LAW SOCIETY SUBMISSION

LAW SOCIETY OF IRELAND

RESPONSE TO CONSULTATION ON SUPPLEMENTARY PENSIONS REFORM: ROADMAP FOR PENSIONS REFORM 2018-2023

THE INTERDEPARTMENTAL PENSIONS REFORM AND TAXATION GROUP (DEPARTMENT OF FINANCE)

OCTOBER 2018

ABOUT THE LAW SOCIETY OF IRELAND

The Law Society of Ireland is the educational, representative and regulatory body of the solicitors' profession in Ireland.

The Law Society exercises statutory functions under the Solicitors Acts 1954 to 2011 in relation to the education, admission, enrolment, discipline and regulation of the solicitors' profession. It is the professional body for its solicitor members, to whom it also provides services and support.

The headquarters of the organisation are in Blackhall Place, Dublin 7.

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1. Introduction and General Observations

1.1 The Law Society is pleased to provide its views to the Interdepartmental Pensions Reform and Taxation Group on specific elements of the Consultation Paper on Proposed Supplementary Pensions Reform.

1.2 The Law Society is the representative body for solicitors in Ireland. We represent over 11,000 members (spread over the public and private sectors), of which a significant proportion are self-employed.

1.3 The Law Society considers that pensions reform must create a level playing field for both the public and private sector, and the cost to the Exchequer of pensions arrangements for both needs to be evaluated with this in mind.

1.4 Equally, a fair regime should prevail as between those in employment and those in self-employment, which is not always the case at present.

1.5 The Law Society also considers that pension arrangements should be capable of being used flexibly and accessible by individuals to facilitate partial draw down over a certain age, perhaps 55, whilst continuing to work, perhaps on a part time basis as the individual approaches retirement.

1.6 Equally, greater flexibility should be afforded in relation to the quantum and the timing of the payment of contributions to retirement benefit arrangements.

1.7 We consider that the structure of pensions arrangements should be reworked to enable greater economies of scale, as regards running costs, and other charges both in the accumulation phase and at drawdown. It is clear from recent reports (e.g. the Pensions Council Report on ARF charges [2016]) that the level of charges, especially in smaller arrangements, impact the level of benefits enjoyed by members.

1.8 Below we set out our response to certain questions in the consultation. Not all questions in each section of consultation have been responded to.

2. Response to Section A of the Consultation: Simplification and Reform

A1. Do you agree that PRSAs, BoBs and RACs largely fulfil the same function for a consumer and that it would be beneficial to simplify the DC contract landscape by prospectively ceasing BoBs and RACs? If not, why?

2.1 While it may appear that Personal Retirement Savings Accounts (PRSAs), Buy-out-Bonds (BoBs) and Retirement Annuity Contracts (RACs), in simplistic terms, fulfil similar functions for a consumer, in fact, the detail between all, and their usage within the pensions industry differs significantly.

2.2 RACs, while similar in some respects to PRSAs, allow the consumer a broader range of investment options.

2.3 In addition, *many representative bodies and similar entities provide a Retirement Trust Scheme for their members, via a RAC. For instance, the Law Society provides such for its members (the Law Society's Retirement Trust Scheme (LSRTS)). These arrangements are regulated under the Pensions Act 1990 and members have the benefit of the protections that trust law brings, as well as economies of scale inherent in a large pension scheme. It would not appear to be appropriate to replace this with a group PRSA product, the charges of which could be greater than currently apply to an existing Retirement Trust Scheme.*

2.4 BoBs are the vehicle of choice when a member of an occupational pension scheme is being transferred out without their formal agreement, either on the wind up of the scheme or where the size of the member's pot is valued at less than €10,000. They are usually chosen by scheme trustees (usually having taken professional advice) as opposed to scheme members, which may afford the member a level of protection when compared with a PRSA or a RAC, which can be entered into by a consumer without a requirement for advice to be taken. It should also be noted that BoBs are not capable of being used as a retirement savings product; a transfer is generally made from a scheme into a BoB, after which the individual is not required to input into the future management of the BoB or to make investment decisions. Again, this differs significantly from the position with a PRSA, which requires ongoing oversight by the consumer.

A2. What, if any, positive or negative consequences would you foresee from the prospective cessation of BoBs and RACs? What changes would be required to the legislation governing PRSAs? What transitional measures would be required?

2.7 PRSAs, RACs and BoBs are written under contract and the holder does not have the benefit of the protections of trust law available to members of a trust RAC. Removing the trust RAC option would remove the protections offered by having trustee oversight and would also mean that individuals who are currently included in trust RACs would have a lower level of protection with respect to potential attack by creditors.

2.8 In addition, with PRSAs, RACs (other than trust RACs) and BoBs, there is no third party involved to ensure that the individual is getting a reasonable return on the investment made, when initial and recurring charges are taken into account.

2.9 It would not be desirable to require the holder of a PRSA, RAC or BoB to move into any product due to the implementation of pensions simplification if the result is that the member suffers greater charges than would have occurred had no change arisen.

2.10 As noted above, in the event that, on the wind up of a scheme, members are required to transfer into a PRSA as opposed to a BoB, an ongoing level of involvement or oversight will be required from the member, which is not required with a BoB.

A3. What changes would you recommend to the design of the PRSA product?

2.11 The Law Society does not wish to make a submission on this point.

A4. In terms of pension vehicle rationalisation, what impact could the introduction of the pan-European Personal Pension Product (PEPP) have?

2.12 It is difficult to envisage what kind of impact the introduction of the pan-European Personal Pension Product (PEPP) could have in terms of pension vehicle rationalisation.

2.13 At a basic level, the introduction of an additional pensions product would appear to be unhelpful in circumstances where rationalisation is the goal. However the introduction of a portable pension product that could potentially benefit from European-wide economies of scale appears to be a positive development.

2.14 While the PEPP will clearly appeal to individuals who require a pensions product that is easily portable cross-border, within Europe, it is less clear whether individuals who are based within Ireland and anticipate that they will remain in Ireland during their retirement would be interested in this product. This will depend in part on how the PEPP is presented, how it is structured and what advantages it offers.

2.15 It may be the case that individuals who might otherwise have invested in a PRSA would invest in a PEPP were it to be a product that the public find easy to understand and that offers advantages such as cross-border economies of scale.

A5. In what ways would consumers benefit or be disadvantaged by the standardisation of minimum and maximum drawdown ages across occupational schemes and personal pension products?

2.16 The standardisation of minimum and maximum drawdown ages would simplify the pensions landscape significantly. However, unless the standardisation is to the most flexible minimum and maximum drawdown ages, some individuals will be disadvantaged.

2.17 As things stand, an individual with a personal pension (usually those who are self-employed) cannot (absent ill-health) take their benefits before age 60 and can continue to contribute until age 75.

2.18 An individual with a PRSA can take benefits from age 50 if they are an employee, without actually retiring from employment – the individual can take up employment with a different company. Again, individuals with PRSAs can continue to make contributions up to age 75.

2.19 Individuals with an occupational pension scheme (“OPS”) can take benefits from age 50, where they stop working and the trustees and employer of the scheme agree. Normal retirement age is required to be set between 60 and 70.

2.20 These differences mean that it is difficult for consumers to understand the options available to them and, in some circumstances, may make it difficult for a consumer to switch between products. That said, having products with different drawdown ages would appear to allow some individuals to phase their retirement.

2.21 The Law Society recommends that, given the changing circumstances with respect to the State pension age and people working for longer, standardising the upper drawdown age across all arrangements at 75 is something that should be considered.

A6. Would harmonising the treatment of employer contributions to occupational schemes and PRSAs be beneficial? How would this be best achieved? Would it result in a shift from single member schemes (and possibly SSAPS?) to PRSAs? How would any change impact the funding incentives for employees/employers?

2.22 The Law Society considers that harmonising the treatment of all contributions to OPS, RACS and PRSAs would be beneficial and that there is no justifiable reason to retain the differential treatments that prevail.

2.23 It seems inexplicable that there is an effective cap on the annual amounts that may be contributed in respect of an employee to a PRSA, whereas the contribution amounts to an OPS are infinitely greater. Equally, there does not appear to be any valid reason why the contributions which may be paid in respect of self-employed contributors to RACs or PRSAs are subject to the relevant age-related percent of earnings up to €115K per annum.

2.24 It appears to be patently unfair that individuals whose employer does not offer an OPS, or who are self- employed, should be treated differently to those who are in employment, whether in the private or public sector, and enjoy this benefit. This disparity of treatment needs to be removed.

A7. Would harmonising the calculation method for maximum tax-free portion of the retirement lump sum across DC occupational schemes and personal pension products be beneficial? How would this be best achieved? Would it result in a shift away from single member schemes?

2.25 Harmonisation of the calculation method of taxation of tax free lump sum benefits would be sensible. However, it is important that members of Defined Contribution (DC) arrangements are not disadvantaged when compared to Defined Benefit (DB) members. Equally, the economic advantages for public sector employees should not be less or more beneficial as there should be parity of treatment for all taxpayers who earn.

2.26 It is difficult to assess if this would result in a shift away from single member schemes although this seems unlikely given the broad range of investment options available to members of single member schemes, which is one of the drivers for individuals to invest in these schemes.

A8. Should the rules around the tax treatment of death-in-service benefits between DC occupational schemes and personal pension products be harmonised? How would this be best achieved?

2.27 There would appear to be advantages to harmonising the rules around the tax treatment of death-in-service benefits between DC OPS and personal pension products. The Law Society recommends, however, that there should not be a levelling down to the tax treatment of death-in-service benefits paid from RACs or DC OPS.

2.28 It is difficult to understand, for example, why an annuity should have to be purchased for a spouse/dependents after the lump sum is paid from an OPS rather than there being a choice available for the spouse/dependent to take out an annuity or purchase an ARF. This can be contrasted with RACs and PRSAs, from which the entire fund is paid as a lump sum and which allows dependents a level of flexibility which is beneficial.

2.29 Similarly, the differences in income tax treatment, whereby the entirety of an ARF fund can be paid to a spouse tax-free, whereas a spouse's pension payable from a DC OPS is taxable in the hands of the spouse, are not easily explained.

2.30 Harmonising the tax treatment would again ease understanding of the system and reduce complexity.

A9. Are there constructive changes that could be made to eliminate inconsistencies in the treatment of DC and DB scheme members?

2.31 The Law Society considers that Revenue rules around calculation of maximum benefits for DB members, and the rules relating to late retirement options, do not easily translate to DC schemes and should be easier to understand.

3. Response to Section B of the Consultation: Cost to the Exchequer

B1. How should the economic and social benefits of tax relief on pension contributions and investment returns be considered/measured and how do you believe the system of tax relief performs in that context?

3.1 A fair measurement of the economic and social benefits of tax relief could be determined by evaluating through financial modelling the cost of provision to the Exchequer of public sector and private sector pension arrangements. This would ensure that taxpayers and the Government appreciate the real cost of these. For example (i) in the context of an annualised cost of tax reliefs provided to employees and the self-employed (including the impact of exemption from tax on investment gains) and (ii) the notional cost of annualised accrual for Established and Non-Established Civil Servants and Prison Officers who are not members of the Single Public Service Pension Scheme ("Single Scheme") which commenced 01 January 2013 and, to new entrants recruited after that date who are members of the Single Scheme.

3.2 This measurement could track the annual cost by reference to salaries from a notional €20,000 per annum to the highest level of pay amongst public sector employees. Private sector employees are not subject to salary caps although the lifetime Standard Fund Threshold (SFT) limit for pension purposes creates an effective cap.

3.3 It is also important to recognise that the EET (exempt, exempt, taxation) model is built around deferral of tax (as opposed to non-payment of tax) and that the cost of tax not being received during the years an individual is saving for retirement must be considered against the tax paid by that individual in retirement, as well as their reduced reliance on State support in retirement. In that context, the Law Society is of the view that the current system of tax relief provides a valuable level of support to individuals to allow them to make reasonable provision for retirement and performs relatively well.

B2. To the extent that the State's tax expenditure on pensions has not resulted in high coverage rates, what in your view explains this?

3.4 As mentioned previously, the State's tax expenditure on pensions can only properly be considered when the true cost of the provision of pensions funded on a pay-as-you-go basis is known.

3.5 The complexities of the current pensions system, with myriad products available, may be a factor in preventing some people from making provision for their retirement. The current proposals to simplify the system should go some way to address this.

3.6 The advantages of the current EET system, as well as those of taking out a pension early so as to benefit from compounding returns, appear to be poorly understood. We suggest that children and young people should be educated in relation to saving for their retirement so they understand the need for personal responsibility to fund for their retirement at an early age, rather than expect that this is someone else's responsibility. At a personal level younger people need to be encouraged to save. The primary and secondary curriculum could be adjusted to cover this area. The state pension needs to be regarded as a basic minimum payment which will require to be supplemented and paid for on an individual basis. It is easy to understand that people have a preference to save for a benefit which they can access immediately such as housing. Also, the cost of childcare is significant and many people may consider that they are unable to afford to fund for their pensions and have children.

B3. What adjustments, if any, could be made to marginal relief to best support the rollout of automatic enrolment?

3.7 Consideration could be given to providing an additional contribution directly to the pensions vehicle, instead of via the net pay arrangement.

B4. What form of financial incentives for supplementary pensions, alternative to existing ones offered by the State, would better encourage lower and middle income earners to save for their retirement?

3.8 Consideration could be given to facilitating the tax free withdrawal, at certain intervals for example every ten/fifteen years, of a small percent of savings accumulated at that time.

B5. In evaluating equity in the distribution of the economic and social benefits from this tax expenditure, what factors should be considered?

3.9 In evaluating equity in the distribution of economic and social benefits, the cost to the State of both (a) the public sector pension payroll, including state pension and (b) tax foregone by the State due to tax reliefs provided to pension funds, employers and individuals needs to be taken into account, as it is not appropriate to evaluate equity in the distribution of the economic and social benefits from tax expenditure alone.

3.10 Factors to be considered should include the impact on individuals and employers, and the amount required to be invested/saved to generate a reasonable level of pension when in retirement, taking into account the tax reliefs likely to be available and the amounts likely to be contributed during the accumulation phase.

3.11 Revenue limits currently operate to cap the amount of pension income to be drawn down (for DB arrangements) or value of pension pot (for DC and DB arrangements). However, the actual value of income likely to be capable of being drawn down in DC scenarios is an unknown and dependent on various factors, principally investment ones, size of fund and lifespan.

B6. Should changes be made to the existing tax treatment of pensions in any of the following stages?

- **Tax treatment of employee contributions**
- **Tax treatment of employer contributions**
- **Tax treatment of growth in pension funds**
- **Tax treatment of drawdown of pension**

If so, what kind of changes should be introduced and for what reasons?

3.12 We consider the existing EET system is fair and we do not suggest that there should be any changes to this system.

3.13 We do consider, however, that self-employed individuals ought to have an opportunity to pay a greater level of contributions than those whose employers contribute to a pension arrangement on their behalf to ensure that they too have the opportunity to generate a pension pot up to the level of the SFT limit of €2,000,000. Such an approach would enable contributions greater than the current age related percentages to be paid to an individual arrangement at the time when the individual is in a position to pay contributions. This may vary between individuals and depends on their personal circumstances.

3.14 In addition, our view is that, with respect to employee contributions generally, an overall limit would be more appropriate than an annual limit. Removing the annual limit would allow individuals to save as and when it suits their circumstances.

4 Response to Section C of the Consultation: Approved Retirement Funds

C1. What, if any, limitations are appropriate for pension savers when drawing down benefits in retirement? Should the current suite of retirement savings drawdown options be changed in any way? For example, should savers be required to defer a portion of pension drawdown for a defined period?

4.1 Individuals should be able to access the funds in an Approved Minimum Retirement Fund (AMRF) early in cases of ill-health.

4.2 The Law Society is not of the view that savers should be required to defer drawdown for a defined period. It must be recognised that individual circumstances can differ greatly and that there are any number of reasons why an individual could require access to their funds.

C2. What, if any, changes need to be made to ARF access, and why?

4.3 It may be helpful to widen the ARF access rules to enable dependants on the death of a member of a DC scheme to take out an ARF in relation to part of the inherited benefit, as an ARF may suit some dependants. The law in relation to accessing ARFs as part of a pension adjustment order could be considered further and updated.

C3. Given the narrowing gap between State pensions and the AMRF income threshold, what is an appropriate minimum level of required income where an AMRF would not be necessary and should this amount be indexed? What is an appropriate set aside amount and should it vary? If so how? Should the conversion age of 75 be adjusted?

4.4 It would be sensible to track the State pension as a minimum level of income required to avoid the need to take out an AMRF, which is very restrictive with respect to accessing funds.

4.5 Rules should be introduced to enable earlier conversion on grounds of ill-health.

C4. Are the current imputed distribution requirements appropriate? What changes, if any, would be appropriate?

4.6 The Law Society does not consider the current imputed distribution requirements are appropriate. There is no justification for requiring any level of imputed justification, especially when taking into account that in DB and DC schemes members are able, in some circumstances, to access tax free lump sums without the need to draw down the remaining benefits.

4.7 Taxpayers should have the flexibility to draw down benefits without being required to. The imputed distribution regime may well have the effect of depleting an individual's ARF to prevent an adequate retirement income being available for the individual's later retirement years.

4.8 As things stand, the relatively high level of charges applying within some ARFs, when combined with the imputed distribution requirements could result in some individuals being required to draw down more quickly than is suitable for their circumstances. If abolishing the imputed distribution requirements is not possible, consideration should be given to setting a level below which the imputed distribution requirements do not apply.

4.9 Given the changing circumstances with respect to the State pension age, consideration could be given to whether the ages at which the imputed distribution requirements commence remain appropriate.

C5. To improve data capture and to facilitate the assessment of retirement outcomes, what additional returns should be required of Qualifying Fund Managers (QFMs)?

4.10 The Law Society does not wish to make a submission in relation to this element of the consultation at this point.

C6. Are current consumer protection arrangements in relation to ARFs effective? How might consumer protection requirements be improved? Is there a role for maximum or standard charges?

4.11 The Law Society's view is that there are areas in which improvement is needed in relation to consumer protection and ARFs. In terms of charges, consideration should be given to making the charging structure (particularly with respect to commission) more transparent.

4.12 Consideration should also be given to whether a group ARF product could be made available to allow ARF holders to benefit from economies of scale. The fees being charged for some ARF products appear to be significantly greater than those that arise for investors in large investment funds, and there appears little justification for this, even taking into account the reporting obligations of ARF providers.

C7. How can ARF owners be adequately informed and supported to make the decision that best suits their needs through retirement, especially given that ARFs require ongoing management? Is there a role for mandatory advice? How can access to good quality affordable advice be facilitated/provided for?

4.13 While ongoing advice in all cases would appear to be the ideal, the introduction of a mandatory advice requirement would result in increased charges for individuals and this would be likely to impact on those with smaller funds given that those with larger funds are likely to be already taking adequate advice.

4.14 ARFs with a life-styling element could be a welcome development as this would take the requirement for decision making out of the hands of the individual to some extent. Another possibility would be the development of a type of "standard" ARF, perhaps one which is linked to a range of passive funds, which would include low risk investment options only and in relation to which relatively low cost advice could be provided.

4.15 Consideration could be given to building in provision for a situation where the ARF owner is no longer capable of making financial decisions.

C8 How might in-scheme drawdown and group ARFs be facilitated? What additional requirements should be placed on schemes that want to provide in-scheme drawdown to ensure they have capacity and capability to do so?

4.16 The Law Society does not wish to make a submission in relation to this element of the consultation at this point.

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