Society of Actuaries in Ireland

Comments on sections 3 and 6 of the Report of the Interdepartmental Pensions Reform & Taxation Group 2020

Submitted to the Department of Finance

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Preface

The Society of Actuaries in Ireland ("Society") is the professional body representing the actuarial profession in Ireland.

The Society submitted a detailed response to the Consultation on Supplementary Pensions Reform issued by the Interdepartmental Pensions Reform & Taxation Group (IDPRTG) in August 2018 and is pleased to note that many of the issues identified in that submission have been addressed in the report of the IDPRTG, published in November 2020. This paper sets out the Society's comments on the conclusions in section 8 of the report in relation to *Reforming & Simplifying the Existing Supplementary Pension Landscape* (discussed in section 3 of the report) and *Review of the Approved Retirement Fund* (discussed in section 6 of the report).

We would be happy to respond to any questions on this paper. Please contact Philip Shier, Head of Actuarial Practice, at philip.shier@actuaries.ie.

Section 3 - Reforming & Simplifying the Existing Supplementary Pension Landscape

The Society's comments on the published conclusions in the order set out in the Report are as follows:

1. Revenue will review and update the Pensions Manual to reflect any changes introduced on foot of the Pensions Roadmap process.

It is important that the Pensions Manual is up to date and comprehensive and the Society would be happy to engage with Revenue to ensure that the Manual is fit for purpose. The Society is aware of a number of issues where the Manual should be updated and/or clarified.

Whilst policy is a matter for Revenue/Government, the Manual should recognise and address implementation issues, and this can be best achieved by the inclusion of stakeholders in the drafting process e.g. by having a stakeholder group or by Revenue issuing a draft to stakeholders for consultation before it is finalised.

2. BOBs and RACs should cease to be available as Third Pillar pension saving products on a prospective basis. The PRSA should operate as the sole personal pension product.

The Society supports the proposal that there be a single personal pension product on the market, and that this should be the PRSA, subject to the framework for PRSAs being amended in a number of areas, including increased investment and charging flexibility, and amendments to the disclosure and reporting requirements. It is important that this review is finalised, and new-style PRSAs available, before RACs and BOBs are withdrawn.

3. Existing BOBs and RACs should be allowed to run-off over time, retaining their existing product features, terms, and conditions. The proposed changes to the PRSA set out in Chapter 3 should facilitate transfers from BOBs.

The Society agrees that BOBs and RACs should be permitted to be run-off over time, but with flexibility to transfer to a PRSA at any time. Transfers would be facilitated by ensuring that the new PRSA would be sufficiently flexible to enable the specific features of BOBs and RACs to be replicated on transfer.

4. In order to facilitate the prospective cessation of BOBs, the provision in the TCA banning transfers to PRSAs for scheme members with more than 15 years qualifying service should be removed.

The Society is strongly supportive of the removal of this restriction.

5. In order to facilitate the prospective cessation of BOBs, Section 122(2) of the Pensions (Amendment) Act 2002, should be commenced in order to permit existing BOB holders to transfer to PRSAs.

This would be appropriate provided the new-style PRSAs (with appropriate amendments to the existing PRSA regime) are available. The maximum tax-free lump sum for BOBs transferring to PRSAs should be based on service and salary details and this will have knock-on implications for the data PRSA providers need to hold.

6. Direct transfers from existing RACs to occupational pension schemes should be provided for.

The Society supports this proposal as being more efficient than the current indirect approach of "bed and breakfast" in a PRSA.

7. Allowing discounts to be offered in the case of bulk transfers from schemes to PRSAs should be provided for.

The Society believes that there should be flexibility for providers and advisers to charge each client according to the service they provide to that client, subject to appropriate consumer protection measures including the maximum charges on standard PRSAs. We believe that consumer protection measures are better delivered through the Consumer Protection Code, rather than through PRSA-specific requirements set out in the primary legislation. The example of bulk transfers is one circumstance where the existing requirement to charge all clients the same is not in the interests of the customers.

8. Ring-fencing of lump sum benefits within a PRSA to allow for a salary and service based lump sum for the portion of assets related to a transfer in from an occupational scheme should be provided for.

Yes – we have referred to this in Q5.

9. The Pensions Authority will reconsider the requirements in relation to the provision of Certificates of Benefit Comparison, in particular in relation to transfers to PRSAs from DC arrangements, and make recommendations to the Department of Social Protection for legislative change where necessary.

The Society has previously engaged with the Pensions Authority on this issue and is of the view that requiring a Certificate of Comparison for transfer from a DC scheme to a PRSA serves little useful purpose and should be abolished. We would recommend that in situations where the charges are changing due to a transfer, the advisor should provide a rationale for the recommendation including an estimate of the impact of the change in charges.

We appreciate that the initial concern in requiring a Certificate of Comparison for transfers from DB Schemes was to inhibit mis-selling, in the light of the pensions mis-selling scandal in the UK. We agree that it is important to have appropriate advice on any transfers from DB into DC. However, we believe that Certificates of Comparison as they stand are not useful for this purpose. We suggest that the Authority should be asked to consider what changes would be needed for these Certificates to be fit for purpose. We recommend in particular that the adviser rather than PRSA provider is responsible for the recommendation to transfer or not transfer.

10. In view of the recommendation to eliminate RACs on a prospective basis, the ability to avail of life cover, in-line with that which is currently provided for in Section 785 of the TCA with respect to RACs, should be retained. This could be provided for either on a standalone basis or as part of a PRSA.

The Society agrees that Personal Pension Term Assurance should continue to be available. It is better (from a transparency point of view) that life cover is available on a standalone basis rather than as part of a PRSA.

Providers must be appropriately regulated in line with life office regulation, or life cover should only be provided by a regulated life office.

11. As far as possible, and consistent with the objective of rationalisation and simplification, the transposition of the PEPP Regulation should aim to align with existing PRSA legislation. A PRSA or contract-based pension reforms introduced prior to PEPP transposition should be cognisant of PEPP and aim to avoid anomalies or the duplication of product legislation.

The Society agrees in principle with the recommendation that "the transposition of the PEPP Regulation should aim to align with existing PRSA legislation". However, there are some aspects of the PEPP Regulation and related (draft) Regulatory Technical Standards which are significantly different from the existing PRSA framework and might not be considered appropriate for the Irish domestic market.

12. The Pensions Authority will review the PRSA product approval process with a view to eliminating the need for pre-approval in the case of non-material changes to an existing PRSA product.

The Society strongly supports this proposal and would be happy to engage with the Pensions Authority on this issue. It will be necessary to have clarity on what is a "non-material" change. Furthermore, the Society would question the rationale for requiring pre-approval of PRSA products more generally. Other products (e.g. ARFs) do not require pre-approval, and this requirement adds an extra layer of complexity for PRSAs. The Society agrees that pre-approval of PRSA providers would continue to be necessary.

13. In order to manage and contain costs, PRSA communication requirements should be primarily in electronic form, in-line with IORP II and PEPP. Consideration will also be given to enhancing communication requirements in the area of transferability.

The Society supports the provision of information to consumers primarily in electronic form. The Society would be pleased to engage in discussions about "enhancing communication requirements in the area of transferability". The Society believes it would also be important to review the information that is required to be provided to PRSA holders, rather than simply providing the existing information in electronic form. Current customer disclosure may not be fit for purpose and together with changes arising from the IORPS Directive, it would be timely to review the disclosure requirements for PRSAs more generally.

14. The Pensions Authority will examine whether charging rigidity acts to limit investment choice for PRSA providers and if amendments to the non-standard PRSA are required to facilitate transfers from single member schemes.

The Society believes that charging rigidity can limit investment choice and that greater flexibility should be introduced.

15. The Pensions Authority will review the use of / need for multiple PRSAs by individuals and will identify whether any changes to the product should be advanced.

The Society is not aware of any major issues here but is willing to engage with the Pensions Authority in their review of reasons.

One reason clients use multiple PRSAs is to facilitate staged drawdown. In other cases, PRSA holders may not realise they can continue contributions from separate employments to one PRSA.

17. The lower age limit at which savers can access retirement benefits should be increased to 55. Consideration should be given to providing for a lead-in period to allow those retiring early in the shorter term to do so.

The Society supports this in the interests of simplification and consistency across products. However, this will impact on pension planning for a small number of clients and there should be an appropriate lead-in time, and perhaps some grandfathering arrangements, to facilitate planning.

18. The upper bound of 'normal retirement age' should be increased to age 75.

The Society supports this in the interests of simplification and consistency across products. It may be necessary to consider if there are any impacts for particular investment funds if someone wants to stay invested beyond 70, e.g. funds with set guarantees.

The Society notes that this may have an impact on estate planning, which is a key consideration for high net worth individuals as death benefit tax treatment is generally more favourable on pre-retirement products.

19. To the extent possible, the respective definitions of ill-health to access benefits at any age before 60, should be harmonised.

The Society agrees that one consistent set of rules should apply to all ill-health and serious ill-health retirements.

20. The mandatory requirement to purchase an annuity having taken a lump sum based on the salary and service methodology should be abolished. The ARF option should also be available to the DC element of pension savings where an individual has DB and DC entitlements from the same employer.

The Society supports both of these recommendations.

The extension of a salary and service lump sum option to PRSAs increases the potential for PRSAs to replace one-member company pensions. However, the salary and service benefit rules are complex and require clients to provide salary information / evidence on each old employment, so it would be appropriate to carry out a review of the salary and service approach to see if this can be simplified.

21. The differential treatment of the PRSA for funding purposes should be abolished, employer contributions to PRSAs should not be subject to BIK.

The Society strongly supports the recommendation that PRSAs should move to current company pension contribution rules – i.e. consistent BIK, age related limits and €115k threshold treatment. This would remove the most significant reason why one-member schemes are used by owner / directors rather than PRSAs.

Consideration should be given to removing this differential treatment soon and ahead of other parts of the reform proposal. IORP II will pose a significant challenge to the viability of single person executive pension plans and an alternative vehicle needs to be available to ensure pension saving is not discouraged.

If PRSA reform is carried out correctly there is an opportunity to resolve a large portion of the 100,000 plus single member/small schemes in Ireland by removing the differential treatment for funding, charging flexibility and fund choice together with the introduction of innovative transition arrangements for transfers from single person schemes to PRSAs.

22. As an alternative to compulsory annuitisation, the ARF option should be available for excess funds remaining after the payment of the maximum death-in-service lump sum.

The Society supports this and notes that advice for the surviving spouse/partner will be important.

The Society recommends that steps be taken to address the complexity of death benefit rules between company pension death-in-service, preserved benefits, retained benefits, PRBs and PRSAs.

Section 6 - Review of the Approved Retirement Fund

The Society's comments on the published conclusions in the order set out in the Report are as follows:

1. ARF providers should make annual data returns to the relevant regulatory authority.

The Society is supportive of requiring ARF providers to make annual data returns to enable the supervisory authority to monitor and oversee the market. It is essential that the rationale for collecting each piece of data, and the use to which they will be put, are fully considered in advance. The requirements must be proportionate and not impose a significant burden on providers, which would probably be passed on to the customers. The Society would be pleased to assist in deciding which data should be collected.

2. Annuities still have a purpose.

The Society agrees that annuities still do have a purpose and this underlines the importance of advice at and during retirement. Annuities are perceived to be poor value, particularly with current low interest rates, and customers greatly value the flexibility that an ARF provides (and not just for inheritance). However, for risk-averse customers, or those with limited financial knowledge or for those who are not eligible for full State pension, an annuity might be the best recommendation.

Deferred annuities, referenced in the report, are, presently, even poorer value than immediate annuities because of the greater uncertainties. There is no customer appetite for these currently: if there was, the industry would be selling them.

3. ARFs should be replaced by in-Scheme drawdown and re-designed WOL PRSA.

The main reasons given for replacing the ARF are:

a. Not as regulated as the PRSA

The majority of ARFs are provided by life companies, and are thus subject to strict sales disclosure regulations, investment restrictions, solvency requirements etc. The report suggests that ARFs should fall within the ambit of the Pensions Authority but the Society does not consider that to be necessary. If the supervision of ARFs were to become the responsibility of the Pensions Authority, this would involve setting up a mechanism which already exists in the CBI. Our preference would be for the CBI to continue to regulate ARFs and to redesign the PRSA to a more modern and less restrictive design.

There are also a considerable number of "non-insured" ARF providers (QFMs) where the terms of business are agreed between the QFM and the ARF owner. It is noted that, presently, there is no approval process to become a QFM which is a situation which should be altered. We do not know to what extent the advice in relation to the purchase of a "non-insured" ARF is monitored by the regulator of the QFM, but we would recommend that the protection for consumers should be similar for insured and non-insured ARFs.

We are strongly of the view that ongoing advice should be provided to the ARF holder in retirement and we agree that this should be regulated appropriately. It is of course also important that the costs of such advice are transparent and reasonable.

b. Charging not transparent and highly varied

The Society would dispute the view that there is a lack of transparency in relation to "insured" ARFs given that life companies follow life disclosure rules. "Non-insured" ARFs are governed by the QFM's Terms of Business. Those contain details of the charges to apply to the ARF.

We would argue that charging should be varied in a competitive market. In general, charging on the ARF reflects two main elements – the cost of advice, both at retirement and subsequently, and the cost of the underlying investment chosen. The former is, by necessity, higher on an ARF or drawdown from a PRSA when compared to annuity purchase. Moving to in-scheme drawdown or some form of WOL PRSA will not reduce the cost of that advice. "Non-insured" ARFs typically offer a more bespoke choice of investment which would incur higher charges for the provision of further advice and the potential higher costs involved in such investments.

A concern which has been expressed regarding "insured" ARFs relates to the regular repositioning of the investments, which generates further commissions, ostensibly to remunerate the advisor for the provision of investment advice. The Society would be concerned if such investment switching were being advised, and implemented, for reasons other than the interests of the customer; if investment advice is obtained this should be remunerated on a transparent basis.

4. Consider legislation to enable in-scheme drawdown.

This should be relatively easy to introduce but before any significant work is undertaken on this, it would be prudent to assess the appetite for this option.

Will existing scheme trustees want to remain responsible for retirees and their funds for the remainder of their lives? Will the scheme sponsors be willing to maintain and perhaps pay for a connection with former employees in retirement? The advice requirement at and post-retirement would vastly exceed that in the pre-retirement phase; "default" recommendations may not be appropriate, since retirement is different for everyone.

Another important issue is whether the available accumulation fund choices are suitable for the decumulation phase.

5. Group will advance proposal in parallel for Group ARFs

This appears counter-intuitive given the proposal to replace individual ARFs with a WOL PRSA. However, we do recognise that a group ARF type arrangement, probably structured as a Master Trust, would provide an option for retirees from Schemes which do not wish to retain former active/deferred members in retirement. Economies of scale should emerge as well as the benefits of fiduciary supervision. They would also provide a solution to the concern expressed above about fund choices in the decumulation phase as, by definition, all funds would be so orientated.

It is likely that the choice of investment will be very limited in a Group ARF.

It is important that the current uncertainties in relation to Master Trusts, and the concerns expressed by the Pensions Authority about the levels of governance in existing Master Trusts, are addressed before developing Master Trust ARFs and abolishing stand-alone ARFs.

6. Group will advance proposals to replace ARFs with WOL PRSAs.

The Society notes that these already exist in that PRSA holder can vest the PRSA at retirement and draw down retirement income from it. However, the investment, charging, drawdown and age restrictions which exist with Vested PRSAs would need a huge overhaul to become fit-for-purpose. If these differences were all removed, then the Vested PRSA would be much more popular, and very similar to an ARF! A key difference is the current inability with the Vested PRSA of being able to charge for advice at retirement.

The report refers to the "more comprehensive product approval process" undertaken by the Pensions Authority in relation to PRSAs. The Society feels that this process is in practice overly cumbersome and in need of significant revision to make it more efficient, and is another reason why PRSAs have not completely replaced RACs already.

Additionally, under the current PRSA structure, there is a Vested Standard PRSA and a Vested Non-Standard PRSA, and if the ARF was to be replaced by a WOL PRSA, this would be an unnecessary complexity. We would recommend that the PRSA legislation be re-designed such that the PRSA product has a default fund which meets the current standard PRSA requirements but that all other funds could be different on the same product.

A more general point here is that some retirees could end up with an in-scheme drawdown pension, a Group ARF and a WOL PRSA. Would the rules governing all three of these be the same and would a retiree be able to transfer into and out of all three interchangeably?

The Society would favour an alternative proposal to design ab initio a personal pension product which extends into retirement. As commented above, amending the existing PRSA legislation could be a very complex exercise. The transferability of existing products into this new product and into the proposed group ARF should be accommodated.

7. AMRF should be abolished.

The Society fully supports this proposal. All existing AMRFs can become ARFs provided sufficient time is given to communicate to AMRF-holders and outline the changes.

8. ARF proceeds on death should be subject to CAT and Income Tax.

This proposal would put ARFs into line with pre-retirement pension pots on death, where lump sums are subject to CAT only or, if the Trustees/estate purchase a survivor's annuity, the annuity income is subject to income tax only.

The Society accepts that the ARF should be treated as a retirement income vehicle and not as a tax-efficient wealth management structure. In its early years, the ARF was primarily a "wealth management" vehicle used by high net worth individuals, but as is evident from the numbers referenced in the report, this is no longer the case and on average, ARF pots on drawdown are relatively modest.

Given the minimum drawdown requirement of 4/5% and average life expectancy of, say, 20 years post-retirement, the average retiree would have withdrawn amounts broadly equal to the initial ARF amount and have been taxed on these withdrawals, and hence ARF inheritance is not an issue.

Where this proposal will hit is those retirees dying relatively soon after retirement, which seems inappropriate – the estate is being penalised for the early death. This would have significant impact in the case of someone retiring in ill-health or with greatly reduced life expectancy, for whom an annuity would not be an appropriate option and, under this proposal, they would see their drawdown pot doubly taxed.

This could discourage pension saving. The ability to pass on pension fund proceeds to children or grandchildren on death is a perceived benefit to pension savers even if, in reality, the majority of their pension pot is exhausted on death. Removing this perceived benefit further reduces the attractiveness of pension saving.

In our view, any distributions on the death of the ARF owner (in excess of the amount transferred to spouse etc.) should be subject to CAT under the normal rules.

9. Group would engage with CBI to advance proposals to replace ARF with WOL PRSA.

As mentioned above, we recommend that this should be a new personal pension product, rather than amending the PRSA legislation. In any event, there should be consultation involving the industry and other stakeholders to ensure that the new product is fit-for-purpose and meets current market demands. It is important that when this new product becomes available, RACs, BOBs and ARFs are closed to new business, to avoid increasing the complexity of the market, as happened when PRSAs were introduced.

10. ARFs should be captured in the Investor Compensation Scheme.

The Society supports this.

Clanwilliam House
Clanwilliam Place
Dublin 2, D02 AV90,
Ireland
Tel: + 353 1 634 0020
Fax: +353 1 634 0039
Email: info@actuaries.ie
Web: www.actuaries.ie