.K. adopted an approach of slowly ramping up contribution rates by employees and employers alongside a matching state contribution. Applying this approach in Ireland also would have the desired impact of not resulting in a sudden increase in overall payroll costs for employers or an unmanageable reduction in take home pay for employees.

Based on the current indicative timetable it will be 2026 before the full 6/6/2 rate of contribution is in place. Given the urgent need to improve pension adequacy alongside pension coverage this should be considered to be maximum timeline for full implementation. Should there be any delay to the start date of AE the phased increase in contribution rates should be accelerated.

Consideration should also be given to allowing employees to increase their contribution rates above the mandatory minimum levels during the phase in period and achieving a commensurate higher rate of state contribution. This should not impact on minimum employer contributions.

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



According to the Strawman “when purchasing a pension in the private market, an individual aged 23 who is on the current average wage of c. €37,775, intending to retire at 68, and with a target replacement rate of say 60% (or c. €22,600 per annum), would need total contributions of approximately 13% of their annual salary for pension purposes<sup>28</sup>. This is in line with the ultimate contribution rate of 14% proposed in this Strawman.”

The key assumption underpinning this is that the Contributory old age pension will be maintained at its current level of 35% of average earnings. Pressure on the public finances may limit the State’s ability to do this in future years and it may be prudent for individuals to make greater provision for a supplementary pension to meet their retirement needs. It is also important to note that for individuals paying the top rate of tax the proposed structure is a significant dis-improvement on the current system of marginal tax relief. In the U.K. higher rate taxpayers are able to claim a credit for tax relief foregone as part of the AE system.

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

There are clear existing rules regarding the annual amount an individual can contribute to their pension pot and the overall size of pension pot they can accumulate. A salary cap of €115,000 applies along with age – related contribution limits. This cap has been reduced significantly over the years as has the Standard Fund threshold.

We believe the same rules should be used for the AE system as currently apply to pension savers. Therefore, the cap on qualifying earnings should be €115,000 rather than €75,000 in order to ensure equality of treatment of members across the different systems.

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

This would be an unnecessary complication in the system. A study in the U.K. has recommended abolishing the provision and there would be no benefit to introducing an income dis-regard in Ireland at the commencement of AE.

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

Yes.

The employer should be required to match contributions up to 6% for ALL employees and similarly the State should do the same for any tax relief/credits. There would appear to be no logical reason to exclude persons who wish to opt-in and it may lead to perverse recruitment and retention incentives of staff.

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

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

The proposed financial incentives provided by the State should be easier for members to understand than the current system of tax relief. It makes sense as it focuses on the

low to mid earners. The bonus/top-up mechanism seems appropriate as large numbers are either not paying tax or are not in the higher tax bracket.

However, we need to be explicit that this proposal is a reduction in the incentive for higher rate tax payers.

Whilst there is clear attractiveness in the simplicity of the proposal for the target audience, this is countered by the extensive complications that may be caused with the operation of two differing taxation regimes. In particular, the complexity that will arise in areas including communication, advice and operations with two conflicting systems will be huge, as everything from transfer of pots to arbitrage based on income shall occur. Marginal rate tax payers would need advice as regards best options for them as auto-enrolment would offer poor value and they would look to defined contribution scheme instead; those who pay standard rate taxes in existing defined contribution plans would be approaching employers looking for auto-enrolment plans to improve their outcomes

While there is a strong case to increase the incentive to save at lower levels of income by offering a higher rate of top up of 25%, the progressive nature of the tax system is best maintained on an overall basis by maintaining marginal rate tax relief

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

The top-up should be consistent with the existing tax relief system. For non/lower tax payers 25% top up seems appropriate. However for higher taxed pension savers the top up should match the higher marginal tax rate of 40% i.e. 3/2 rather than 3/1.

The current proposal is in fact a reduction in the incentive for higher rate tax payers.

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

We would recommend alignment with the current tax relief regime

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

Yes.

Without a cap the cost to the state will be too prohibitive. There should be alignment with the current caps within the market and if these are deemed adequate for occupational pension schemes then they should be similarly applied for auto-enrolment. The cap should be the marginal rate of tax relief with a threshold of €115,000.

## **6. Investment Options**

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

Yes.

A simple range will be easier for members to understand. However, we do not think members should be defaulted into the lowest risk option given the potential adverse impact on long term returns. In terms of objectives, pension adequacy should be as important as pension coverage.

An alternative would be to have a lower risk ‘foundation phase’ for new joiners to avoid losses in the early years, but then revert to a higher expected return portfolio later in membership. This is the approach taken by Nest in the UK.

A High Growth investment option would provide auto-enrolment savers the choice of getting more equity market exposure over the long term. A lifestyle strategy should be the default that de-risks auto-enrolment savers 6 to 10 years from retirement to a Fund or Funds appropriate to the amount they have saved and their profile rather one fund.

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

The funds should be named in plain English so that auto-enrolment savers understand from the title the expected risk and return or the retirement benefit they are seeking to target. The asset component matching the risk profile should be determined by the investment manager.

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

We do not think this additional complexity would be beneficial.

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

Our understanding is that 0.5% cap applies to investment and member administration. For a scheme such as this, our experience indicates that the vast majority of that fee will be taken up by administration costs and the level for investment will be low.

Given the likely low level of assets involved in the initial period it is important that the maximum charge is set at a level which is commercially viable for auto-enrolment providers to encourage them to tender for RP positions. In other jurisdictions, such as the UK and Australia with much larger populations, where auto enrolment is in place the maximum charge is higher so it is difficult to understand the rationale as to how it can be delivered for less within Ireland.

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

In setting the annual maximum charge it is necessary first for the range of services and activities covered by the fee be clearly defined

A 75bps to 100bps range would be a desirable maximum charges range.

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

Yes, though it should not be actively promoted. The scheme should emphasise that the default is appropriately constructed and suitable for the majority of members.

Ultimately, the money belongs to the member and they should have the ability to make decisions as to how it is invested.

Service providers should be in a position to facilitate a fully online service to members to allow switching between funds. This will facilitate a greater sense of ownership over the process for auto enrolment savers.

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

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

Yes.

We agree with a minimum period. However, six months is too short. The appropriate minimum should be at least a year. The longer a saver is in the system the more likely that saver will be retained.

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

We agree with an opt-out window of two months and to be consistent with Q 41. That period should be months 13 and 14. To avoid a cliff edge effect at the end of month twelve there should be a phased initial introduction by employer.

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

Yes.

We agree that re-enrolment should occur automatically after three years with the same 12 month minimum compulsory membership.

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

Yes.

Members should be allowed to take only one period of savings suspension but, similar to the opt-out provision, this period of suspension should be limited to three years and should only be allowed for a specific once off life event.

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

No.

Contributions should be retained for the benefit of employees who will be re-enrolled after a period of three years. If opt out is persistent the contributions (employer, employee and State) should be used to acquire a deferred pension for the employee.

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

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

No.

The current suite of products – annuities, ARFs and Vested PRSAs are sufficient to meet retirement needs. Registered providers should be able to provide all of these as options also to persons within an auto-enrolment scheme. We do not feel there is a need to create new draw down options or standard ranges of options that may add unnecessary layers of complexity to pension savers. Industry participants have extensive expertise in this area.

However, the suggested fee rate of 0.5% takes no account of the cost of advice which should be mandatory at the draw-down stage.

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

Yes.

Pensioners should be free to make their own choices on retirement and those saving within the auto-enrolment scheme should also have access to these options. Independent advice should be mandatory

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

No.

Members should have the choice to do with their pot what they wish. However, where a member is unable or unwilling to make that choice then a default option with some level of annuitisation should be available.

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

No.

The member should make the choice but with a minimum age of 60. To facilitate flexible working conditions members should choose when contributions should cease particularly when working beyond the State pension age.

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

Yes.

Age is not relevant, the issue is that the retiree will have to take what is available, it's what the pot buys.