



THE ASPEN INSTITUTE

INITIATIVE ON FINANCIAL SECURITY

ISSUE BRIEF ■ NOVEMBER 2004

FILLING THE RETIREMENT SAVINGS GAP IN IRELAND

*By Lisa Mensah, executive director; Rachel Schneider, associate director;
and Magda Aboulfadl, program associate*

The Irish government introduced the Personal Retirement Savings Account (PRSA) in 2003 in order to increase the country's private pension coverage. The PRSA was designed to appeal chiefly to people consistently left uncovered by existing pension arrangements. Although it is too early to judge its ultimate success, the PRSA already stands out as a model of government creativity and active commitment to dramatically increasing retirement security.

The mission of the Initiative on Financial Security (IFS) is to examine solutions to America's asset crisis so that more Americans can own homes, finance college, start businesses and prepare for a secure retirement. In collaboration with business leaders, IFS is exploring and recommending financial products that create asset building opportunities for the tens of millions of working Americans who currently lack access to tax-advantaged or employer-subsidized savings vehicles. IFS is supported by the Ford, Charles Stewart Mott and Annie E. Casey Foundations.

BACKGROUND

Retirement in the industrialized countries in the 21st century could be a more impoverished experience for many than it was in the second half of the 20th. In the coming decades, there will be fewer workers per retiree paying into state pension funds and people will live decades past the traditional retirement age. Public, employer and individual retirement savings are, on the whole, currently insufficient to fill the gaps in retirement funding created by these demographic trends.

Achieving genuine retirement security will entail finding workable arrangements at all three levels. A key concern is that not all workers have the same access to existing savings structures. Moreover, certain groups of workers are more likely to be excluded than others. In the U.S., for example, only slightly more than one-quarter of people earning between \$10,000 and \$15,000 are covered by their employer,¹ and vesting requirements disqualify short-term and part-time workers. At 50%, the employer provided private pension

coverage rate for workers in both the U.S. and Ireland is higher than in many countries, but is still disturbingly low. In Ireland, the government's solution to low private pension coverage is the Personal Retirement Savings Account (PRSA), which was created as a structure to reach those not currently saving for retirement, whether by choice or by exclusion. Combining elements of employer provided and individual savings plans, the PRSA stands out as an important case study in pension reform.

WHY A PRSA?

Ireland's comparatively young population buys policymakers some time, but this reprieve will not last forever: by 2031 the current ratio of five workers to one retiree is projected to drop to fewer than three to one.

Employment and pension provision patterns in Ireland have changed considerably over the last generation in ways similar to the U.S. Employers are moving away from paying for traditional pension plans that guarantee a lifetime income stream toward providing 401(k)-type retirement savings plans that are primarily funded by employee contributions and subject to investment risk. At the same time, long-term employment with the same employer is less common. A 1995 government sponsored survey showed that only about half of Irish workers had private pension coverage. More than 70% of the self-employed were found to be uncovered.²

These findings prompted the government to set in motion a multi-sector

"As the structure of work changes around the globe, pension benefits are increasingly endangered. The Irish government has done a great service by making sure that anyone who wants to set money aside for retirement has an equal opportunity to do so. Ireland has been steadily moving out of poverty in recent decades, although not everyone has benefited. Old age poverty cannot be allowed to slip in through the back door and threaten this progress."

*- Mary Robinson,
Former President of Ireland*

consultative process that culminated in a 1998 report outlining recommended reforms to the entire pension system, including the creation of a new personal retirement account.³ Thus the PRSA was born.

WHAT IS A PRSA?

The PRSA is a tax-advantaged savings and investment retirement account that can be opened by any individual regardless of employment status. Private sector financial institutions are the sole sales agents and must be authorized by the Irish Financial Services Regulatory Authority to enter the PRSA market.

As with the Individual Retirement Account in the U.S., individuals can purchase a PRSA from and contribute directly through a financial institution. However, individuals can also access a PRSA through their employer and contribute through automatic payroll deduction, making the distribution of the account similar to an employer provided 401(k)-type plan.

EMPLOYER ROLE

Employers who do not offer their own pension plan, whose plan does not allow for additional voluntary contributions or whose plan excludes certain workers or makes them wait longer than six months to join the plan, are *required by law* to facilitate their employees' access to a PRSA. No employer is exempt, and seasonal, part-time and fixed-term contract employees may not be excluded.

Employers' responsibilities include choosing and entering into a contract with an authorized PRSA provider, notifying eligible employees of their right to open an account, providing for automatic payroll deduction and making work time available for employees to meet with a sales agent. Neither employers nor the government bears fiduciary responsibility for the accounts. Employers do not have to contribute to PRSAs, but those who do

can deduct their contribution from their corporate taxes, subject to certain limits.

Precautions have been taken to ensure that the introduction of the PRSA does not undermine existing employer provided pension plans. The Pension Board's consumer guide cautions that PRSAs are largely aimed at people who are not already participating in an employer provided plan. Transfers from employer provided plans to PRSAs are restricted and providers who recommend such a transfer must explain the benefits of the transfer in writing to the client.

For workers who change jobs with some frequency, however, one of the major advantages of the PRSA is its portability. PRSAs can be transferred among providers and into employer provided plans without paying any fees or taxes.

CONTRIBUTIONS

Contributing to a PRSA offers two primary tax benefits:

1. Income and social insurance taxes are not levied on contributions. The percentage of income on which workers can receive tax relief begins at 15% and increases with age to 30% for workers aged 50 and over.

The maximum annual income toward which tax relief percentages are applied is 254,000 euros (~\$314,500). Employer contributions are counted toward this limit. Contributions that exceed the tax relief limit are allowed, but receive no income or social insurance tax relief. These excess contributions, however, may be applied toward the following year's tax relief maximum.

2. Investment income and gains are not taxed, including those on excess contributions.

INVESTMENT OPTIONS

There are two categories of PRSAs, differentiated primarily by their investment options and service charges. The Standard PRSA can only invest in pooled funds (funds in which multiple

investors contribute assets and hold them as a group) and service charges are capped at 5% of contributions paid and 1% of assets per year. The financial regulator recommends the Standard PRSA for most people because of its lower risk and costs. Employers are required to provide access to at least one Standard PRSA. The non-Standard PRSA allows investments in funds other than pooled funds and providers may set their own service charges.

Both types of PRSA have a Default Investment Strategy, which is required to be a fund that shifts automatically from primarily equity to primarily fixed income investments in order to decrease risk progressively as retirement age approaches. Consumers can choose a different investment strategy, but must opt out of the Default Investment Strategy in writing first.

DISTRIBUTION

Benefits are taken between the ages of 60 and 75. One-quarter of the PRSA's value can be taken as a tax-free cash lump sum at retirement. Withdrawals beyond that amount are taxed. The distribution method of the balance depends on what other sources of retirement income the individual retiree has. The Irish system favors annuities, which ensure guaranteed annual retirement income for life. Retirees who do not have a guaranteed income of at least 12,700 euros (~\$15,300) per year, including their government pension, are required to spend at least 63,000 euros (~\$76,000) of their retirement account balance to buy an annuity or to leave that amount in their account until age 75.

WILL THE PRSA WORK?

The PRSA was introduced specifically to increase private pension coverage from 50% to 70% of the workforce over age 30. Introduced in February, 2003, the PRSA is still in its infancy. Although it is

MANDATORY CONTRIBUTIONS?

The issue of making employer contributions mandatory arose during the pension reform discussion but was postponed until 2006, when the government is committed to reporting on the PRSA's progress. Mandatory employee contributions are also on the table. In early 2004, financial services executives who were worried about low PRSA take up rates made this suggestion⁴ and later that year the Social Affairs Minister warned that contributions could become mandatory if not enough employees purchase PRSAs voluntarily.⁵

therefore too early to conclusively judge its effectiveness, some preliminary observations can be made.

Approximately 350,000 people would have to acquire a pension for the first time for the 70% coverage goal to be met.⁶ As of September 2004, a year-and-a-half after appearing on the market, 37,086 PRSAs had been sold with a total value of 106.6 million euros.⁷

The PRSA was designed to help increase pension coverage partly by appealing to "excluded workers." As described by the head of the Pensions Board: "The aim is that the PRSA will be a low-cost, easy-access, long-term personal investment account available to all. . . It is intended to be particularly suitable for women, part timers, contract workers and those in lower paid employment."⁸

The Pensions Board requires financial institutions to provide information quarterly and annually on the number and employment status of contributors, as well as on the level and source of contributions. However, neither this information nor the follow-on analysis of the PRSA market has been made publicly available.

In the meantime, initial anecdotal evidence on how the PRSA is meeting its goals is mixed. Two leading financial institutions that together have a 70% share of the PRSA market reported that many of their PRSA customers were first-time buyers and that some are younger as well as from a lower income base, i.e. just the populations the PRSA targets.⁹ On the other hand, PRSA sales have been weak at another major financial institution relative to sales of other private pension products, although this may be because this institution sells most of its products through brokers, who have less financial incentive to actively sell the PRSA because of the cap on service charges.

There is a structural issue that may keep the PRSA from reaching one its target groups: there is no incentive to save—such as a match or refundable tax credit—for lower income workers whose tax liability is insufficient to benefit substantially from the improved tax relief the PRSA offers. Ireland already has experience using matching funds as an incentive for individuals to save. In 2001 the government introduced the Special Saving Incentive Account (SSIA), which provided a 25% match on deposits (up to 63.50 euros monthly, or ~\$78) for a limited five-year period to anyone who wanted to participate. A refundable pension tax credit has been suggested by Ireland's largest trade union as a way to give lower income workers more incentive to purchase a PRSA.¹⁰ If these or other incentives are not introduced, an important target group could remain uncovered even as overall coverage increases.

Other issues, however, suggest that PRSA sales will increase as time progresses. Some observers in Ireland considered sales to be slow during the first year in part due to initial bad press about operational problems that arose after the launch, competition for deposits from the SSIA and a delay in the rollout of the government's

campaign. Today those operational problems are being smoothed out, the SSIA is no longer available and a focused multi-media awareness campaign is firmly underway throughout the country.

WHY THE PRSA MATTERS

Many countries are struggling with similar pension coverage problems, and are searching for simple, portable products that will incentivize private savings without disrupting employer coverage. The PRSA experience to date highlights several important design points for policy-makers in other countries to consider as they search for solutions.

KEEP IT SIMPLE

Neither buying nor selling the PRSA is as simple a process in practice as originally envisioned. From the consumer perspective, the PRSA complicates the market because it adds to, rather than replaces, existing personal pension products. For their part, financial institutions find the double layer of consumer protection measures burdensome. The financial regulator approves each PRSA product but also mandated an extensive one-on-one sales process. In combination, these measures make the PRSA more difficult and expensive to sell, which may have led to fewer financial institutions entering the market and less active marketing of the PRSA.

The Standard PRSA is nevertheless simpler than previous personal pension products. The default investment choice and standardized costs may increase sales by decreasing many individuals' resistance to purchasing financial products. It is notable that 80% of the PRSAs sold were Standard PRSAs. The experience of the Standard PRSA therefore suggests that simple, standardized products that appeal

to consumers and financial institutions alike are the best way to reach the uncovered.

INNOVATE

The architects of the PRSA were particularly creative in reconfiguring the roles of employers and financial institutions in their attempt to expand pension coverage. The decision to require all employers to act, in effect, as distribution agents for the PRSA dramatically increases employees' exposure to and therefore likelihood of purchasing a PRSA. The probability of increased sales is likewise heightened by the financial institutions' ability to gain access to groups of pooled customers by marketing PRSAs directly to employers, thereby aggregating small accounts that would otherwise be costly to acquire and service. Preliminary PRSA sales data suggests that mandated employee access will be effective; as of

September 2004, nearly half of those sold were sold through an employer.

ACT

Ireland looked at its pension system shortcomings squarely, acted upon what it found and set for itself the highly visible goal of increasing private pension coverage from 50% to 70% of the workforce over age 30. The PRSA stands out as one of the very few attempts worldwide to consciously target "excluded employees" as part of the effort to expand pension coverage to a nationally acceptable level. Moreover, care was taken not to erode the viability of existing employer provided pension plans or the state pension system. While the specific characteristics of effective pension reform will vary from country to country, more nations must follow Ireland's lead and experiment with new pension solutions.

- ¹ Peter R. Orszag, Iris Lav, and Robert Greenstein, "Exacerbating Inequities in Pension Benefits: An Analysis of the Pension Provisions in the Tax Bill." Center on Budget and Policy Priorities, 8 October 1999, p. 3.
- ² Gerard Hughes and Brendan Whelan, "Occupational and Personal Pension Coverage 1995." The Economic and Social Research Institute, Dublin, 1996.
- ³ The National Pensions Policy Initiative. See <http://www.pensionsboard.ie/information/booklet13.asp>.
- ⁴ Keane, Conor. "'Too Early' to Make PRSAs Compulsory." Irish Examiner, 21 January 2004.
- ⁵ <http://www.breakingnews.ie/2004/09/09/story165702.html>.
- ⁶ See <http://www.pensionsboard.ie/publications2.asp?id=4&name=News+Updates&rid=30> for highlights of the Pension Coverage Survey of 2002 and <http://www.cso.ie/pressreleases/qnhsq202.html> for employment figures from the Central Statistics Office of Ireland.
- ⁷ http://www.pensionsboard.ie/_fileupload/members/PRSAFigsforQ32004.doc
- ⁸ <http://www.siptu.ie/nwf/pens.html>.
- ⁹ Aughney, Jim. "Pension Managers Welcome Big Increase in the Take-Up of PRSAs." Irish Independent, 13 January 2004.
- ¹⁰ "SIPTU Seeks More Tax Breaks." Irish Times, 3 October 2003.



THE ASPEN INSTITUTE

The Aspen Institute is an international non-profit organization founded in 1950. Its mission is to foster enlightened leadership, the appreciation of timeless ideas and values, and open-minded dialogue on contemporary issues. Through seminars, policy programs, conferences and leadership development initiatives, the Institute and its international partners seek to promote the pursuit of common ground and deeper understanding in a nonpartisan and nonideological setting.

Copyright © 2004 by The Aspen Institute. All rights reserved.
Printed in the United States of America. ISBN: 0-89843-419-X