SECTION 4.4 AE STRAWMAN - FINANCIAL INCENTIVES PROVIDED BY THE STATE

STRAWMAN PROPOSALS

FINANCIAL INCENTIVES PROVIDED BY THE STATE

- The State will provide an incentive for people to participate in the AE system.
- Although both the value and the mechanism for providing this incentive will only be finalised following this consultation, the incentive is, for the purpose of this Strawman, presented as a contribution worth €1 for every €3 the employee contributes towards their retirement savings account.
- Where the employee makes contributions in excess of minimum requirements, the State may also make additional contributions subject to a maximum level of contributions of 2% of annualised salary.
- The State contributions will match employee contributions on a pro-rata basis subject to a cap – possibly linked to a defined annual earnings level such as the proposed €75,000 maximum earning threshold or an average annual earnings threshold as reported by the Central Statistics Office.

The Government has confirmed that, under an AE system, the State will support employees by financially incentivising retirement saving. To this end, and to underpin the development of an AE system, the Government's 'Roadmap for Pensions Reform 2018-2023' contains a commitment to review the cost of funded supplementary pensions to the Exchequer[29]. This review is in progress and a separate public consultation process is currently being undertaken via the Interdepartmental Pensions Reform and Taxation Group and the Department of Finance in this regard[30].

It is intended that this review, together with feedback received during the AE Strawman consultation process, will inform future Government decisions relating to the level of financial incentive and the most appropriate manner in which this incentive should be delivered under the AE system.

RATIONALE FOR STATE INCENTIVES

1. Within the resources available, any State provided financial incentive should be structured in a way that best supports the policy objective of AE and promotes long term saving. This should target the current gap in coverage of retirement savings, i.e. primarily those with low to middle incomes. It should improve coverage and adequacy for those with intermittent employment patterns and help address the gender gap in pensions coverage amongst private sector employees.
2. Available literature indicates contributions to voluntary retirement saving pension plans benefit from tax advantages in most OECD countries. Typically these tax advantages take the form of a deduction on the

29 At present, the State incentivises supplementary pension provision in the form of tax relief on a saver pension contributions.
30 See https://www.finance.gov.ie/updates/invitation-to-make-a-submission-to-idprtg-public-consultation

income tax base. The OECD has expressed the view that given that retirement savings generally increase with income level, "an incentive structure skewed toward higher income may be far from the best way to increase participation and contributions[31]".

3. At present, Ireland's highly progressive income tax system results in, for example, a single individual entering the higher income tax bracket below average earnings. At these moderate income levels, marginal relief represents a significant financial incentive for pension savings. In addition, the 'Exempt, Exempt, Taxed' (EET) structure of providing tax relief means that while those on higher incomes may receive higher levels of tax relief during the savings phase, a pension is taxed at prevailing tax rates through the income tax system in retirement.

4. Nevertheless, tax reliefs as currently structured in Ireland provide a more limited incentive, or indeed no incentive, for workers on lower incomes.

5. In addition, despite the cost of tax reliefs to the State[32], the benefits of tax relief are not at all well understood. Research in the UK has shown that 66% of those surveyed had little or no understanding of how the tax system impacts pension contributions[33]. To enhance the potential for the success of AE, the financial incentives should be structured in such a way that caters best for the target employee group and be sufficiently attractive to encourage such earners to participate.

6. Any financial incentive for AE should be effectively communicated, easily understood and appreciated. The €1 for every €3 saved approach, set out for illustrative purposes, is easy to communicate and simple to understand. This could counteract the risk of opt-outs, in a system which will for the first time introduce an element of compulsion to retirement saving.

7. A system of 'matching contributions' for retirement savings has previously been advocated and would be income-neutral (i.e. the incentives are the same for all income levels)[34]. A key advantage of any system which standardises the level of saving incentive and presents it as a 'top up' to a member's contribution is the simplicity of the message. Standardisation of the incentive for pension saving was previously proposed as a way to restructure the pensions system in the National Pensions Framework (2010). The reasoning given for this reform proposal was that it would "promote simplicity and equity and ensure that similar options are available to all groups of employees"[35].

8. Irrespective of the manner in which the incentive is designed, a new form of incentive could be introduced based on the State uprating the worker's contributions on a matching basis and be presented as a '€Saver's Bonus'.

31 OECD 2012 Pensions Outlook p.173.
32 The Department of Finance estimate that the annual subsidy is €2.4 billion, and it represents the single biggest component of tax expenditures, accounting for about 45% of total tax expenditures (€5.3 billion) in 2014.
33 http://www.aviva.com/media/news/item/uk-two-thirds-of-people-in-thedarkover-pension-tax-relief-17526/
34 https://www.oecd.org/daf/fin/private-pensions/DCPensionDesignHighlights.pdf p.7.
35 The 2009 Commission on Taxation also recommended equalisation of tax relief for an individual's pension contributions citing reasons of equity and to provide an incentive to save. A matching contributions approach was also advanced. See http://irserver.ucd.ie/bitstream/handle/10197/1447/Commission_on_Taxation_Report_2009.pdf?sequence=1

9. Some AE systems around the world operate a cap on the value of the State incentive, the purpose of which is to help to manage costs. This consultation process will consider the cost to the State, and by extension the taxpayer, of providing a financial incentive to encourage sustained participation in the AE system. As an illustration, if 80% of the 410,000 people eligible for automatic enrolment under the contribution levels detailed in this Strawman proposal (6%, 6%, 2%) remained enrolled for a full year then the cost to the State of a 2% contribution, presuming all were on the average national wage, would amount to c. €248m.

10. Further evidence building and detailed analysis and sectoral engagement will be undertaken before any Government decisions are made.

SOME SUGGESTED QUESTIONS TO CONSIDER

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?

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

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

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