

What the National Pensions Framework really means for everyone

Written by Brian Molloy

The Government launched its National Pensions Framework on Wednesday 3 March. If implemented in full, it will represent a fundamental change in the way pensions will operate in this country in the future. This article looks at the changes proposed and the impact of those changes.

The situation to date

Most people were focussed on the fact the State Pension (previously known as the Old Age Pension) is going to be moved out to age 68 from 2028. This change makes sense and reflects the longer life expectancies we are experiencing.

More important is the commentary that the Government is targeting a State Pension of 35 per cent of average weekly earnings. This is an important commitment (albeit not a guarantee!!), as many would have felt that the Government would seek to reduce pension levels in the future. There has been a move away from the complicated averaging system to a 'total contributions' system with a max pension paid to people with 30 years contributions and a start point of ten years (520) contributions paid.

Some additional flexibility issues include allowing people to defer receipt of the pension and make up any contribution shortfalls.

Changes

Overall the changes to the State Pension were reasonably well flagged and generally speaking these changes were expected.

Mandatory Pension plan (from 2014)

This represents a massive change in Pension strategy in Ireland. A new mandatory pension scheme will be operated by the State with contributions taken from individuals and companies via the PRSI system. An added contribution will come from the State. The levels of contribution are reasonably low – eight per cent in total with four per cent from employee and two per cent from the employer and two per cent from the State.

A floor will be put on earnings to allow people earning very low incomes not to have to join this new scheme. Also, a cap will apply - earnings over 50,000 will be excluded.

Existing small plans can transfer into this new plan if they want to – a cap of €10,000 is likely to apply. Funds in excess of this will have to remain in existing plans.

Existing plans (defined contribution)

Existing pension plans will cease to get tax relief on contributions paid into them from 2014. Instead, a credit will be added to the plan equivalent to a tax relief of 33 per cent. This means that the gross cost of pension contributions will be deducted from salaries and pension contributions will no longer attract tax relief.

Existing pension structures will be reviewed with a view to streamlining, reducing complexity and making them more transparent. Regulation will be strengthened

At retirement, the benefits will no longer have to be taken in the form of an annuity – an Approved Retirement Fund will now be available to all (from 2011). Changes are being made to the eligibility criteria and the Approved Minimum Retirement Fund concept will be removed.

Defined Benefit Scheme

Most of the changes are in the area of Defined Contribution schemes. The framework highlights the need for a review of the Defined Benefit model and suggests that a model which offers lower benefits but greater certainty should be considered (you get less but you know you will actually get it when you retire!). Regulations are also to be tightened up.

Public Sector Pensions

The Public Sector pension's model will be focussed on streamlining and standardising the benefits with a view to reducing the long term cost on the State of providing Public Sector pensions. The retirement age will be linked to the State Retirement age, with a maximum of age 70.

Pensions will be based on career average earnings (for new joiners) rather than final salary and will take account of the state pension entitlement. Contributions will be set at 6.5 per cent of all pensionable pay. Increases in retirement may be linked to inflation rather than linked to pay grades in the public service. Some changes are envisaged to areas like added years and non-reduced early retirement benefits.

Overall comment from HC Financial Services Group

The changes outlined in the framework could fundamentally change the face of pensions Ireland. Everyone is impacted - employers, employees, self employed, young and old – and, as a result, it is important that everyone takes the time to review their own individual arrangements and make sure that they are appropriate to their personal circumstances.

Broadly speaking, most people knew that tax relief was going to reduce and the State Pension age was going to be increased. However, with the new Compulsory Pension plan, you would have to wonder why any employer would maintain an existing pension plan with all the administration costs, trustee requirements, consultancy fees and legal/regulatory headaches when all they need to do is maintain the new compulsory scheme – no costs, no consultancy, no charges and no hassle!!

For employees who wish to have more than eight per cent in their pension plan, they will be able to set up their own pension (or PRSA) plan, in their own name, invested where they want, with contribution levels that they decide on and with complete confidentiality. The change in tax relief means that the advantage of having this private plan operated through payroll has been significantly eroded.

These changes could end up being very positive for the most important people in the pension's world – that is the members (employees). For too long the plans, the legislation and the consultants have focussed on the employers and the trustees.

