An Bord Pinsean -
The Pensions Board

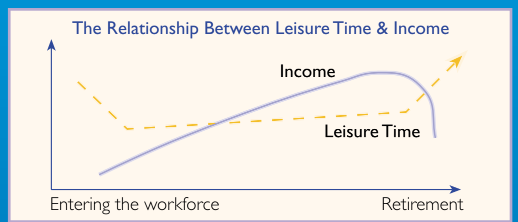
Authority for Pensions

THE IRISH TIMES
Business 2000
SIXTH EDITION

SECURING THE FUTURE

THE IMPORTANCE OF PENSION COVERAGE

When employees retire, after a long working life, their time should be pleasurable. Unfortunately many people do not make adequate provision for their retirement. Most put it off, feeling that it is a long way away. However, this can be very costly. In the early years of retirement, resources are needed to take maximum advantage of new leisure time. As illustrated in the diagram this situation is reversed when working. In later retirement an adequate pension is required to meet demands such as healthcare costs.



The State, through the Social Welfare system, will provide a basic pension. However, this pension may not provide a level of income to maintain the standard of living before retirement. It is therefore important to make adequate provision while working, to provide supplemental pension cover for what may be a retirement period of twenty to twenty-five years – almost half as long as one's working life. *Occupational pension schemes* are designed to supplement social insurance pension cover.

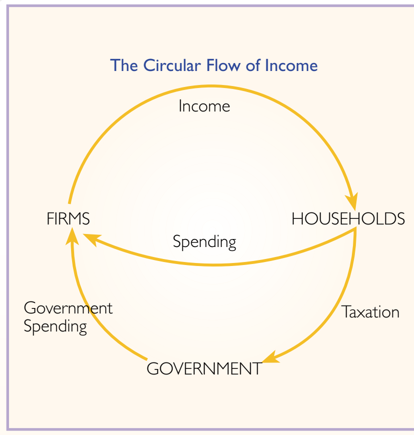
The Social Welfare system provides a basic level of pension (currently 31% of average industrial earnings). Private or supplementary pension provision is provided under ***occupational pension schemes, personal pension plans*** and, in the future, by ***Personal Retirement Savings Accounts (PRSAs).***

Over 600,000 employees in Ireland are members of *occupational pension schemes*. As their pensions may be the most valuable asset they have it is essential that this asset be protected. It was principally for this purpose that the Pensions Board, a statutory government agency, was set up under the Pensions Act, 1990.

When the Government establishes an agency like this, it does so in the context of its role of business regulator. The Board protects 'consumers of pensions' when it carries out its primary function of monitoring and supervising *occupational pension schemes* and *PRSAs*. The providers of *personal pension plans* are regulated by the Department of Enterprise, Trade and Employment (DETE) and therefore do not come under the Board's jurisdiction.

OCCUPATIONAL PENSION SCHEMES

When we look at pension provision it is important to distinguish between public sector and private sector *occupational pension schemes*. *Occupational pension schemes* set up by most private sector employers and commercial semi-state bodies are usually financed by putting aside the contributions received each year in a ***trust fund*** to finance the scheme members' pension entitlements. On the other hand, pension contributions made by the non-commercial public sector, such as the Civil Service, Local Government, Education, Gardaí, Prison Services and Health Services are used by the Exchequer on **current expenditure** items. Non-commercial public sector and Social Welfare pensions are also part of this current expenditure. This is known as a **"Pay As You Go"** method of paying pensions and is only feasible if a sufficient percentage of the population is working or economically active. Those who are working receive an income as a result of producing goods or services. This results in a **circular flow of income**.



The economically active contribute to the economy by paying taxes. This tax revenue funds Government expenditure, as on state pensions and other social welfare benefits. These state benefits are regarded as **Transfer Incomes**. Transfer Incomes include incomes received although there has been no corresponding contribution to the output of goods and services. Such incomes represent a redistribution of income within the nation from taxpayers to recipients. It is a social responsibility of Government to redistribute income in this way.

TYPES OF SCHEMES

There are two main types of *occupational pension schemes:*

- a **defined benefit** scheme is where the scheme promises the employee a pension and/or a lump sum at retirement related to their earnings just before retirement.

  Example - Defined Benefit

  An *occupational pension scheme* which promises to provide each member with a pension at retirement age of $1/60^{th}$ of pre-retirement earnings for each year of service, subject to a maximum of $2/3^{rds}$ of pre-retirement earnings.

- a **defined contribution** scheme, where the employer agrees to contribute a certain amount to the scheme to provide retirement benefits for the employee. These contributions are then invested and accumulated to retirement age to provide a pension and/or lump sum benefit.

Example - Defined Contribution

An employer contributes 7% of each employee's earnings to this *occupational pension scheme*. The employee contributes 5% of earnings. The contributions are invested and accumulated to retirement age to provide retirement benefits for employees.

The accumulated fund for retirement is first used to provide the maximum allowable lump sum retirement benefit and the balance of the fund is then used at that stage to secure a pension for the employee. No promise is given in advance about the retirement benefit which will be provided by the scheme. This would depend on the size of the accumulated fund and the level of annuity rates ruling at retirement.

The important difference is that under the **defined contribution** scheme, the employee is not promised any specific level of retirement benefit, as there is no guarantee what the accumulated contributions will have grown to, by retirement age.

FINANCING OCCUPATIONAL PENSION SCHEMES

The Revenue Commissioners require that the employer must contribute to their occupational scheme and must pay at least $1/6^{th}$ of the cost of the scheme. Employees do not have to contribute, but it is common in many schemes that employees are required to contribute to the scheme as a condition of membership. As the name suggests, a **contributory scheme** is one where the member contributes a percentage of his/her salary as well as contributions by the employer. A **non-contributory scheme** is one where the funding is made solely by the employer. This does not mean a non-contributory scheme is better because the member does not contribute as the ultimate benefits may not be as good as those provided by the contributory scheme.

TAX BENEFITS

To encourage supplemental pension provision for retirement, successive Governments have provided generous tax benefits to encourage the establishment of *occupational pension schemes*.

- Any contribution made by the employer to the scheme is tax deductible as a business expense in the accounting period in which the contribution is paid.
- Any personal contribution made by the employee to the scheme is deductible for income tax, up to an annual limit of 30% of remuneration on an age-related scale.
- Any contribution made by the employer to the scheme to provide benefits for an employee is not treated as a *benefit-in-kind* for the employee concerned.
- No tax is levied on investment returns earned by the scheme therefore funds accumulate tax free within the scheme.

The maximum employee contributions are as follows:

Age	Maximum Contribution %
Less than 30	15
30-39	20
40-49	25
50+	30

Tax relief on pension contributions greatly reduces the real cost of contributing to a pension scheme. Take for example a scheme member with a salary of € 25,000 per annum; with a marginal rate of tax of 42% and an average PRSI contribution of 5%. The member pays a contribution of 5% of salary to the scheme. The gross contribution is € 1,250 but with income tax and PRSI relief the net cost to the member would be € 662.50. This highlights again the important social role played by Government in promoting pension coverage.

ADDITIONAL VOLUNTARY CONTRIBUTIONS

Occupational pension schemes may allow employees to improve their pension cover by making Additional Voluntary Contributions (AVCs). If a scheme is not providing the maximum pension benefit allowed by the Revenue Commissioners, then it is wise to "top up" pension benefits with AVCs. When these are paid to supplement a pension the employee is the sole contributor. Full tax relief is allowed to the maximum limits set out in the table above, and provided the topped-up benefits do not exceed the maximum allowed under Revenue Commissioners' rules.

MAXIMUM RETIREMENT BENEFITS

In general a pension may always be provided at the employee's normal retirement age of 1/60th of *final remuneration* for each year of completed service with the employer, subject to a maximum pension of 40/60ths of final remuneration.

The sliding scale is sometimes referred to as **n/60ths** with **n** representing the number of years of completed service with the employer by normal retirement age.

Example

John has worked in the company for 40 years. His *final remuneration* at normal retirement age is € 60,000. He has been promised 40/60ths of his *final remuneration* for each year of service, up to a maximum of 2/3rds of *final remuneration*. The amount he will get is calculated as follows:

40/60ths x € 60,000, i.e. € 40,000 per annum

Furthermore, the scheme may provide John with a **tax free** lump sum retirement benefit either as:

- a separate benefit from the pension, or
- as commutation of part or all of the pension entitlement.

In **defined benefit** schemes, the commutation may be on fixed terms, e.g. € 9 cash for each € 1 pension commuted. This factor, i.e. 9:1 is called the **commutation factor**.

However, Revenue limits apply to the level of lump sum that may be provided, and to the combined level of pension and lump sum which can be provided.

In general, **an individual may always be provided with a lump sum at normal retirement age of 3/80ths of *final remuneration* for each year of completed service,** up to a maximum of 120/80ths of *final remuneration*. So John's lump sum benefit will be calculated as follows: 120/80ths x € 60,000 i.e. € 90,000

Note however, that the <u>combined</u> pension and lump sum benefits cannot exceed 2/3rds of John's *final remuneration*.

THE PENSIONS BOARD

The Pensions Board was established under the terms of the Pensions Act, 1990. Its role is to regulate *occupational pension schemes* and in the future *Personal Retirement Savings Accounts (PRSAs)*, to advise Government on pensions generally and to promote increased pension coverage in the private sector and the importance of contributing early to a pension scheme. Its functions include;

- monitoring, supervising and providing advice on the operation of the Pensions Act and pension developments generally
- issuing guidelines on the duties and responsibilities of trustees of schemes and codes of practice on specific aspects of their responsibilities
- encouraging the provision of appropriate training for trustees of schemes, and to advise the Minister on standards for trustees.

Occupational pension schemes, as discussed above, must register with the Board. The Board can act on behalf of scheme members who are concerned about their scheme. The staff of the Board is available to answer any enquiries and supply information on the legislation.

The Pensions Board has a Chairperson and 16 ordinary members. 13 of the 16 members must be nominated by, or be representative of specific interests or interest groups. Many of these are included in the following diagram:

The Board operates a committee system. These committees may include people who are not members of the Board who are usually appointed because of their expertise on a particular matter being examined. Day-to-day functions are carried out by a Chief Executive and appointed staff. The Board has extensive powers under the Pensions Act to obtain information and to take Court action for breaches of the Act. In addition, the High Court can replace trustees of pension schemes if this is deemed necessary to protect the interests of scheme members.

INCREASING PENSION COVERAGE

The issue of adequate and comprehensive pension cover has been under consideration in Ireland for over 20 years. The Irish debate has been set against an international background of the so-called demographic "*time bomb*". Due to increased life expectancy and declining birth rates most industrialised countries are going to experience ageing of their populations leading to increased financial difficulties in sustaining pension coverage.

The age dependency ratio measures the number of people who are **economically inactive** (aged sixty-five or over) relative to those who are **economically active** (of working age). In Ireland, our **age dependency ratio** is rising. At present we have a ratio of one retired person to five of working age. That ratio is expected to rise to one to four by 2016, and to one to two by 2050.

The population age structure is a key issue when planning pension provision. Demographic and economic predictions indicate dramatic shifts highlighting the need for adequate resources.

A survey on pensions coverage undertaking by the ESRI in 1995 revealed that only 46% of the workforce had supplementary pension coverage.

The Government has established a National Pensions Reserve Fund for the purpose of meeting the substantially increased costs, which will arise for Social Welfare and public service pension provision. A sum equivalent to 1% of GNP will be paid by the exchequer into the fund each year until at least 2055.

The Government has also turned its attention, through the Pensions Board and appropriate legislation, to introduce proposals designed to improve the quality and extent of supplementary pensions coverage.

These proposals have been passed into law in the Pensions (Amendment) Act, 2002. The Act provides for the introduction of a framework for *Personal Retirement Savings Accounts (PRSAs)* and their associated tax reliefs and arrangements. *PRSAs* are a new style of private pensions saving account. This low cost, easy access, investment account is designed to allow people to save for retirement in a flexible manner. The *PRSA* is designed to be owned by an individual, regardless of their employment status. The *PRSA* is transferable from job to job and available from a variety of providers. All employers who do not currently provide access to an *occupational pension scheme*, or have certain restrictions, will have to provide access to a standard *PRSA* from next year.

NATIONAL PENSIONS INFORMATION AND AWARENESS CAMPAIGN

The initiatives to improve the quality and extent of supplementary pensions coverage will need to be supported by an effective education and awareness campaign if they are to have the maximum desired effect. The level of understanding and awareness of pensions among the general public appears to be low. Consequently, the Pensions Board has recommended a Government driven pensions awareness campaign be conducted in conjunction with the relevant public and private sector bodies. This recommendation has been accepted and it is intended this campaign will start at the same time as *PRSA* products become available in early 2003.

CONCLUSION

As the Irish population ages there is an increasing need for the Government to ensure that all residents in the State can maintain their established standard of living on reaching retirement age. The Pensions Board remit is to ensure that *occupational pension schemes* and *PRSAs* are controlled and regulated in the interest of pension scheme members and holders of *PRSAs*. This in turn will ensure the continued flow of wealth in the economy by securing the future standard living of the country's workforce.

GLOSSARY OF TERMS

Final Remuneration - The term used by the Revenue Commissioners for the maximum amount of earnings which it will permit to be used for the purposes of calculating maximum approvable benefits.

Trust Fund - This is generally defined as the monies and assets for the time being held by the trustees subject to the trust scheme. It is held under the legal control of the trustees of the scheme.

Benefit-in-Kind - Additional benefits given by an employer are often called benefits-in-kind, such as travelling expenses, medical insurance and employer pension contributions.

Occupational Pension Scheme - A pension scheme set up by an employer to provide retirement benefits for employees. This term is used interchangeably with "company pension scheme".

Personal Pension Plan - These are contracts effected with an insurance company. They are applicable to the self-employed and to persons in non-pensionable employment. This type of pension is fully funded by the policyholders.

Personal Retirement Savings Accounts (PSRAs) - A PSRA is a contract between an individual and an authorised PSRA provider in the form of an investment vehicle used for long term retirement provision by employees, self -employed, homemakers and any other category of person.

TASKS AND ACTIVITIES

1. Explain the concept of a 'pension'.
2. Why is it important for the Government to promote the idea of increased pension coverage?
3. Explain the following terms
   a. Circular Flow of Income
   b. Transfer Incomes
   c. Trust Fund
4. The Government plays an important role as business regulator. Outline three economic benefits of this role in relation to regulating pension coverage.

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