SWIMMING AGAINST THE TIDE – Mandatory or Voluntary DC for Ireland?

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Like many pension systems around the world, the retirement model for Ireland is undergoing change. Now at a vital crossroads in terms of policy, the future direction has significant implications for retirement savers. Industry stakeholders will need to focus on improving participation and savings behaviours, regardless of the structure that is ultimately adopted.

The Society of Actuaries in Ireland (SAI) recently proposed that the government should make contributions to pension schemes mandatory by the year 2019. In their view, it is only by adopting this obligatory route that a requisite level of pension coverage and adequacy could be truly attained. Only around half of workers aged between 20 and 69 are currently enrolled in an occupational or personal pension scheme.[1]

MYSAVER – REFORM IN PROGRESS

The current Irish pensions system bears a striking similarity to the one that was in place in Britain before recent reforms and the introduction of auto enrolment. Now it is generally accepted that change is also needed in Ireland where pension coverage is low and the state pension is likely to be an inadequate source of income replacement at retirement.

An OECD review of the Irish pension regime in 2013[2] discussed mandatory contributions but also examined the merits of auto enrolment, whereby individuals are enrolled into a pension scheme but have the option of opting out. The Irish government has committed to introducing a comprehensive occupational pension scheme to achieve universal coverage. Indeed, the new scheme was recently given a name — MySaver. But the debate over whether it will be a mandatory system or a quasi-mandatory auto enrolment system similar to the UK is ongoing. Although the economy has rebounded somewhat from post-financial crisis lows, there remains some reticence to executing reforms at a time when workers are still recovering from the legacy of austerity.

Lessons can be learned from other countries where research on opt-out rates is not as disappointing as many would think.

However, the improving market environment may help ease concerns that a population suffering from austerity-fatigue might take the first chance to opt-out, which would quickly defeat the overall purpose of the scheme. In fact, the OECD report suggested that the greatest dropout rates would be concentrated in the lowest income groups – although this hasn't necessarily proven to be the case in other systems around the world.

It is for this reason that the SAI holds the view that a mandatory system is superior to an auto enrolment regime, although for people already finding it hard to make ends meet, the mandatory approach might seem penal. Interestingly, the OECD's report also indicated that the Irish government should gravitate towards a mandatory or quasi-mandatory system. This is not surprising given that it would reduce the pressures on the public purse by maximising the number of people providing for themselves in the future, thereby relieving the burden on the state.

LESSONS FROM ABROAD

Lessons can be learned from other countries where opt-out rates have been lower than expected. Inertia is a powerful force and, in the same way that a large number of pension scheme members end up in the default fund, a high proportion typically remain enrolled in the pension scheme itself. In fact, across all the public and private sector employers included in a study commissioned by the UK's Department for Work and Pensions in 2013, the average opt-out rate was just 9%.

Ireland's population isn't ageing as rapidly as other countries, so the tipping point in terms of pension funding is likely to be further off. Ireland may have a little more time to analyse the various approaches and learn from the experience of others.

Whatever route is chosen, be it mandatory or auto enrolment with an opt-out facility, the focus on improving participation and savings behaviours needs to be paramount. Overall, the universal lesson learned elsewhere is that the status quo is not sustainable.

Top 3 Tips For Trustees And Sponsors

In anticipation of changes to the DC pension system in Ireland, there are actions that can be considered now to help members be better prepared.

1. SETTING GOALS

Ensure members are motivated to consider their goals in retirement. This lays the groundwork for taking action on savings.

2. PROMOTE THE SAVINGS HABIT

Help members understand the link between savings and retirement aspirations. Starting early and saving more means retiring better.

3. TARGETED COMMUNICATIONS

Consider the range of communications and decision tools that can help members engage with their DC plan. Pension calculators, information sessions and social networking can help.

[1]Quarterly National Household Survey Quarter 4 2009. [2]Review of the Irish Pension System, OECD April 2013. IREMKT-1146 Exp. 31/07/2015.