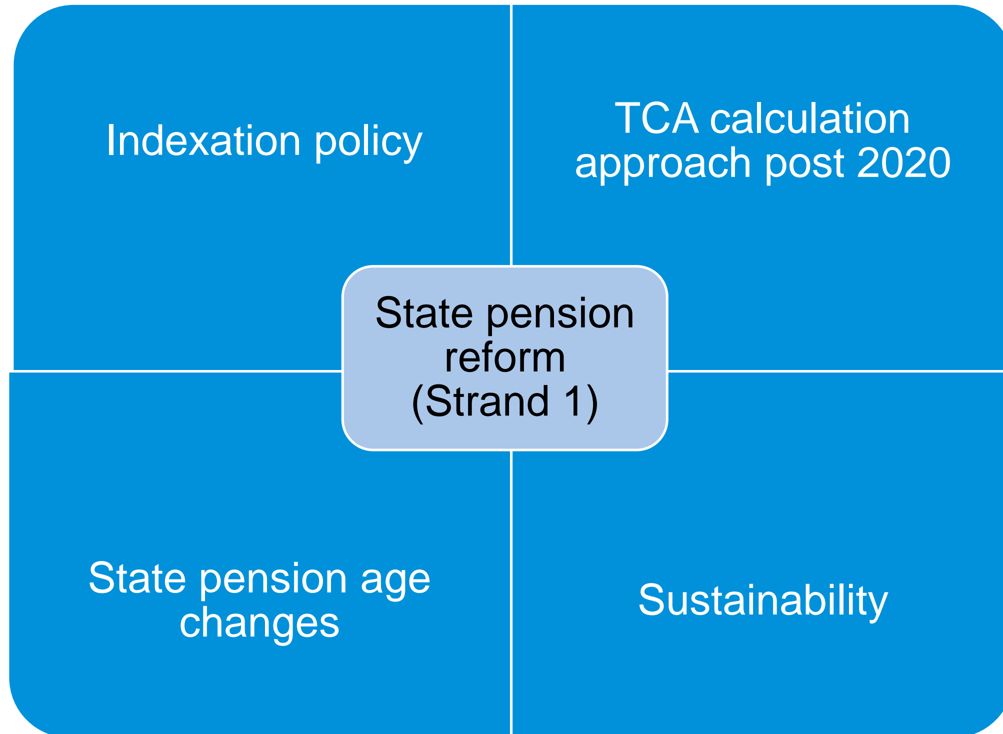
Presentation to the Pensions Council

Pension roadmap 2018-2023 – State pension and Social Insurance Fund aspects

15 March 2018

Pension Roadmap: State pension reform



Reforms outlined in Strand 6 – Fuller working Lives (amongst others) will also have wider implications for the SIF and for age-related expenditure

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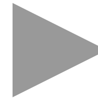
Pension Roadmap 2018 - 2023: State pension

Indexation

- Set a formal benchmark for 34% of earnings
- Future changes in pension rates of payment are linked to changes in the consumer prices index and average wages by 2018



Implications?

- Contradictory objectives or…..
- Perhaps an individual approach is intended whereby the pension would continue to increase broadly with earnings such that 34% of average earnings at point of retirement but…..
  - post retirement the pension increases at a lower rate (at some composite of earnings and prices)?
  - This would mean that the pension at retirement would vary depending on year of retirement (reflecting prevailing average earnings in that year) but increases to that pension in retirement would be based on some declared percentage?
  - Adding €5 to the state pension on an ad hoc basis will not achieve this. [The level of income provided to pensioners in the form of the State pension is currently decided through the annual budget process.]
  - Communication challenge?
- In other countries indexation is invariably linked to earnings with some linked to prices [Source: AWG Report]
- Risk of "locking in" rates at times when fiscal space constrained and therefore recognition that needs to be accompanied by reform of the funding of the system

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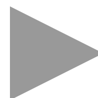
Pension Roadmap 2018 - 2023: State pension

TCA Design

- A TCA design which would make the level of pension directly proportionate to the number of social insurance contributions paid with credits granted for those who have taken time out to perform caring duties
- The strawman (subject to consultation) is to offer a TCA design which will give a full pension to those with 40 years contributions (i.e. 1/40ths).
- Up to 20 years credits will be allowed to be accumulated
- Unemployeds will also be allowed to get credits provided they have certain minimum contributions paid
- Finalise the TCA design by Q4 2018 following consultation.
- Offer existing post 2012 pensioners on reduced rates the option of a pension review based on the TCA model to take effect from March 2018, with payments from Q1 2019. This calculation can include up to 20 years of a new Home Caring Credit for periods spent in homemaking/caring roles.
- Implement the TCA by Q3 2020



Implications?

- As part of the actuarial review we were asked to examine alternative TCA approaches in detail = 40ths was not one of them (30ths, 35ths) i.e. full pension delivered after 30 or 35 years of contributions
- The TCA approaches examined (30ths, 35ths) resulted (on average) in lower pensions in 2020 as compared with the existing design. Typically 40ths will result in an even lower weighted average rate but the final result will be dependent on how credits are to work and whether there will be capping. Homemaker scheme still only applies from 1994?
- Not possible to ensure there will no individuals worse off than under the current design when changing the formula for calculation unless some form of underpin or guarantee is given that pension will be no less worse than previous calculation rules
  - Could view this as compromising the objectives somewhat in that performing calculations under both sets of rules and is administratively complex
- Alternatively accept the inevitability that some will be worse off than under the previous design but try to minimize…
- 87% of the Citizens Assembly members recommended that the Homemakers Scheme is backdated to 1973

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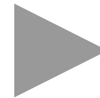
Pension Roadmap 2018 - 2023: State pension

State pension age

- Ensure that there will be no further increase in the State pension age prior to 2035 other than those already provided for in 2021 and 2028.
- Ensure that any change to the State pension age after 2035 will be directly linked to increases in life expectancy. This will begin with an actuarial assessment of life expectancy in 2022 to include a review of the proportionality between time spent in working life and retirement.
- Undertake an actuarial assessment of life expectancy every five years to inform State pension age decisions (i.e. the next assessment after 2022 will take place in 2027)



Implications?

- No change to SPA for immediate to medium term future other than an increase to 67 in 2021 and to 68 in 2028
- For changes thereafter there will be an actuarial assessment every 5 years (presumed to coincide with the actuarial review of the SIF)
- This in itself will have implications for numbers going onto Jobseekers and other benefit types (possibly increased incidence of invalidity, illness benefits) during the additional "gap" years from point of retirement from the workforce and the state pension kicking in
- Not clear whether current transitional measures for Jobseekers benefits for those aged 60+ will be extended?
- Other changes to SPA may occur after that point but noted that recent studies are indicating that the rate of mortality improvements previously anticipated are slowing down particularly at older ages.

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Pension Roadmap 2018 - 2023: State pension

Funding state pensions on a sustainable basis

The Government proposes to move to a system whereby social insurance contribution rates and contribution classes are actuarially reviewed on an annual basis to determine what changes would be required to fund benchmarked increases in payment rates or expansion of benefits cover.

- Progress work to consider and present options for the amalgamation of USC and PRSI, via the Working Group recently established by the Minister for Finance.
- Publish a consultation paper on an appropriate rate-setting/funding approach for the Social Insurance Fund by the end of Q4 2018.

Implications?

- What is "sustainable"? It is a subjective concept
- Roadmap: *"Affordable benefits that do not undermine competitiveness and do not undermine competitiveness of flexibility in the labour market"*
- Can we come up with a robust definition?
- Attempts in other countries to perform relevant calculations –e.g. the steady state method in Canada, the actuarial balance method used in the US, general average premium method used in other countries where ILO has helped establish SSRS
- The benefits from the SIF are a social contract constituting an obligation rather than a liability?
- Does the definition need to take account of other "age related" expenditure pressures including healthcare?
- As an aside noted that Citizen's Assembly "How we best respond to challenges and opportunities of an ageing population" :
    - Recommendation 5 was *In this question members were asked to rank in order of preference where they believed overall funding for care of older people should come from. A compulsory social insurance payment received the most first preferences.*
- Gives rise to the suggestion that more benefits should potentially be payable from the SIF or some reformed version of the SIF requiring amalgamation of PRSI and USC?

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State pension -wider context

A holistic assessment

- A holistic assessment of all age-related expenditure on a consistent basis needed to inform the debate?
- Can we determine sustainability of the state pension and other SIF line items without knowing what other items (including other age-related expenditure such as long term care, health and indeed non contributory pensions) are likely to cost?
- We were not required to project non contributory pensions and other means tested payments including invalidity pensions as part of the actuarial review exercise as not within scope. These items are financed from general taxation rather than the SIF.
- The International Actuarial Association recommends that (notwithstanding the conditional nature of these benefits reflecting the ability of governments to change future benefits and entitlement), actuarial projections of cashflows should be prepared on a regular basis.

Mandatory retirement ages in the workplace

Existing mandatory retirement ages will become increasingly difficult to justify:

Per the Citizens Assembly report "How we best respond to challenges and opportunities of an ageing population" which is cross referenced in the roadmap:

- 96% of the members recommended the removal of the anomaly, which arises when a person who must retire at 65 is not entitled to the State pension until 66
- 86% of the members recommended abolishing mandatory retirement based on age

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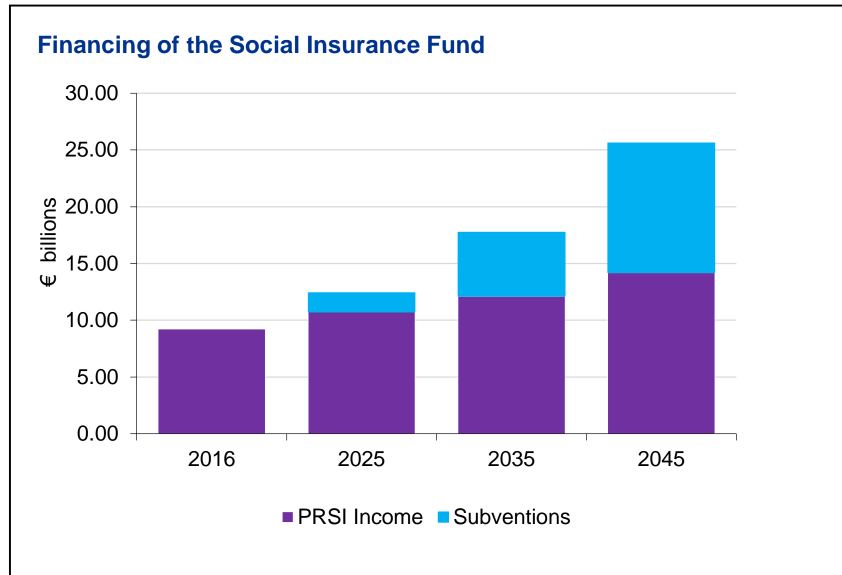
Recap - results Actuarial Review 2015

Performed in 2017

Overview of Key results



- The Fund currently has a modest surplus of income over expenditure in cash terms (2016 surplus of €0.4 billion on expenditure of €8.8 billion and receipts of €9.2 billion)
- The surplus is projected to increase in 2017 before reducing in the period 2018 to 2019 and returning to a small shortfall in 2020
- The annual shortfalls are projected to increase from 2021 onwards as the ageing of the population starts to impact
- In the absence of further action to tackle the shortfall, the excess of expenditure over income of the Fund will increase significantly over the medium to long term. The modest 2020 projected shortfall of €0.2 billion is expected to increase to €3.3 billion by 2030 and to €22.2 billion by 2071
- As a percentage of GDP, the shortfall is projected to increase from 0.1% of GDP in 2020 to 0.9% in 2030 and 3.1% in 2055 before gradually reducing to 2.9% of GDP by 2071
- One of the key results from this Review is the net present value of future projected shortfalls which is €335 billion based on a real discount rate assumption of 1.5% per annum

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Assumptions underpinning the core review

For the base case:

- the macroeconomic assumptions for the short term (up to 2021) projections are those set out in the Stability Programme Update of April 2017
- Thereafter, the demographic assumptions and macroeconomic assumptions from 2022 onwards are those produced by the European Commission for Ireland and intended to be used in the 2018 Ageing Report: Economic and budgetary projections for the 28 EU Member States (2016 - 2070) which is due to be published in September 2017
- The base case assumptions are therefore generally consistent with the assumptions used by the Department of Finance for current projection purposes save for an adjustment to the mortality assumptions which are in line with CSO's most recent view of mortality improvements into the long term future

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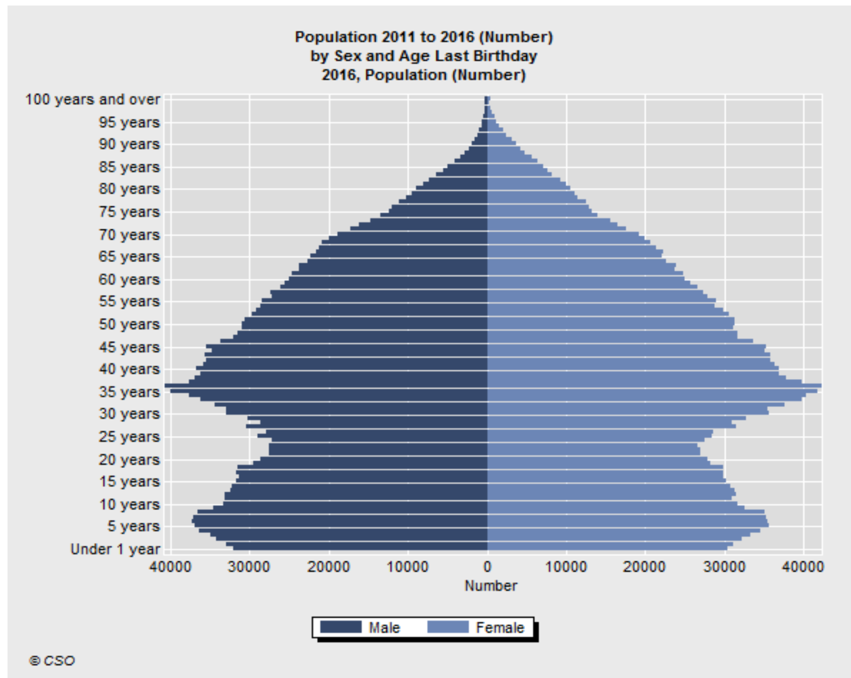
Population projections and pensioner support



- The population over State Pension Age (SPA) is projected to increase from 12% of the total population in 2015 to 17% in 2035 to 23% in 2055
- The pensioner support ratio (measured as those over 65) is projected to decline from **4.9 workers for every individual over age 66 to 2.9 workers in 2035 and to 2.0 workers by 2055**
- Alleviated by the increase in the SPA to 67 and 68 in 2021 and 2028 respectively
  - 2035 – Pension Support Ratio of 3.4 workers (from 2.9) for every individual over age 68
  - 2055 – Pension Support Ratio of 2.3 workers (from 2.0) for every individual over age
- It is the *effective* retirement age which is important.
- The 2015 Ageing Report included 2015 Irish statistics on effective retirement rates – the age at which people actually stop working - of 64.9 years for males and 64.8 years for females.
- Therefore the bolded figures may continue to provide the more meaningful measure of pensioner support ratio based on past trends

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Income and Expenditure and Deficit as % of GDP

	Income and Expenditure Projections			
Year	Receipts	Expenditure	Surplus / (Shortfall)	Shortfall as a % of GDP
2015	8.5	8.6	(0.1)	0.0%
2016	9.2	8.8	0.4	0.2%
2017	9.6	9.1	0.5	0.2%
2018	9.8	9.5	0.2	0.1%
2019	9.9	9.9	0.0	0.0%
2020	10.0	10.3	(0.2)	0.1%
2021	10.2	10.8	(0.6)	(0.2%)
2022	10.4	11.4	(1.0)	(0.3%)
2023	10.8	11.6	-0.7	(0.2%)
2024	10.6	11.9	(1.3)	(0.4%)
2025	10.7	12.4	(1.7)	(0.5%)
2026	10.8	12.9	(2.1)	(0.6%)
2027	11.0	13.6	(2.7)	(0.8%)
2028	11.1	13.9	(2.8)	(0.8%)
2029	11.2	14.1	(2.9)	(0.8%)
2030	11.3	14.6	(3.3)	(0.9%)
2035	12.1	17.8	(5.6)	(1.4%)
2045	14.2	25.6	(11.4)	(2.4%)
2055	16.9	34.2	(17.3)	(3.1%)
2071	22.5	44.7	(22.2)	(2.9%)

Pension related expenditure in 2016 is €6.1 billion rising to €12.9 billion by 2035 and €35.7 billion in 2071 i.e. 69% of overall expenditure rising to 80% over the period

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Equalised Contribution Rates

Starting	No Subvention	Subvention of 25%	Subvention of 33%
	Equalised Contributions for 5 year period		
2018	102%	77%	69%
	Equalised Contributions for 10-year period		
2018	110%	82%	73%
2028	139%	104%	93%
2038	173%	130%	116%
2048	197%	148%	132%
2058	202%	151%	135%
	Equalised Contributions for 20-year period		
2018	125%	94%	84%
2038	186%	140%	125%
2058*	201%	151%	134%
	Equalised Contributions for whole projection period		
2018	174%	131%	117%

Over the entire control period where no further change to benefits were to occur a 74% increase in PRSI income as compared with what is currently being paid would be required

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Value for money

Value for money

Similar findings to previous Reviews

- Excellent VFM achieved for:
  - those on the lower part of the income distribution
  - shorter contribution histories,
  - the self-employed.

- For those at the higher end of the income distribution, the Fund is redistributive and such contributors generally get back less than they pay in.

- The value for money impact on gender is less clear cut:

  - Women have longer life expectancies and therefore get better value for the same level of SPC
  - Men have a higher propensity to claim other benefits from the SIF including Invalidity, Jobseeker's and Illness Benefit. Where these benefits are taken into account in addition to SPC, men tend to fare better overall than their female counterparts.

[Note the incidence of a particular benefit claim will reflect the propensity to need the particular benefit but subject to satisfying the relevant contribution requirements to qualify. Note invalidity pensions payable from the SIF but there are also means-tested invalidity payable outside the SIF which were not within scope.]

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Contribution Rate Required to Replicate SPC (only)

Weekly Pension	Minimum Wage			NAE			NAE x 2			NAE x 3		
	Required PRSI Rate	Effective Annual Rate		Required PRSI Rate	Effective Annual Rate		Required PRSI Rate	Effective Annual Rate		Required PRSI Rate	Effective Annual Rate	
		Class A	Class S		Class A	Class S		Class A	Class S		Class A	Class S
€238.30	30.8%	8.2%	3.7%	15.5%	13.0%	3.7%	7.8%	13.0%	3.7%	5.2%	13.0%	3.7%
€233.60	30.2%	6.8%	3.1%	15.2%	10.8%	3.1%	7.6%	10.8%	3.1%	5.1%	10.8%	3.1%
€214.20	27.7%	5.1%	2.3%	13.9%	8.1%	2.3%	7.0%	8.1%	2.3%	4.6%	8.1%	2.3%
€202.80	26.2%	3.4%	1.5%	12.2%	5.4%	1.5%	6.1%	5.4%	1.5%	4.1%	5.4%	1.5%
€155.20	20.1%	2.6%	1.2%	9.4%	4.1%	1.2%	4.7%	4.1%	1.2%	3.1%	4.1%	1.2%
€95.20	12.3%	1.7%	0.8%	5.7%	2.7%	0.8%	2.9%	2.7%	0.8%	1.9%	2.7%	0.8%

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Contributions Rate as % Salary Required to Replicate SPC, Invalidity, Illness, and Jobseeker's

Weekly Pension	Minimum Wage			National Average Earnings			National Average Earnings x 2			National Average Earnings x 3		
	Required PRSI Rate	Effective Annual Rate		Required PRSI Rate	Effective Annual Rate		Required PRSI Rate	Effective Annual Rate		Required PRSI Rate	Effective Annual Rate	
		Class A	Class S		Class A	Class S		Class A	Class S		Class A	Class S
€238.30	36.6%	8.2%	3.7%	18.4%	13.0%	3.7%	9.2%	13.0%	3.7%	6.1%	13.0%	3.7%
€233.60	35.4%	6.8%	3.1%	17.8%	10.8%	3.1%	8.9%	10.8%	3.1%	5.9%	10.8%	3.1%
€214.20	31.7%	5.1%	2.3%	16.0%	8.1%	2.3%	8.0%	8.1%	2.3%	5.3%	8.1%	2.3%
€202.80	29.1%	3.4%	1.5%	13.7%	5.4%	1.5%	6.9%	5.4%	1.5%	4.6%	5.4%	1.5%
€155.20	22.1%	2.6%	1.2%	10.4%	4.1%	1.2%	5.2%	4.1%	1.2%	3.5%	4.1%	1.2%
€95.20	13.6%	1.7%	0.8%	6.4%	2.7%	0.8%	3.2%	2.7%	0.8%	2.1%	2.7%	0.8%

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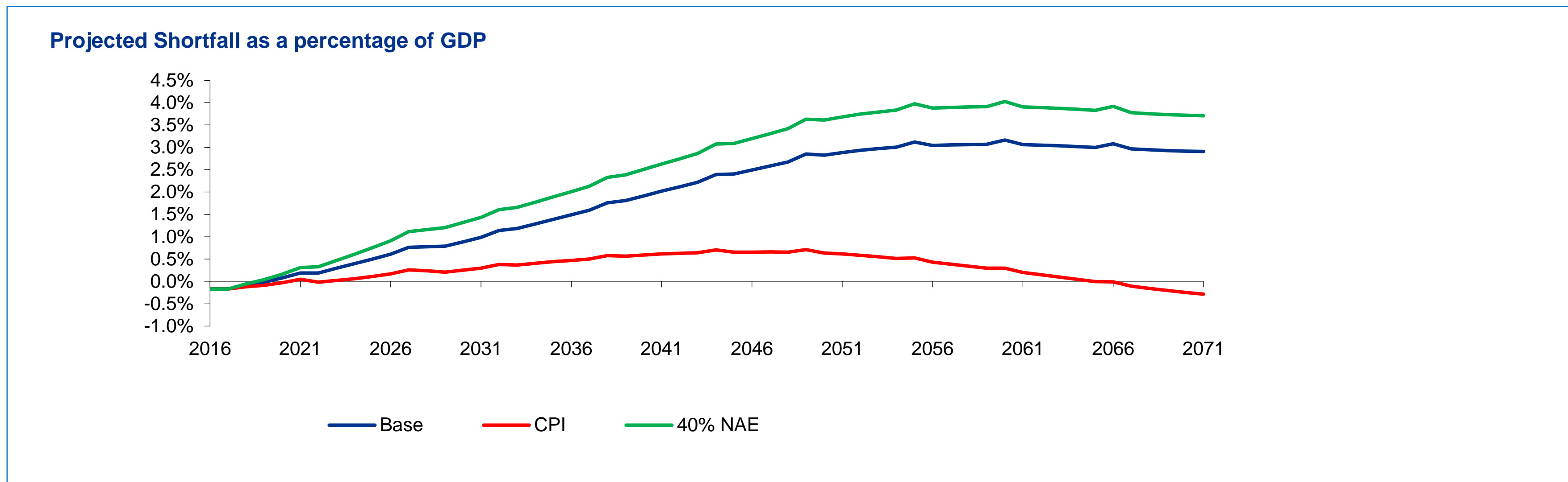
Policy Options

Indexation of benefits - crucial in longer term



- Our base case scenario assumes that benefits generally increase in line with average earnings
- Re-rating benefits in line with CPI rather than in line with earnings dramatically impacts the Fund finances and alleviates the projected shortfalls
- However, re-rating benefits in line with CPI over a prolonged period results in pension rates of payment significantly behind the current pension level of 33% of Average Earnings. The compounding effect of a given pension indexation policy becomes very material over a prolonged period.

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Policy Options - SPC Total contributions approach

- Scenario 1: 35ths, 10 year cap on credits, no “guarantee” of link to what would have been received previously under YA
- Scenario 2: 30ths, no cap on credits, “guarantee” for those retiring in the five years 2020 - 2024 of no less than 90% of the pension YA rules
- Scenario 3: 30ths for five years 2020 - 2024 reverting to 35ths from 2025 onward, 10 year cap on credits. Pension guaranteed of at least 100% of the pension under YA rules. ”Guarantee” to remain in place for 5 years (2020 – 2024)
- Scenario 4: 30ths throughout, no cap on credit, 100% guarantee

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Policy Impacts examined and results - 2020

We examined a range of alternative TCA scenarios. None of these have a material impact in the early years following introduction in 2020. It takes a number of years for changes in expenditure of any note to emerge for SPC.

For example where new entries in 2020 would comprise €208 million of expenditure in that year under existing rules, this would reduce to €199 million under the proposed TCA rules and increase to €211 million where the rules change such that the greater of current rules and TCA rules apply.

Expenditure New Recipients SPC – Yearly average (current rules) and 2020 Variants (€ millions)		
Retiring in spot year	**2020**	**2030**
Current rules ("YA")	208	323
2020 Variants ("TCA")		
30ths	199	320
31sts	197	317
32nds	195	315
33rds	192	312
34ths	190	309
35ths	188	306
40ths	177	292
Greater of YA and 30ths	211	330
Greater of YA and 35ths	209	327

The expenditure figures are higher in 2030 reflecting the fact that more individuals are expected to qualify for SPC in 2030 compared with 2020 due to:

- the ageing of the population;
- records are improving through time meaning that these individuals typically qualify for higher pension rates

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Micro Impact - proposed 2020 changes

Illustrative scenario examined

A TCA approach based on the best 30 years of contributions and credits (30ths) with an overall cap of 10 years credits, including homemaking credits, and applying a “guarantee” that the pension is no less than the pension the individual would have received under the current rules for the first five years of the new scheme (i.e. 2020 – 2024 inclusive). After the first five years have elapsed any new retirees in the scheme will receive a pension based on a TCA approach reflecting 35ths and a 10 year cap on credits

Overall profile of those impacted	Yearly Average (current rules)	Illustrative TCA design	Yearly Average (current rules)	Illustrative TCA design
Retiring Sample	2020		2030	
	Current rules	Greater of YA and 30ths: Cap	Current rules	35ths
Overall weighted average pension	93.3%	94.9%	94.4%	89.4%
Increased SPC	0	10,661	0	8,366
Decreased SPC	0	0	0	14,965
Greater than 10% increase SPC	0	153	0	0
Greater than 10% decrease SPC	0	0	0	9,945
Total in Sample	**31,107**	**31,107**	**39,547**	**39,547**

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