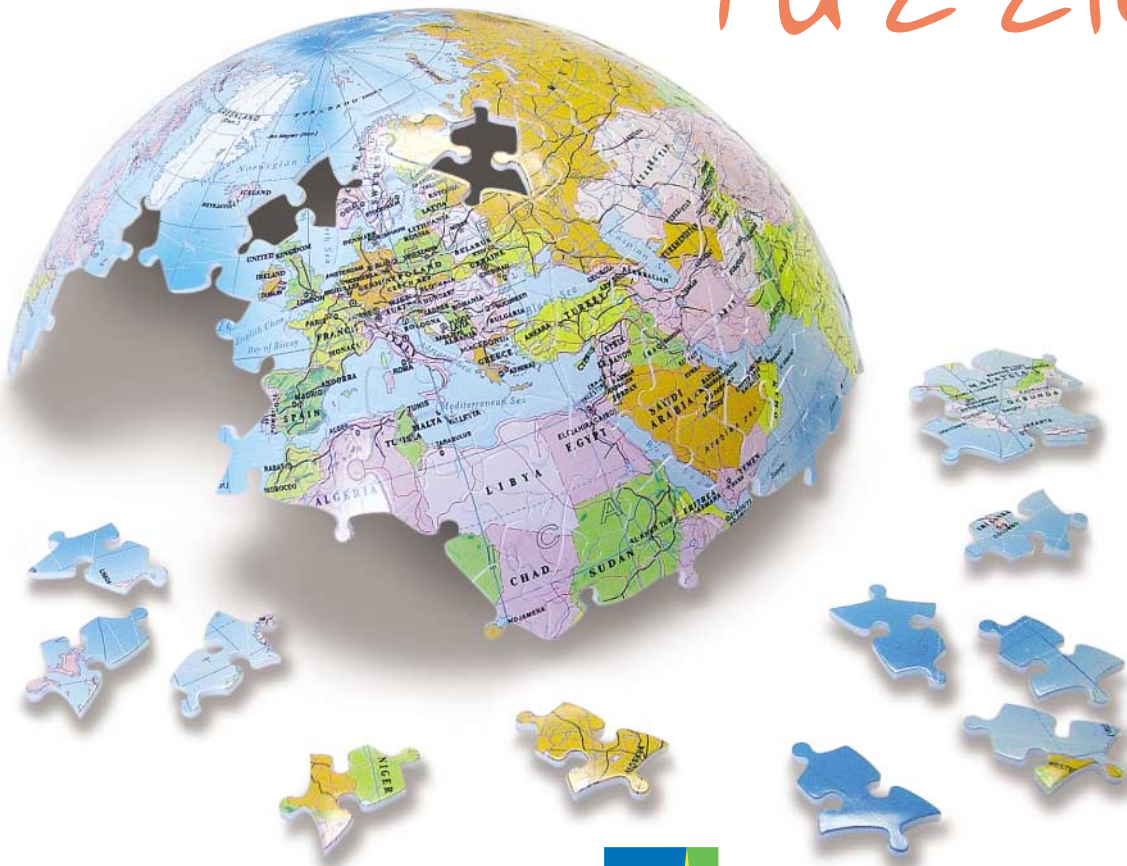


A look at our domestic pension problems in a global context

# The Global Pensions Puzzle



**HIBERNIAN**

an AVIVA company

*' There are bad times just around the corner,  
There are dark clouds hurtling through the sky  
And it's no good whining about a silver lining  
For we know from experience that they won't roll by...'*

*Noel Coward*





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## Foreword

This report has been produced as a contribution towards the overall debate that is taking place in Ireland about the future of pensions – and to stimulate discussion about the ways in which we might be able to address our problems, in order to achieve a satisfactory and effective outcome.

However, the challenges that we face are not unique – nor, indeed, are they quite as extensive as in some of the other developed economies of the world. The report therefore begins by looking at the problems in a global context, summarising how they are affecting three large countries – the USA, France and the UK – in differing ways.

We then review the particular problems affecting our pensions system. Although many of the initiatives to be taken will, inevitably, be the responsibility of the government, it is also important to consider the extent to which ordinary Irish men and women are prepared to act, to help themselves.

We have therefore commissioned some detailed research into the opinions and attitudes of Irish people in the 40 to 60 age group – and what they told us forms a key part of this report.

Finally, a few countries have already taken apparently successful steps to overcome their pension problems – and we thought that it might be helpful to summarise these. We concentrate on New Zealand, Sweden, Chile and Australia, because some of the problems that they have addressed were fairly similar to our own.

We hope that you will find this report both interesting and informative.



**Tony O'Riordan**

*Managing Director*

*Desk research into the international pensions crisis was carried out by FMC International Limited.*

*Local research into Irish attitudes to pensions was conducted by Behaviour & Attitudes.*

## Introduction

**Speaking in the Reichstag 1889, Otto von Bismarck said:**

*' I will consider it a great advantage when we have 700,000 small pensioners drawing their annuities from the State, especially if they belong to those classes who otherwise do not have much to lose by an upheaval - and erroneously believe they can actually gain much by it.'*

*(What a superb example of buying off the workers in an age of revolution!)*



*In fact, there are two pension traditions:*

- 1 *The extravagant, which is exemplified by the Bismarckian system – and has been adopted by the majority of developed countries in Continental Europe. By guaranteeing pension security, the aim of this policy has been to promote industrial modernisation and mobility of labour.*

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- 2 *The puritan, which stresses individual morality and self-reliance – and is typical of the Anglo-Saxon systems which have been adopted in the USA, Britain and Ireland. This policy has aimed to limit State liability – and has largely viewed occupational pensions as a way of raising funds for investment.*

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However, no matter which of these approaches a country has followed, its pension system is almost certainly facing a very severe crisis. In almost every developed country of the world:-

- Governments are finding that the costs of maintaining their State pension schemes are escalating exponentially – and will soon become unsustainable.

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- Public sector pension schemes are usually unfunded, with their benefits being paid out of general taxation. There is no central pot to pay out future pensions – and no element of investment – so these schemes are becoming increasingly expensive to provide.

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- Private sector companies have found that, with falls in stockmarket values, there will be insufficient money in their 'final salary' pension schemes to provide their staff with the promised level of benefits. In some cases, large companies have found that what they owe their workers in future pension payments exceeds the total stockmarket value of the company. So, many companies have cut back on pension schemes. New staff have not been allowed to join the old schemes that paid pensions linked to earnings. Instead, they have been offered membership of new schemes, to which the employers' contributions are much lower – and the pensions will depend on how well the contributions have been invested over the period to retirement.
- 
- In some countries, lack of legislative protection has meant that workers who have contributed to company pension schemes now find that, as a result of the firms they have been working for going out of business, they are not only out of a job, but have also lost their entire pension entitlement.
- 
- Most of the workers who are not included in a company scheme are failing to save up adequately for their retirement. At the same time, many workers who could have joined a company pension scheme have refused to do so – even though this results in the loss of the contributions that their employer would have paid on their behalf.
- 
- Yet many employees are concerned that their standard of living in retirement will be worse than it is now – 49% in the USA, 44% in Germany and 40% in Italy. Only 13% of French, 8% of Italians and 3% of Japanese are very confident that they will be able to pay for basic expenses after they retire.

*Source: Management Issues, 2004*

These trends are already making headline news around the world.

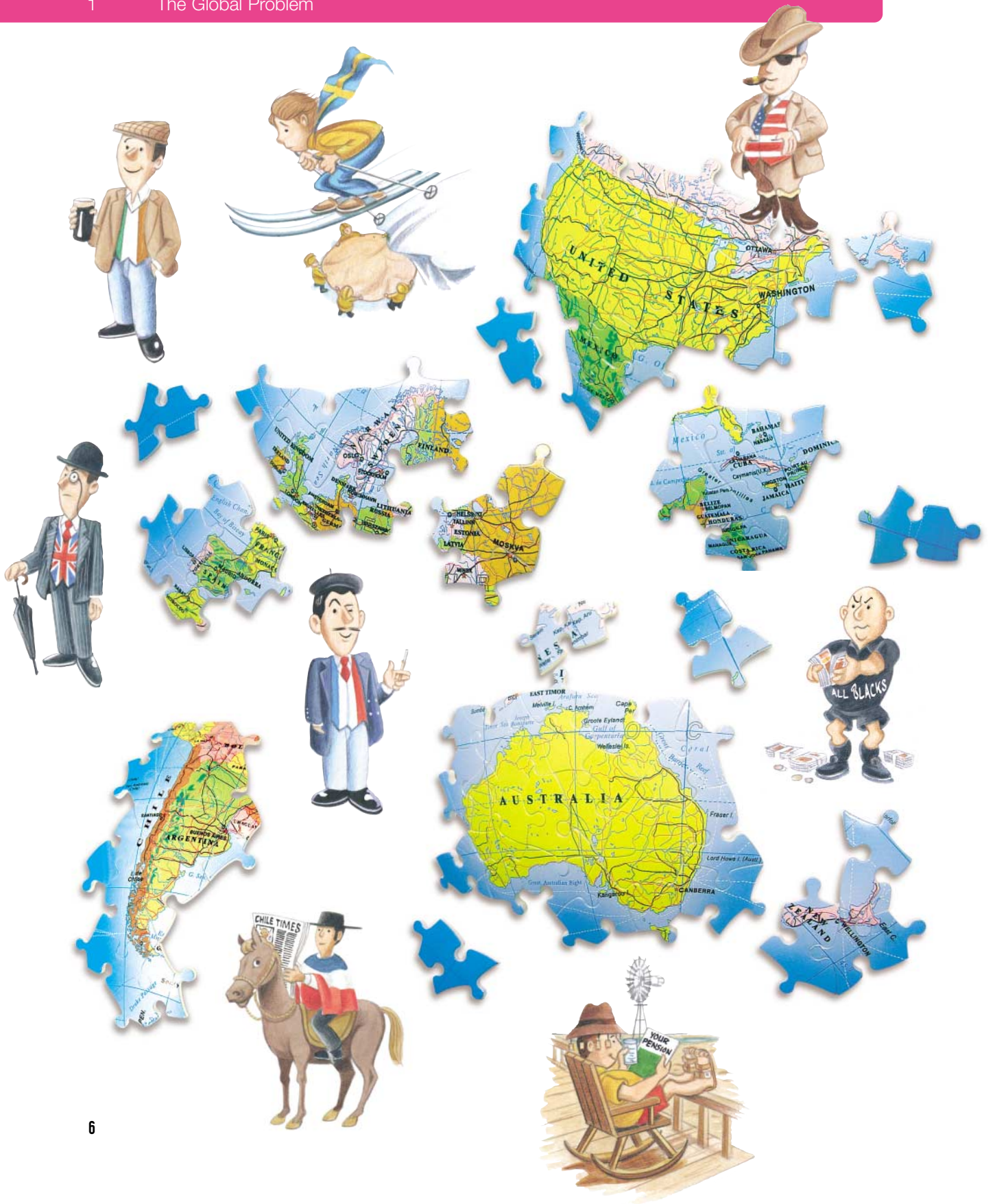


# Chapter 1

## The global problem

**Let's look at some of the main pension issues facing the USA, France and the UK...**





## The US – don't let's beat about the Bush!

**In the USA, President George W Bush has said 'The US pension system is heading towards bankruptcy' and that 'social security will be insolvent by 2041 if it is not reformed'.**

*Source BBC, 27th September 2005*

**Nearly all the other OECD countries face a similar prospect – and need to reform their pension systems urgently, before the costs become too horrendous.**

**So, what has caused this massive crisis? Well, there are several factors, each of which is serious in itself but, when taken together, demand urgent action:-**

1 As in most other developed countries, the US social security system operates on a 'pay-as-you-go' basis, which is a form of wealth transfer system. The government levies a charge, in the form of tax or PRSI, on all the people who are working – and then pays the money, as pension, to all the people who have retired.

2 That system was fine in the past, but the number of Americans working is dwindling, while the number of pensioners is increasing. By 2050, the number of Americans of working age is projected to rise by only 32.9%, while the number of those aged 65 and over is projected to increase by 135% – and the number of people aged 85 and over by 350%.

*Source: US Bureau of the Census*

As a result, the cost to the workers of meeting the retired people's pensions is likely to become unsustainable.

3 The problem is compounded by the fact that the average person is now living longer. Due to healthier lifestyles, plus advances in medical science that are enabling people to recover from what in the past would have proved terminal diseases, the average American born in the year 2000 could have expected to live for 76.8 years. But, in official projections, that figure is expected to rise to 81.3 years by 2050, while the US Census International Service predicts that it will actually be 83.2 years.

*Source: EU/OECD*

4 Private pensions are also in crisis. The large stockmarket falls in 2001 not only dragged down the value of companies' own share prices, but also of the holdings in their pension schemes. Although the markets have recovered significantly, they are still well below their former peaks, so the problem remains very serious. In 1999, more than half of the companies in the S&P 500 Index had surpluses in their pension funds. Only 51 of them do today.

*Source: Forbes Magazine, December 2004*

5 During the last few years, several companies – some of them huge corporations, such as Bethlehem Steel, US Airways and WorldCom – have gone into liquidation, leaving huge deficits in their pension schemes. Although the US government has set up a special rescue scheme for such eventualities, it has been paying out so much money that it now has a record deficit of about \$5.4 billion – and may itself need to be rescued by the government.

*Source: The Economist, 30 July 2003*



## France – La Grande Illusion!

**As the Independent newspaper reported on 2nd February 2003, ‘The French vow to defend their gold-plated pensions’.**

Trades union members, left-wing politicians, activists and thousands of pensions campaigners had marched through a score of French cities to demand that nothing should be done about the most acute problem that faces France in the next decade. And, this being France, no-one told them that they couldn't have their way.

There is a well known saying in French government circles:

*‘When you want to drain the swamp,  
you don't ask the frogs’*

Approximately 60% of French adults have secure, life-long jobs and the promise of generous pensions when they retire. These people have a vested interest in preserving the status quo and avoiding any radical reform of the system.

Yet the problems facing France are actually greater than those of its principal EU partners.

That's because:-

- The State pension scheme is a pay-as-you-go arrangement. Pensions are funded by today's workers, whose own pensions will in turn be paid for by the next generation of wage earners. It is supposed to be a pyramid – with more workers than pensioners. However, as the workforce shrinks and pensioners live longer, the pyramid is in danger of turning into a mushroom – with a huge burden of liabilities relying on a much more slender support.
- The system is integrated with company pension schemes (which are also run on a pay-as-you-go basis), with contributions being paid by both employers and employees and the arrangements being monitored by administrative councils, composed of their representatives.
- France has the most generous retirement terms – especially for State employees – of any large developed country. On average, workers can look forward to a pension of between 70% and 75% of wages. Source: Harvard University, Centre for European Studies
- The average French person retires at age 57.5, compared with the average of 64 that applies across the whole EU. Source: The Independent, 3rd February 2003





- The demographic changes in France are expected to be more dramatic than in other countries. For the first time in its history, France will soon have more citizens over age 60 than under age 20. From 2006, its 'active' population (already one of the smallest in Europe) will start to fall, for the first time in half a century. By 2040, if the present pension rules remain unchanged, France will have 7 pensioners for every 10 people in work. *Source: The Independent, 3rd February 2003*

Given the generosity of the State system, there is little need for additional pension arrangements. However, some professional groups have set up voluntary supplementary schemes for their members – and some large corporations (such as insurance companies and banks) have set up additional arrangements, called 'chapeaux', for their employees. Both types of supplementary scheme are fully funded.

However, no funded pension schemes exist for employees covered by 'le régime général', which covers private sector employees in industry and commerce, who constitute the majority of the French workforce.



## The UK – I'm not all right, Jack!

**Winston Churchill said:**

*'Government must provide both a ladder and a safety net.'*

In the field of pensions, he meant that the State should provide a basic retirement income as a safety net – but that people should be incentivised to use the ladder of opportunity, in order to provide themselves with more.

Unfortunately, UK pensions are facing such a severe crisis that the safety net is getting very frayed – and may not last much longer – while the ladder is already looking decidedly rickety.

What, exactly, are the problems? Well. In a nutshell, they can be summarised as follows:-



### State pensions

- Due to healthier lifestyles and improved healthcare facilities, people are living longer than their parents and grandparents – with the result that they will need to be provided with a pension for a greater number of years.
- The State pension scheme uses the contributions that it collects from today's workers straightaway – to pay the instalments of pension due to the people who have already retired. At present, 60% of Britons are working to pay the pensions of the 21% who have retired – but, it is calculated that, by 2030, there will only be 56% of Britons working to pay the pensions of the 27% who have retired.

*Source: The Independent, 12 October 2005*

- Despite these problems, the State pension is becoming progressively less valuable. Increases are linked to prices, rather than wages. So, for the estimated 4 in 10 Britons who rely on it as their sole source of income, the retirement prospects are grim. Indeed, if current trends continue, the basic State pension will be worth less than 10% of average earnings by 2050 – and anyone relying just on that will officially be living in poverty.

*Source: Government Actuary's Department, August 2005*

- A recent government report has recommended raising the retirement age under the State scheme and encouraging workers to defer their retirement for even longer. *Source: BBC News, 30 November 2005*

### Public sector

- There are 5.8 million employees in the civil service and local government, most of whom are in final salary pension schemes, under which they retire at age 60. The schemes cost £18.5 billion a year – and, in 30 years' time, will cost £31 billion (in today's money). The schemes are only partially funded and the government's unfunded liabilities are estimated to be a staggering £690 billion.

*Source: Watson Wyatt, October 2005*

- The average shortfall in local government pension funds equates to 27% of their liabilities. 20% of council tax already goes to local government pensions – and, to cover the liabilities, this tax will have to rise significantly.

*Source: Sunday Times, 23 October 2005*

### Private pensions

- Employers have encountered major problems in keeping their company pension schemes afloat. Until recently, many firms had provided staff with pensions linked to their earnings shortly before retirement. However, the costs of providing those pensions have risen, due to people now receiving their pensions for longer.

- At the same time, the money in the pension fund hasn't grown in value as expected, due to a lengthy slump in share prices. As a result, more and more companies have been switching their pension schemes to a less costly basis, called money purchase, under which there is no link to 'final earnings'.

- Half of all salary-related pensions closed to new entrants in the three years between 2000 and 2003. Altogether, two-thirds of all final salary schemes are no longer open to new members.

*Source: TUC General Secretary, Brendan Barber, 11 September 2005*

- Money purchase schemes do not guarantee any level of pension, but depend on investment ups and downs. They can provide a reasonable benefit if the contributions are high enough – but they usually aren't. Experts agree that you need to save 15% of your pay in a money purchase scheme. Yet the average employee contributes just under 3% – and the average employer contributes around 6%, compared with the 14.5% that it pays into a salary related scheme.

*Source: TUC General Secretary, Brendan Barber, 11 September 2005*

- Despite this trend, some employers have maintained their final salary schemes – at least for the existing members. However, the shortfall in the value of their schemes is now estimated to total an astonishing £130 billion.

*Source: Association of Consulting Actuaries, October 2005*

That's a black hole equal in size to the total foreign debt of Brazil.

*Source: Daily Mail, 6 October 2005*



- In the private sector, only 1 in 4 employees is lucky enough to have access to a company pension scheme. If that trend continues, in 20 years' time, only 1 in 10 employees will be members of an occupational pension scheme.  
*Source: TUC General Secretary, Brendan Barber, 11 September 2005*

- The government tried to revitalise participation in workplace pensions with the introduction of stakeholder pensions in April 2001. However, these low-cost, simplified pension arrangements have failed to capture the public's imagination. Most employers simply do not make any contribution to stakeholders – and, even among those that do, their average contribution is just 2.2% of the employee's earnings.  
*Source: TUC General Secretary, Brendan Barber, 11 September 2005*

- Too many people have put pension savings towards the bottom of their priorities – which means that they are putting their future welfare at risk. 37% of full-time workers – as many as 6.5 million people – are not contributing to any company or personal pension scheme.  
*Source: The Sunday Telegraph, 30 October 2005*

- More than a million people are now working beyond the State pension age, because they can't afford to retire. This number could double within a decade, as only 1 in every 4 people currently aged between 55 and 64 believe that they will have sufficient pension or savings to give up work.  
*Source: Daily Telegraph, 5 October 2005*

*If you think pensions are dull, imagine how boring poverty in old age will be!*



# Chapter 2

## The position in Ireland



**Now, let's consider the main issues  
that we need to address**



## Will Irish eyes still be smiling?

- Like all other developed economies, Ireland is facing a pensions crisis. Fortunately, the problems with the State scheme are less acute than in other countries – due to the fact that the Irish government spends proportionately less on pensions than any other country in the EU.
- 
- For example, the average EU country spends 12.5% of its GDP (the total market value of all the goods and services produced within the country) on State pensions – with Austria topping the list at 14.6%, followed by Germany at 13.4%, France at 13.2% and the Netherlands at 13.1%. In contrast to this, the Irish government spends just 3.2%. *Source: Eurostat, based on 2002 costs*
- 
- However, this is rather a two-edged sword:-
    - 1 **On the positive side**, the low level of expenditure means that, although costs will inevitably escalate over the coming years, the effects will not be as devastating as in other countries.
    - 2 **However, on the negative side**, the low cost to the State is matched by correspondingly low benefits – which means that there is greater pressure on the private sector. Unless employers and individuals pay significant pension contributions, people simply won't receive adequate pensions at all. This, in turn, could rebound on the State, which would have to provide people with greater amounts of income through Supplementary Welfare Allowance.



### The State pension

- The system faces increasing strain, as a result of the increasing length of the average person's life. Between 1996 and 2002, life expectancy for men improved by 2.1 years to 75.1 – and for women by 1.8 years to 80.3. *Source: The Society of Actuaries in Ireland, 2004*
- 
- This trend is likely to continue. Today, the number of people aged over 65 is less than 500,000 – but, by 2050, it is expected to be more than 1.25 million. Looked at another way, there are currently six people of working age for each pensioner – but, by 2050, there will only be two. *Source: The Society of Actuaries in Ireland, 2004*
- 
- In 2001, there were 98,000 people over age 80. By 2036, that number will grow to around 320,000. *Source: Combat Poverty Agency, 2005*
- 
- Workers' contributions are collected through PRSI one week – and paid out to pensioners the next. So, as the ratio of workers to pensioners falls, the workers' contributions will have to increase. Indeed, by 2030, unless there are some dramatic demographic changes (such as a sustained increase in young workers as a result of immigration), the contributions will have to almost triple. *Source: The Society of Actuaries in Ireland, 2004*

- To help address the huge potential deficit, a National Pensions Reserve Fund was established in 2001, financed by government payments equal to at least 1% of Gross National Product. This fund was designed to help finance State and public sector pension liabilities from 2025 onwards, as their income shortfalls escalate.  
*Source: Department of Finance, 2005*

- The only compensating factor at present is the relatively high rate of immigration. The influx of younger workers is reducing the rate at which the overall population is ageing – and slowing down the rate at which the pensions timebomb is ticking. However, this isn't curing the problem – it is simply deferring the crisis to a later day.  
*Source: Pensions Ombudsman, 2005*

### Public sector pensions

- The public sector employs 20% of the working population.  
*Source: Central Statistics Office, 2005*

- Pensions for public sector workers are much more generous than in the private sector – as they are based on earnings just before retirement – and increase during payment in line with the pay rises of civil servants who are still working. As the average public sector wage increased by around 9% in 2004, public sector pensions increased last year by over 3 times the rate of inflation.  
*Source: EuroStat, 2005*

- Like the State pension scheme, public sector pensions operate on a pay-as-you-go basis, without any investment of the contributions. The costs being met each year from current government revenue, plus employee contributions.

- The public sector pension bill has increased by 86% over the last 5 years.

*Source: Department of Finance, 2005*

Over the coming years, however, costs are expected to rise further. Today, the cost of providing pensions to civil servants and other public sector employees is around 16% of their total payroll. By 2027, this is expected to rise to 38% of their total payroll.

*Source: Commission on Public Sector Pensions, 2005*

- Questions are already being asked about the fairness and sustainability of asking ordinary workers (through taxation) to finance the exceptionally high pension benefits of public sector workers – which will substantially exceed the maximum level of benefits that the workers themselves can ever hope to receive.



### Private sector pensions

- Nearly half of the working population – 47.6% – have no private pension coverage. That's around one million workers who are neither included in an occupational pension scheme nor hold a personal plan.

*Source: Central Statistics Office, September, 2004*

- An even greater proportion of the self-employed (and those assisting relatives) – 56.9% – have no pension plan.

*Source: Central Statistics Office, September, 2004*

- This is clearly storing up a very serious problem for the future – as those without a pension plan will find it very hard to pay their bills in retirement. However, this problem may affect even more people – as many of those who do have pension arrangements are paying too little into them, so are likely to find their pension benefits inadequate for their needs.

- Traditional company pension schemes are becoming far less generous – particularly for new entrants. Many of the schemes are under-funded – which means that they have insufficient money in them to meet the expected costs of the benefits that have been promised to the members. As a result, employers have been switching the schemes from 'defined benefits' (linked to employee's earnings shortly before retirement) to 'defined contributions' (under which the benefits will depend on investment performance – and will, almost certainly, be lower).

- The government has tried to stimulate the take-up of personal plans through the introduction of Personal Retirement Savings Accounts (PRSAs). Unfortunately, the take-up of these has been disappointing. By the end of September 2005, PRSAs had been taken out by only 59,251 people. That's around 3% of the workforce.

*Source: Pensions Board, October 2005*

- The risk, therefore, is that the one million workers without any pension provision – plus many of the workers whose pension arrangements are inadequate – will fall into the poverty trap when they retire. The number of pensioners living in poverty increased from 5.3% in 1994 to almost 50% in 2001.

*Source: Combat Poverty Agency, 2005*



# Chapter 3

## A focus on the middle-aged group in Ireland

**How prepared are they for retirement?**



## Looking after 'Number One'

As we have seen:-

- 1 The State can't afford to make the old age pension more generous – and may, in fact, find it difficult to maintain its present basis.

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- 2 Employers are finding the costs of their company pension schemes prohibitively expensive, so are cutting back the benefits that they provide.

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- 3 So, it is clearly up to individuals to make suitable arrangements to provide for their own future financial welfare.

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### Middle-aged spread

Almost one million people are aged between 40 and 60 – about a quarter of the overall population.

*Source: Central Statistics Office, 2005*

So, around 1 in 4 adults are in what may be described as the 'waiting room' for retirement. But how many of them will catch the right train? How prepared are they for retirement?

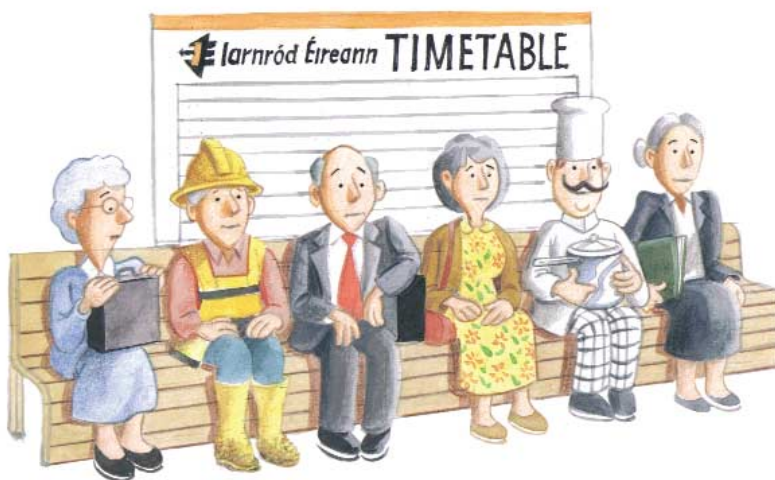
### Researching public attitudes

We commissioned Behaviour & Attitudes to carry out a survey of middle-aged people – defined, for the purposes of this research project, as the 40 to 60 age group.

The following pages present the findings of that survey – which was based on a programme of 400 interviews conducted by telephone.

The sample was designed to be representative of the total population in the chosen age group, on the basis of gender, age and regional distribution.

A technical note, together with a copy of the questionnaire used, on the sampling and interviewing method is set out in the Appendices on pages 48–51.



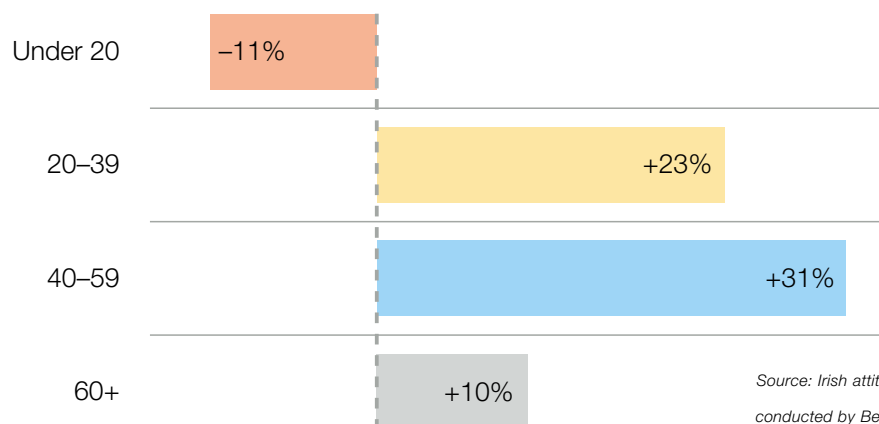
## We aren't as young as we were

*'In youth, we run into difficulties.  
In old age, difficulties run into us.'*

*Beverley Sills – opera diva*

- It wasn't so long ago that Ireland had the youngest, most vibrant population in the EU – after all, weren't we the country where Europe's 'silicon valley' was going to be located, with our young, computer-literate workforce at the forefront of the technological revolution?
- Sometime in the mid 90's, computer companies started to encounter major business problems that ended in the bursting IT bubble. And, at the same time, we began to see that the fastest growing sector of the population was no longer the young, but older workers instead.
- Today almost 1,000,000 Irish people are aged between 40 and 60 – that's 1 in 4 of the population, and it is the group that has expanded most rapidly over the last 10 years.
- Breaking it down a little more, the proportion of people in their 40s and 50s has increased by 31%, while the under 20s group has shrunk by 11%!
- So, 1 in 4 of the population are in the 'waiting room' for retirement and if they haven't already planned for this coming life stage – or if they are not contributing sufficiently to their retirement funds – there is every likelihood that they will 'miss the train' completely!

### Percentage change in population by age – past 10 years



*Source: Irish attitudes to pension research conducted by Behaviour & Attitudes, 2005*

## The gender wars – winners and losers

*‘Nobody will ever win the battle of the sexes.  
There’s too much fraternising with the enemy.’*

*Henry Kissinger – statesman*

- Although, in reality, there is no actual ‘battle’ or ‘war’ of the sexes, there certainly are demographic winners and losers.

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- Within the 40-60 age group – which is the critical one in terms of pension provision – the most recent census showed that the split between men and women was almost exactly 50/50.

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- However, if historic patterns continue, the average woman will outlive the average man – and, when today’s 40-60 age group have all retired, their balance is likely to be 45% male and 55% female. This shows that it is vitally important for women to have their own independent pension arrangements.

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- However, women in the 40-60 age group find it difficult to save up for their retirement because:-
  - Almost two-thirds of them still have dependent children at home. Naturally, the time involved in looking after the children restricts their ability to go out to work and earn money.
  - The cost of supporting their children strains their finances and makes it difficult for them to save for retirement.

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- 75% of women in this age group are married. Whenever possible, they should therefore ensure that when their husbands retire, their pensions are set up on a joint life basis, that will provide a continuing income to the wife after the husband’s death.

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- 15% of women in this age group are single – and, as such, are left to fend for themselves. So, unless they make adequate pension arrangements, they won’t have sufficient money to make the most of their retirement years.

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- The remaining 10% of women in this age group are either widowed or divorced. In fact, for the first time ever in Irish history, divorcees now outnumber widows and widowers. Divorce creates its own problems for retirement planning – not least because the current law identifies pension arrangements as an asset that must be taken into account in the settlement. Its apportionment often adds to the acrimony of divorce cases.

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*Source: Irish attitudes to pension research  
conducted by Behaviour & Attitudes, 2005*

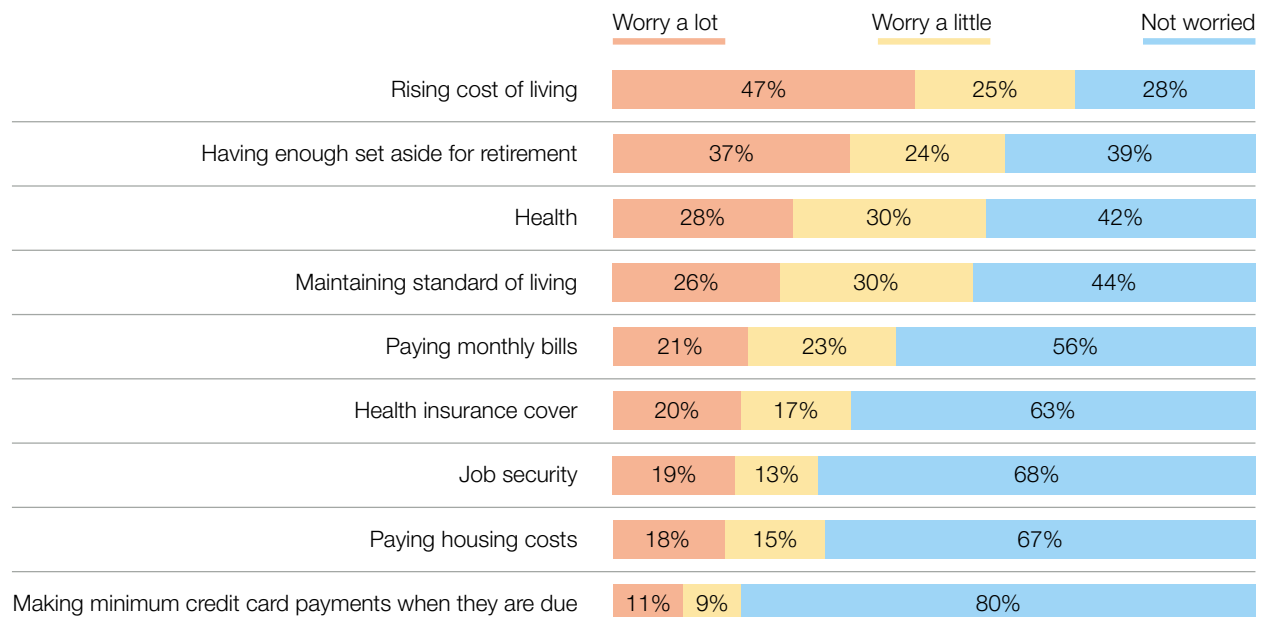
## Who's worried?

*'If I knew what I was so anxious about,  
I wouldn't be so anxious'*

Mignon McLaughlin – journalist and author

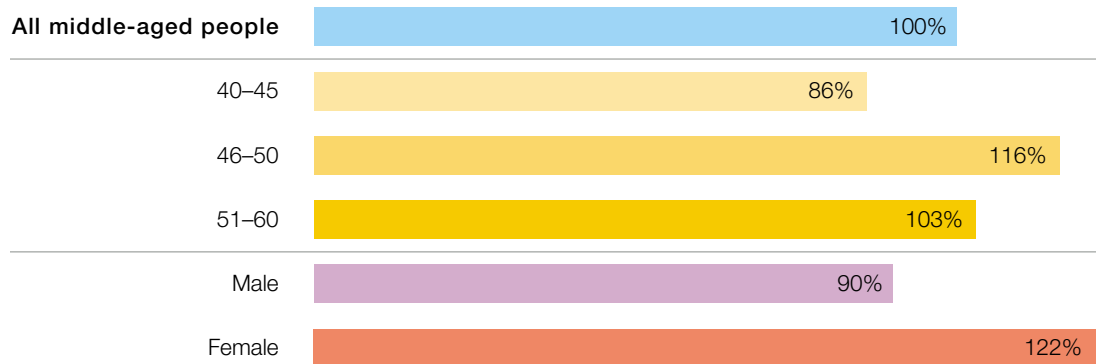
- People aged 40 to 60 are worried about a lot of things – but financial concerns come very high on the list. We worry more about money (or the lack of it) than health.
- As shown in the charts below, the two greatest worries for this age group are the rising cost of living (a concern of 7 in 10) and the likelihood that personal savings for retirement will prove inadequate (a concern of 6 in 10).
- In reality, of course, these concerns are intertwined – because the rising cost of living is eating away at the value of existing retirement savings and making them even less adequate.

### The main worries of the 40-60 age group *(What we worry about and how much)*



- Although inflation has recently been quite modest, the 40-60 group has lived through times of severe inflation – which have left a permanent mark on their collective consciousness.
- By analysing people's lists of worries – and allocating a point for each individual concern – we have prepared an overall 'worry index'. This shows that there are some significant differences between the different age groups – and, even more markedly, between men and women:-

### The worry index



Source: Irish attitudes to pension research  
conducted by Behaviour & Attitudes, 2005

*As you can see, Miss Money Penny is more worried than James Bond!*



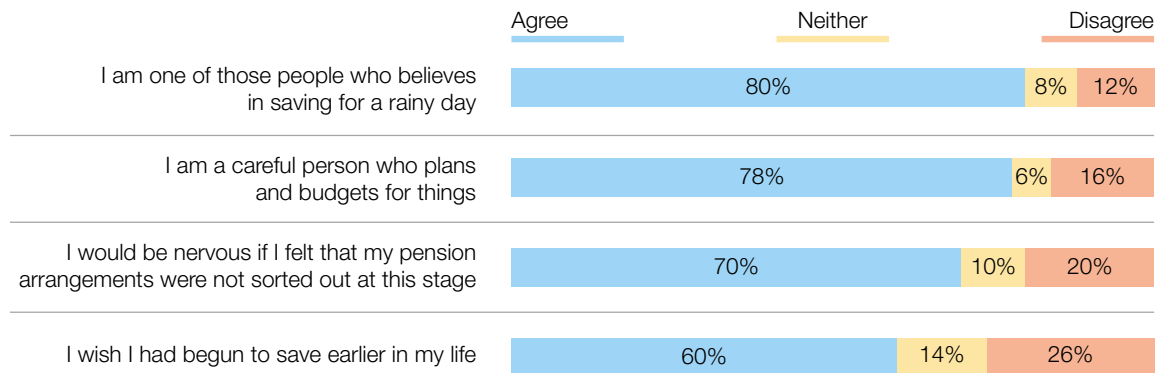
## Saving for a better future

*‘The future is not what it was.’*

*Anonymous*

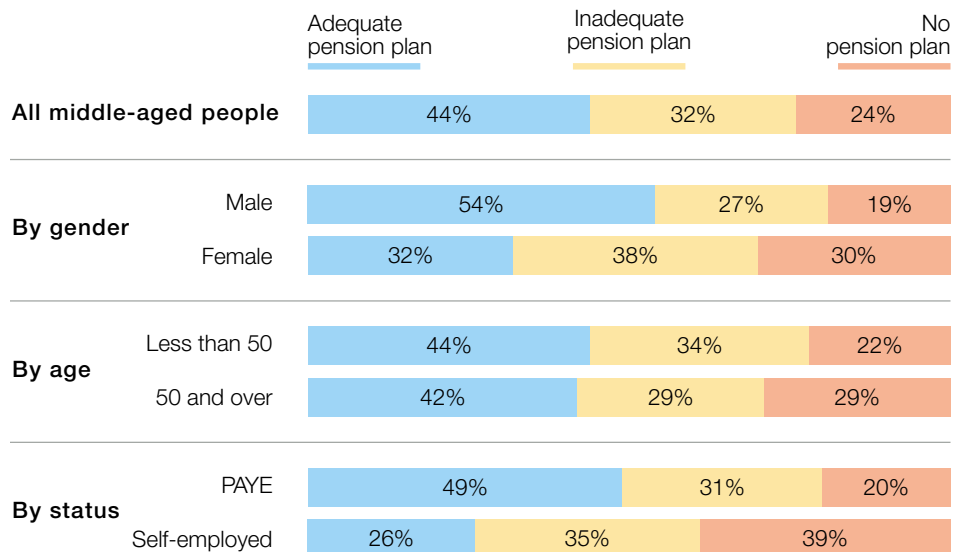
- Setting aside money now for the future – whether through a savings plan, a pension arrangement or a combination of both – is generally seen as the key to ensuring a retirement free of financial worries.
- So, what did the 40-60 age group tell us about their attitude to making such arrangements for their future welfare?
- Well, as a nation, one of our national characteristics is said to be our conservative nature. At least that’s what a number of surveys tell us! So it’s probably not surprising that a very high proportion of the 40-60 age group describe themselves as careful people who plan and budget for things:-

### Attitudes to savings and pension planning



- As you can see, 8 out of every 10 people in this age group believe in planning for a rainy day – and almost the same proportion believe that they are careful with money and budget properly.
- But what about the real world? Are these people truly as prudent and forward thinking as they have indicated?
- When the same group is questioned more specifically about pension arrangements, it becomes apparent that their conservative outlook is based more on how they wish to see themselves, rather than on their true position!

### Adequacy of pension arrangements



- As shown above, less than half of this age group really believe that their pension arrangements are adequate, while around 3 in 10 consider that their pension plans are inadequate – and over 2 in 10 say that they have no plan in place at all. So much for the ‘saving for a rainy day’ mentality!
- It is interesting to note that the highest proportion of people without any form of pension plan – almost 4 in every 10 – were self-employed. However, this begs some important questions about how they expect to finance their retirement.
- Do they plan to work until they drop? Are they intending to sell their businesses for a large amount – and, if so, how realistic is this assumption anyway? Or are they hoping that Great Aunt Mary will die and leave them a large inheritance?

Source: Irish attitudes to pension research conducted by Behaviour & Attitudes, 2005

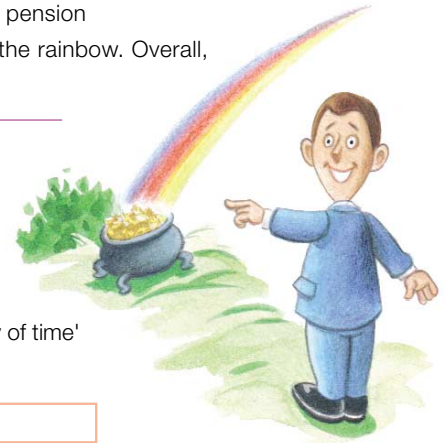


## Somewhere over the rainbow?

*‘Procrastination is, hands down, our favourite form of self-sabotage’*

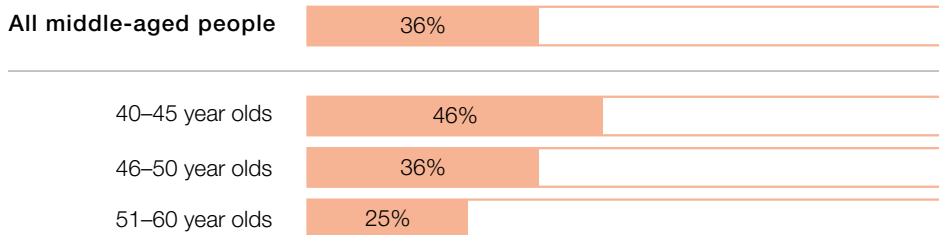
*Alyce P. Cornyn-Selby – American manager and author*

- Many middle-aged people believe that they still have plenty of time to put their pension arrangements in place – and still look forward to a crock of gold at the end of the rainbow. Overall, more than a third of the 40-60 age group expressed this view.
- The belief is strongest at the younger end of this age group – but it tapers off significantly as people get closer and closer to retirement:-



### Is there still enough time? (to put adequate pension arrangements in place)

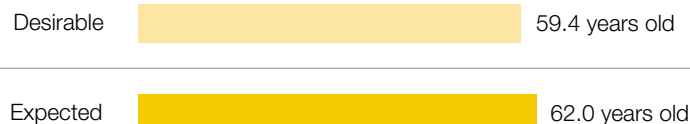
Percentage of people who feel that they still have 'plenty of time' to put their pension arrangements into place



*Source: Irish attitudes to pension research conducted by Behaviour & Attitudes, 2005*

- As always, of course, the dream is tinged with a healthy dose of reality. Most Irish people would like to retire relatively young – yet they recognise that, in order to look forward to a reasonable level of pension, they will have to go on working rather longer:-

### Planned retirement age



*Source: Irish attitudes to pension research conducted by Behaviour & Attitudes, 2005*



## Money, money, money!

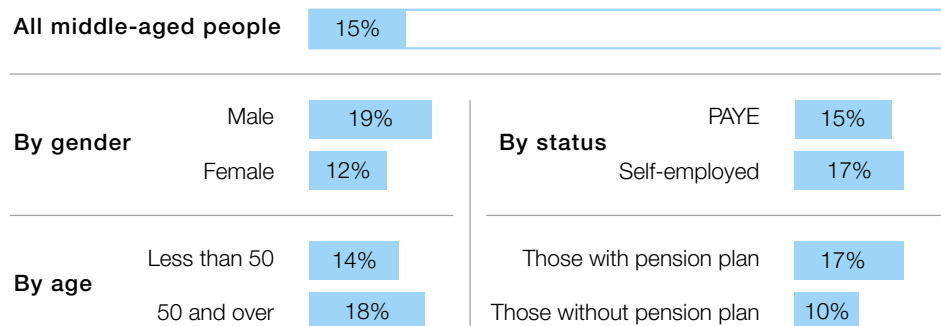
*'Don't gamble. Take all your savings and buy some good stock, hold it till it goes up, then sell it. If it don't go up, don't buy it.'*

*Will Rogers, American humourist*

History has shown that, over the medium to long term, stocks and shares have produced considerably higher returns than other forms of investment. Most pension plans are therefore invested in the stockmarket. But how enthusiastic are people about this form of investment?

- Overall, about 1 in 7 people in the 40-60 age group describe themselves as having a deep interest in the stockmarket. But there are some marked differences between different demographic groups:-

### Deep interest in the stockmarket



- As you can see, men are more interested in stockmarket investment than women – nearly 1 in 5, compared with just over 1 in 8.
- Those over 50 are more enthusiastic than those under 50 – nearly 1 in 5, compared with around 1 in 7.
- The self-employed are slightly more interested in stocks and shares than workers on PAYE – almost 1 in 6, compared with nearly 1 in 7.
- People who have a pension plan are much more enthusiastic about stockmarket investment than those without a pension plan – nearly 1 in 7, compared with 1 in 10.

What hasn't been identified in the research is whether the enthusiasm actually translates into stockmarket activity – personally buying and selling shares as investments – or whether it is simply an interest in monitoring the progress of the pension company's funds, to see how their pension plans are performing.

*Source: Irish attitudes to pension research conducted by Behaviour & Attitudes, 2005*

# Chapter 4

## Coping with the pensions jungle



**The middle-aged share some characteristics  
with the animal kingdom...**



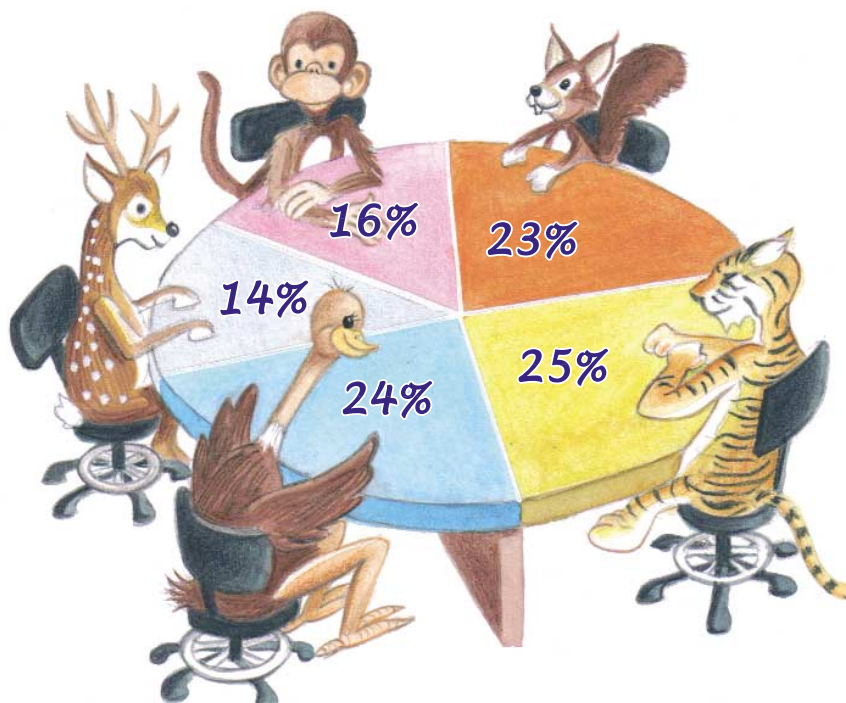
## More than just bulls and bears

*‘ Man is just an animal who plays Bach with his paws ’*

*Bertus Aafjes – Dutch poet and author*

- One of purposes of our research was to see if middle-aged people in Ireland could be segmented into different groups, according to their attitudes to savings and pensions plans.
- Based on the answers to the questions that we researched, we were able to classify the respondents into 5 different groups. For fun, we have associated each group with the tendencies and personalities of a different animal:

### Attitude to pension savings

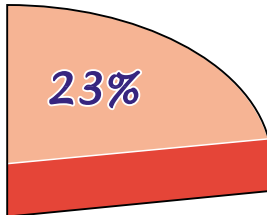


Source: Irish attitudes to pension research conducted by Behaviour & Attitudes, 2005

The characteristics of these groups are set out on the following pages, together with their rating on the ‘worry index’.



## Squirrels – who feel secure about their pension planning



*‘ There is nothing more demoralising than a small but adequate income ’*

*Edmund Wilson – American writer and critic*

- Secure and confident, nearly 1 in 4 of the middle-aged can be classified under this heading.
- As far as pensions are concerned, this group has least to fear in the future – as 84% of them are already storing up money in a pension plan.
- They are quite content with the level of their savings. Half of them (5 in 10) consider that they are saving as much as the average person in their peer group – while 4 in 10 believe that they have saved more than the average amount.
- Almost 8 in 10 are confident that they will have squirreled away enough for their needs by the time they retire.
- They have few regrets. Only 10% of them wish that they had started to save earlier, (compared with the 60% of the total age group who regret the delay).

### ‘Worry index’ rating

- The security and confidence of the squirrels is more than skin deep.

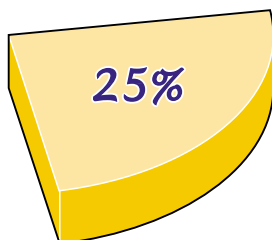
Their worry index rating is just

53

- Compare that with the rating of 100 for all the respondents in this age group.
- In other words, squirrels are only around half as worried as the average animal.

Source: Irish attitudes to pension research conducted by Behaviour & Attitudes, 2005

*Tigers* – who are aggressively pursuing the goal of building a sizeable retirement nest-egg



*'Oh heavens, how I long for a little ordinary human enthusiasm'*

*John Osborne – playwright (from Look Back in Anger)*

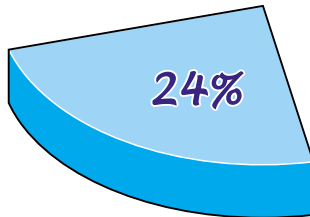
- In their own way, tigers are just as wise – and certainly as confident – as the squirrels. Indeed, they share many of the squirrels' attitudes about savings and pensions.
- However they differ in their age profile – as the tigers are at the lower end of the age group.
- What really distinguishes the tigers from the squirrels is their interest in the stockmarket – with 41% of them being interested in stocks and shares, compared with only 3% of squirrels.
- The tigers are showing some of the more aggressive instincts of their animal counterparts – being hungry for more, rather than satisfied with what they have.
- The tigers have very good reason to be confident – 85% of them already have a pension plan in place – and almost 80% of them believe that they will have an adequate income to meet their needs when they retire.

#### **'Worry index' rating**

- As you would expect from such confident creatures, the tigers' worry index rating is low, at **55**
- Compare that with the rating of 100 for all the respondents in this age group.
- In other words, like the squirrels, tigers are only around half as worried as the average animal.

*Source: Irish attitudes to pension research conducted by Behaviour & Attitudes, 2005*

*Ostriches* – who are always saying ‘if only...’  
they had done something differently or earlier



*‘ An ostrich with its head in the sand is just as blind to opportunity as to disaster ’*

*Anonymous*

- This is the second largest sector, representing almost 1 in 4 of the middle-aged.

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- It is the third highest group in terms of having a pension plan – with 75% of ostriches saying that they are setting aside contributions for their retirement.

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- However, even by their own estimation, they are almost certainly not setting aside enough – as just over half of them are worried that their pension plans will not provide sufficient income for their retirement.

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- Ostriches have a remarkable level of self-knowledge about their failings. They represent a large proportion of the respondents who consider that they are ‘not careful people who plan and budget for things’.

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- It is hardly surprising therefore that this group shows distinct sign of nervousness as they approach retirement. What is more surprising is while they acknowledge of the problem, they don’t feel that they can do anything about it – so they revert to animal instinct and bury their heads in the sand!

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- 9 in 10 ostriches say that they would be very nervous if their pension arrangements hadn’t been sorted out by now. Yet the same proportion believes that that time is running out and that it’s probably too late now to put adequate pension plans in place!

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- As a result, 91% of them they believe that they should have begun to save earlier in life. (Compared with the 60% of all the middle-aged who hold this view).

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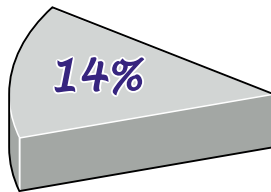
**'Worry index' rating**

- Hardly surprisingly, the 'if only...' ostriches have a high worry index rating.
- Compared with the rating of 100 for all the respondents in this age group, ostriches have a well above average rating of **120**
- Self-knowledge is a marvellous attribute, but coupled with inaction, it is useless.

Source: Irish attitudes to pension research conducted by Behaviour & Attitudes, 2005



*Deer* – who are often too timid to take positive action



*Do not be too timid and squeamish about your actions.'*

*Ralph Waldo Emerson – American poet and essayist*

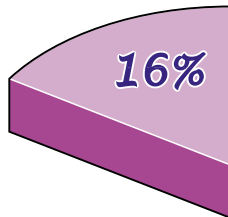
- Some people – around 14% of the middle-aged population – are just born worriers. The problem for them is that, all too often, their worry leads to inaction, particularly when it comes to pension planning.
- Although deer account for a relatively small proportion of the middle-aged group, a staggering 40% of them have no pension plan in place, compared with an average for the entire group of 24%.
- Deer seem to suffer from a classic problem. They worry a great deal about things – far more than any other sector of the middle-aged – yet they have great difficulty in taking the necessary decisions to rectify matters.
- The net result is that they are the sector within the middle-aged population that is least likely to have a pension plan in place. So, they are right to be worried – but they really should try to break out of the inaction that is prejudicing their future financial well-being.

#### **'Worry index' rating**

- As one might expect, deer have an astronomically high worry index rating.
- Compared with the rating of 100 for all the respondents in this age group, deer have a staggering rating of **257**.
- That score on the worry index says it all. Deer seem to be worried to the point of indecision. So, rather like the ostriches, they aren't doing anything to change or improve their pension prospects.

*Source: Irish attitudes to pension research conducted by Behaviour & Attitudes, 2005*

*Monkeys* – who are too busy having fun to worry very much about the future



*'I would live all my life in nonchalance  
and insouciance,  
Were it not for making a living,  
which is rather a nouciance.'*

*Ogden Nash, American humourist and poet*

- Monkeys represent 16% of the middle-aged population.

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- They live for today, largely unconcerned about future responsibilities – and this happy-go-lucky attitude means that only a third of them believe in saving for a rainy day (compared with 80% of the overall 40-60 age group).

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- Only 25% of monkeys consider themselves to be 'a careful person who plans and budgets for things' (compared with 78% for the overall age group).

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- A particular concern, from the pensions perspective, is that only 15% of monkeys say that they would be worried if they found out that their pension arrangements hadn't been sorted out by now. This means that 85% would be totally unconcerned to find themselves in this position. So, they are nearly 5 times more likely to end up with an unrealistically low pension than the average person who is currently aged 40 to 60.

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- Monkeys are rather like Dickens' famous character, Mr Micawber, travelling through life hoping that 'something will turn up'. However, unless they win the lottery or the football pools, they will almost certainly face a relatively bleak retirement – even with help from the State and/or relatives.

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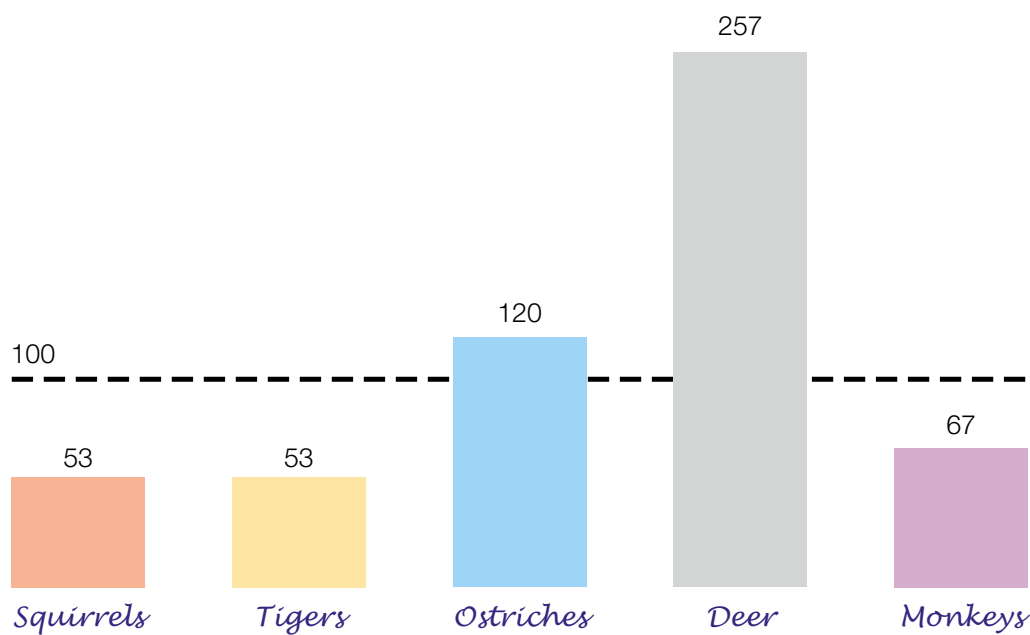


## Pensions bring peace of mind

For the purpose of presenting some of our research findings in a meaningful and interesting way, we created the 'worry index', as described on page 22.

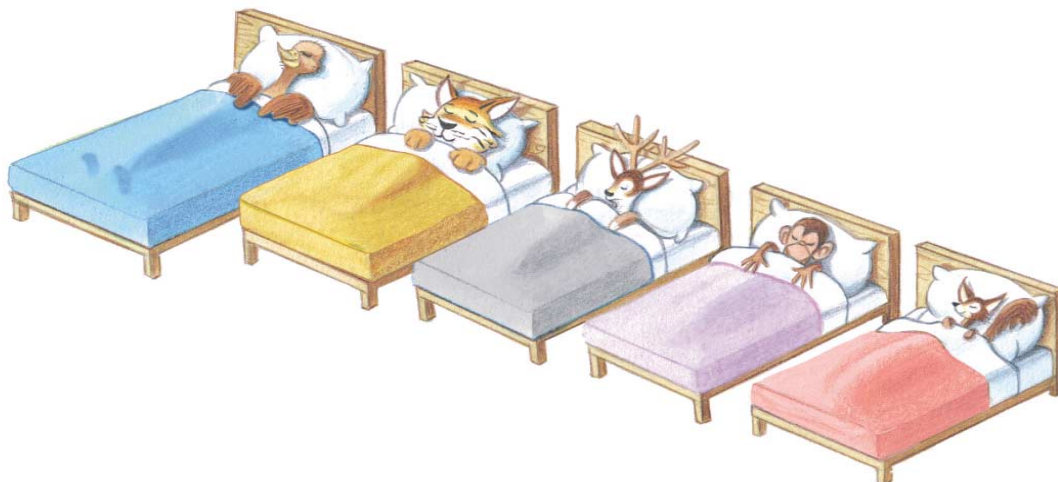
Our final use of this index was to segment the respondents according to their declared satisfaction with their pension plans.

This shows very clearly that, the happier people are with their pension arrangements, the less likely they are to worry about things in general:-



The moral appears to be that having a good pension plan enables you to sleep well at night!

*Source: Irish attitudes to pension research conducted by Behaviour & Attitudes, 2005*





# Chapter 5

## How other countries are addressing the problem



**A look at the steps being taken  
in New Zealand, Sweden, Chile and Australia**

## The New Zealand approach – KiwiSaver

**In New Zealand, there are few large companies and fewer than 15% of workers are members of company pension schemes. To increase the incidence of saving for retirement, a new type of scheme – called KiwiSaver – will be introduced on 1st April 2007.**

### A national savings scheme

- This is not a pension plan in the conventional sense – it is a savings plan. The government's literature doesn't mention the word 'pensions' once.
- Each member will have a personal KiwiSaver account – which may be drawn at retirement as a cash lump sum. There will be no need to buy a pension or annuity. Indeed, there is nothing to stop the money all being spent in one go.



### Who it's for

- **New employees:** Everyone aged at least 18 who starts a new job will automatically be enrolled in a KiwiSaver after the first 8 weeks of employment. However, membership is not compulsory – as there will be a 3-week window to opt out.
- **The self-employed and existing non-pensionable employees:** These people will be able to opt-in to the KiwiSaver scheme.
- **Members of existing pension schemes:** The situation depends on whether or not the scheme is open to all employees of the company, has a total contribution rate of at least 4% of earnings and its benefits are transferable, on leaving service, to the new employer's scheme:–
  - If it does, there will be no requirement for the members to join KiwiSaver – although, if they wish, they may opt to join KiwiSaver instead of, or in addition to, their current pension scheme.
  - If it doesn't, the members must automatically be enrolled in KiwiSaver.
- **Employers:** They will have the option to convert their existing schemes to KiwiSaver.

### Contributions

- Each member must pay a standard contribution of 4% of earnings – although there is the option for the member to pay 8% instead. No other levels will be permitted. The contributions will be deducted from pay under the PAYE tax system – but the self-employed must pay their contributions directly to the Revenue authorities.

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- Employers will be encouraged to contribute to their employees' KiwiSaver accounts – but will not be compelled to do so.

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- The government will make an initial contribution of NZ\$1,000 (approximately €600) to each member's account.

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- Members will have the right, if they wish, to suspend contributions for up to 5 years at a time. In theory, they will be able to ask for a series of contribution holidays, thus effectively opting out of the scheme.

### Investment

- For the first 8 weeks of each account, the contributions will be held by the Revenue authorities. During this time, the member can choose where the money should be invested – from a range of registered industry providers and fund managers. There will be a 'default option' for those who fail to make a choice. Members may switch providers whenever they wish, but may only have one provider at any time.

---

- KiwiSaver will operate on a 'money purchase' basis. That is to say that the value of each account will be purely and simply the value of the investments bought with the contributions. There will be no State guarantee of investment performance, even if the returns are very poor.

### Withdrawals

- The aim is to save for retirement. So, subject to certain exceptions, the accounts will be locked in until age 65 (for both men and women).

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- The exceptions are financial hardship (although, as yet, there is no definition of this), permanent emigration to another country – and a special facility that is available after the first 3 years of contributions. This facility permits funds to be withdrawn to use as the deposit to buy a first home. (However, none of the government's contribution may be withdrawn until after the first 5 years of the KiwiSaver account.)

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- Introducing the scheme in May 2004, Finance Minister Michael Cullen said 'Our estimates are that KiwiSaver will enable around 3,000 households a year to realise their dream of owning their own home'.

**Portability**

- Members will be able to take their KiwiSaver accounts with them, from job to job.
- 

**Tax**

- There are no tax benefits for pension schemes in new Zealand – so no tax concessions will apply to KiwiSaver.
- 

**All in all**

- Although it bears certain similarities to our PRSA, KiwiSaver would almost certainly need significant changes before it could be replicated in a country such as Ireland. It would certainly need to incorporate tax benefits.
  - KiwiSaver has already been widely described as a home deposit savings policy with a retirement option attached.
- 

Sources: New Zealand government and Bank of New Zealand



## The Swedish approach – the Premium Pension Plan

**Sweden had one of the most comprehensive State pension schemes in the world. However, due to its ageing population – one of the oldest in the world – the government was facing ever-increasing deficits in its scheme. As a result, it introduced a new Premium Pension Plan in 1998 – which has made it one of the world's leaders in the transfer from State to private pension systems.**

Its previous scheme (which still applies to older workers) had two tiers – a basic pension and an earnings-related supplement – both of which were financed on a pay-as-you-go basis, with the pension instalments being paid directly from the contributions received.

The new scheme also has two elements – a Notional Individual Account, and a Private Individual Account.

### Contributions

- The total contributions payable are 18.5% of the worker's pay, split equally between employer and employee – *ie* each pays 9.25%. (Previously, all pension contributions had been paid by the employer.) All contributions are collected by, and administered by, a government agency.
- Of this total contribution, 16% goes to the Notional Individual Account – and 2.5% to the Private Individual Account.

### The Notional Individual Account

- This is a compulsory arrangement, with no right for anyone to opt out.
- The contributions continue to be used to pay the pensions of those who have already retired.
- The unique feature of the scheme is that the 16% contribution is notionally credited to a notional individual account for the employee – which is increased each year in line with the rise in national average earnings. (Historic data was accessed by the government, to give workers credit in their accounts for notional contributions paid out of their earnings all the way back to 1960.)
- On retirement – which can be at any time between the 61st and 70th birthdays, the notional value of the account will be applied to purchase a notional annuity that will provide the worker's pension.



- A special formula for calculating this annuity rewards those who delay their retirement (as the incidence of early retirement has been high in Sweden). For example, someone delaying their retirement to age 68 would receive 130% of the pension that would have been payable at age 65 – and someone delaying to age 70 would receive 157%.

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- The pensions are increased each year during payment, in line with the national average wage.

---

- Workers who leave the workforce to raise children are credited with ongoing notional contributions during the relevant period.

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It is intended that the Notional Investment Account will be progressively privatised over the coming years. To minimise the disruption whenever a tranche is outsourced, the government already charges a modest administration fee to cover its costs in running the scheme and maintaining the notional accounts.

#### **The Private Individual Account**

- This is a properly funded, money purchase scheme, providing pensions on a 'defined contribution' basis.

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- That means that the money built up in the worker's account will be used, at retirement, to buy an annuity. The amount of pension payable will therefore depend on the value of the account at retirement – and the rates available at the time for converting this into an annuity.

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- The scheme is currently positioned as part of the State system – but will be repositioned from 2007 as part of the private pension system.

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- This, also, is a compulsory arrangement, with no right for anyone to opt out.

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- The employee may select a fund manager for the account, chosen from an approved list. The employer has no say in this. The funds must follow prudent principles, but are largely free of other regulations (although the managers' charges are controlled).

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- Between them, the approved fund managers currently offer a choice of over 600 funds. Switching is permitted, but there is an administrative fee for doing so.

---

- 85% of members make no active choice of fund, so their accounts are invested in the default fund.

---

- Retirement may take place at any time between the member's 61st and 70th birthdays.

---

- It is anticipated that, over the coming years, the Notional Individual Account will gradually be transferred into the Private Individual Account.

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### The safety net

- Workers on low pay – and those who don't work for several years, due to career breaks, ill health or unemployment – will reach retirement with relatively small credits in their accounts.
- 
- The government has therefore laid down a minimum, means-tested benefit below which people will not be allowed to fall. This minimum is reviewed annually as part of the Budget process.



### All in all

The benefits of this system can be summarised as:-

- **More incentive to carry on working.** Under both modules, workers should receive significantly higher benefits by delaying their retirement.
- 
- **Lower government spending.** The privatisation of the first tier (the Private Individual Account) is already yielding fiscal benefits.
- 
- **Greater fairness.** The new system closely links pension benefits with lifetime earnings.

However, the principal downsides appear to be:-

- **Investment choice:** Most workers seem unattracted (or baffled) by this.
- 
- **Investment risk:** Adverse investment conditions (and/or poor investment management) could devastate the value of the accounts. Indeed, over the first 2 years of the new scheme, the average fund lost 35.3% of its value – although it has since moved back into positive territory.

Overall, of course, the scheme is one designed to transfer a high benefit State scheme, in progressive stages, to the private sector. So it has no relevance to countries, such as Ireland, where the benefits provided by the State scheme are very modest. It could, however, be used as a model by other European countries, such as France, which have very generous (and costly) State schemes.

*Sources: Swedish government, Stockholm University and the Heritage Foundation*

## The Chilean approach – the Personal Retirement Account

**The pay-as-you-go State pension scheme in Chile was heading for disaster. The ratio of workers to pensioners nose-dived from over 12 to 1 in 1955 to just 2½ to 1 in 1980 – so the costs were becoming totally unworkable. In 1980, the government therefore introduced the Personal Retirement Account – the first ‘privatisation’ in the world of a State pension scheme.**

**The PRA has proved very successful for the government, the Chilean economy – and for the approved firms of investment managers. However, although many workers are finding the new system highly rewarding, a large number still face the prospect of poverty in old age.**



### Eligibility

- The PRA scheme applies to all employees who started work after it began in 1981, whether working for private companies or the government (except that air-force employees still have their own separate arrangement).
- Self-employed workers are not compelled to participate – but may do so on a voluntary basis.
- People who started work before 1981 were given the opportunity to join the PRA scheme – but, if they didn't make this choice, they stayed in the old State scheme.

### Personal Accounts

- The Personal Retirement Accounts are tied to the individual, not the companies who employ them – so they are fully portable.

### Contributions

- Employees contribute 10% of their earnings – with the option to contribute more, if they wish, up to a maximum of 20%. These contributions are deducted from their pay by their employers – and credited directly to the employees' Personal Retirement Accounts.
- In addition, employees have the option to contribute an additional amount – currently just under 3% of pay – to provide themselves with life assurance and disability benefits.
- The contributions are deducted from pay before the worker's tax liability is calculated.
- Employers do not contribute to the arrangement at all.

### Investing the contributions

- There are six approved firms of investment managers (which are strictly controlled by a government authority). Each offers a choice of five funds with different proportions of bonds and shares.
- Older workers may only choose the more secure funds, which are 80% invested in bonds. Younger workers may choose any of the funds. The higher risk funds are only 20% invested in bonds; the balance is invested in a mix of Chilean and overseas shares.
- Workers may switch from one investment manager to another, as and when they wish.
- The funds are not liable to tax – so the potential for investment growth is maximised.

### Following the progress of the Account

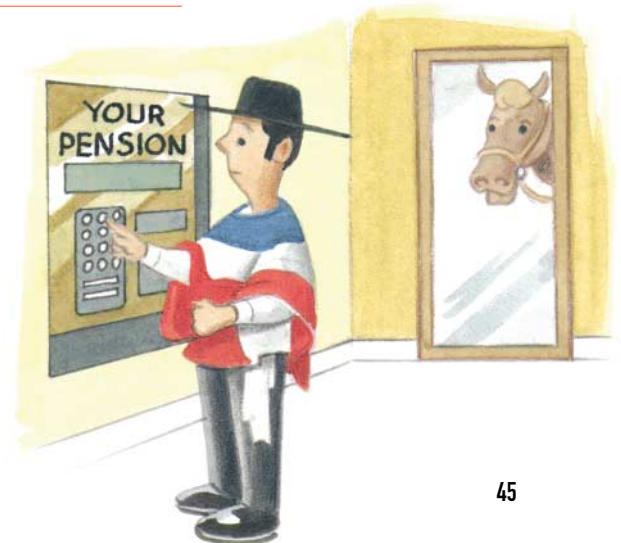
- Each worker receives a quarterly statement from the fund manager, detailing the contributions that have been paid, the value of the Account – and the latest investment performance.
- Every member is issued with a PRA passbook – which can be updated at any time by visiting any branch of their chosen investment managers.

### Retirement age

- The standard retirement ages are 65 for men and 60 for women.
- Workers with sufficient money in their Accounts may retire earlier.
- Workers who wish to carry on working, may choose to retire at an older age.

### Planning to retire early

- Workers may visit any branch office of their chosen investment manager – where user-friendly computer terminals are available to help them calculate the expected value of a PRA at different retirement ages – and show how much extra they need to paid in, to allow for retirement at a given age.
- The worker can monitor the situation regularly, adjusting his/her rate of contribution, as necessary, to take account of fluctuating investment values.



### A choice of retirement benefits

- The accumulated money in the PRA may be used to buy an annuity from any insurance company – to provide a guaranteed income for life, indexed to inflation, plus defined benefits for dependants.
- Alternatively, the PRA may remain invested – and the member can make programmed withdrawals (subject to limits based on life expectancy). On death, any money remaining in the PRA can be paid tax-free to the member's heirs.
- If the money in the PRA is greater than needed to provide a pension of 70% of the member's final year's earnings, the excess may be taken as an immediate cash sum (subject to tax).

### Government safety-net

- Workers who have contributed for at least 20 years are promised that, if their PRAs provide insufficient benefits at retirement, they will be topped-up to the prevailing 'minimum level'. (However, anyone retiring early will be ineligible for the government safety-net.)
- As a result, many workers have invested in the highest risk funds available – in the hope of gaining substantial rewards – but knowing that, should things go seriously wrong, the government safety-net will step in to look after them.
- Any worker who hasn't made 20 years of contributions can apply for a means-tested benefit at a lower level.



### The positive results

- The investment return on the approved funds (from 1981 to 2005) has ranged from minus 3% to plus 30% – and has averaged 10% a year.
- The accumulated funds are already equivalent to around 70% of Gross National Product – so they have provided a significant boost to the country's economic growth.
- The launch of the PRA system before the country embarked on a major programme of privatisation enabled workers to share in the wealth created by that process.
- The new system has made a significant contribution to the reduction of poverty.

### Failures and criticisms

- Because the self-employed don't have to join, few of them do so. However, as nearly half of Chile's work-force is self-employed, there is still a huge poverty trap looming.
- Chile also has a large number of seasonal workers – who rarely declare any income, pay any taxes or contribute to the PRA system. They, also, are still facing a very bleak future.
- The PRA system has already resulted in the equivalent of around an extra US\$60 billion being invested in the Chilean stockmarket – and much of the rise in share prices must have been due to this. However, as more pension money is directed overseas, there is a growing risk of a serious correction in Chilean share values that could hit consumer confidence in the whole scheme.
- The investment managers use commission-based sales-forces to attract PRA business – and to encourage switches from rival funds. A wide range of 'gifts' is therefore offered, ranging from bottles of whiskey to cordless phones, mountain bikes and even big-screen televisions.
- There are widespread concerns about the high costs levied by the six approved investment managers, to cover their marketing and administration costs. Further disquiet surrounds the 'fat cat' nature of these firms, particularly as at least 17 trustees of their funds were cabinet ministers in the military regime that established the system!
- Fraud and corruption are widely suspected – with regular news stories of employers 'forgetting' for months – and sometimes years – to pass on their workers' contributions to the relevant investment managers.



### All in all

The PRA system has undoubtedly relieved the government of a major financial headache – and brought major benefits to a number of workers.

However, it has left a large proportion of the workforce out in the cold – and there are still a large number of question marks overhanging the scheme's operation. Until some of the doubts surrounding the longer-term outcomes of the scheme have been removed, it is far too soon to see the PRA approach as a paradigm for other countries to follow.

Sources: OECD Working Paper, 2004; Adriatic Institute for Public Policy, 2005; Global Action on Aging, 1998; Chilean AFP Association, March 2006; New York Times, December 12, 2004.



## The Australian approach – Superannuation Guarantee

**From 1994 to 2051, the number of Australians aged 65 or over is expected to rise from 11.9% of the population to 23%. This trend was threatening to make the costs of the State pension scheme unsustainable. So, a new system – called Superannuation Guarantee – was devised, to change over from a government run programme to one based on private savings. This scheme was introduced in phases, from 1992 to 2002 – and is now fully operational.**



### Contributions

- All employers are required to contribute 9% of each employee's income to an approved retirement scheme of their choice.
- In addition, workers may contribute to the scheme on a voluntary basis – and a tax credit will be added to such contributions, to encourage workers to pay them. At present, the average employee contribution, including the tax credit, is around 3%.

### Retirement age

- Historically, women retired at 61 and men at 65. When Superannuation Guarantee was introduced, a progressive move was started to standardise the retirement age for both genders at 65. This equalisation will be completed by 2013.

### How the system works

- The employer's scheme may operate on a money purchase (defined contribution) basis – under which the member's accumulated account will be used, at retirement, to provide the member's benefits.
- Alternatively, it may operate on a final salary (defined benefit) basis – under which the member is provided with a pension equal to a proportion of earnings close to retirement in respect of each year of service with the employer. (This basis involves the employer in an open-ended commitment – as the benefits may eventually cost more than the stipulated contributions.)
- The employer may manage the scheme's assets in-house – or can outsource the management to professional specialists. The employer also has the option to allow employees to direct their retirement savings to approved retail investment vehicles, such as unit trusts and other investment funds.

- On leaving service, employees must be able to retain their benefit entitlements, by transferring them to their new employer's scheme. Alternatively, they may invest them in approved deposit funds or deferred annuities. Any withdrawals before age 55 are subject to tax at 30%.

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- To minimise the administrative workload in arranging transfers on leaving service, employers may choose to participate in an industry-wide pension scheme, rather than operate their own.

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- All schemes with 5 or more members are regulated by an industry regulator – and annual reports must be certified by an approved auditor and signed by the trustees.

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### **In-built guarantee**

- It is anticipated that, over the longer term, workers earning the average wage will retire with 2 or 3 times the income that they would have received under the old State scheme. Indeed, after 40 years of service, an employee can probably expect to retire (even on a money purchase basis) on a pension of around 40% of earnings close to retirement.

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- However, in the short term, there are workers – particularly the low paid – whose benefits under the new scheme might be lower than under the old State scheme.

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- To protect their interests, the government has provided an underlying safety net. This is a guarantee that, if anyone is worse off under the new system, the government will top up their benefits to the level that they would have received under the old system (which is 25% of the national average wage).

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For the very low paid, who would have received low benefits even under the old system, there is also a means-tested State pension.



**All in all**

- Superannuation Guarantee is another example of how a government can effectively transfer a State pension scheme to the private sector.

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- In doing so, it has ensured that most workers will earn greater pensions, particularly after the first few years of transition.

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- At the same time, the attractions of tax credits on employee contributions have boosted the overall savings rate in the country.

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- Most importantly, of course, it has significantly reduced long term pressures on their government's finances.

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- There is, of course, the threat that a sustained period of adverse investment conditions could depress the value of members' accounts under money purchase schemes – and increase the employers' costs of maintaining their final salary schemes. Fortunately, however, most of the new schemes managed to escape the recent bear market unscathed – achieving returns of around 7% to 8% a year over the period.

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- A similar transfer from State to private could be considered for Ireland – as, in the same way as Australia, it could be used to increase benefits substantially at the same time.

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- One of the key benefits of Superannuation Guarantee has been its inclusiveness. Although many young people still tend to spend most of their disposable incomes on enjoying themselves (and why not?), their pension benefits are already beginning to build up.

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*Sources: Australian government, New South Wales University and the Heritage Foundation*



# Appendices

## The research for Chapters 3 & 4



## Appendix 1: Survey methodology

The purpose of the research was to establish a snapshot of the extent to which typical sections of the middle-aged public in Ireland have planned – or expect to plan – to provide themselves with a realistic level of pension when they retire. It also aimed to discover the extent to which people were worried about their financial prospects in retirement.

This Appendix summarises the method of recruiting respondents to obtain a representative sample of views – and the research procedures used.

- The overall contact sample was selected by random digit allocation. This is a telephone sampling procedure that generates random combinations of telephone numbers, in order to include unlisted numbers in the survey sample.

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- Contact was made by telephone with the selected households, to establish if there were any household members aged between 40 and 60.

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- Respondents were then selected, using a sampling procedure that chooses specified numbers of people with characteristics known or believed to affect the subject being researched – in this case pension planning. The characteristics specified included age, gender and region.

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- All interviewing was conducted over the telephone by trained members of the Behaviour & Attitudes research team, using computer-aided telephony interviewing. This is a process that ensures that all the questions are asked in the correct, identical order – and enables the answers to be keyed into the computer directly, as soon as they are given.

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- The research team was working under the direct supervision of senior management at Behaviour & Attitudes.

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- The research was conducted between 19th and 30th August 2005.

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## Appendix 2: Questionnaire

Good morning/afternoon/evening. I am ....., from Behaviour & Attitudes – a market research company. We are currently carrying out a survey among people aged 40 and over living in Ireland. Is there anybody of that age in your household?

### When contact made with appropriate person continue

The interview is about the stresses of modern life and the plans people make for the future as they move in to their more mature years.

**Q.1** Are you married/single/widowed or divorced?

Married	1
Single	2
Widowed	3
Divorced	4

**Q.2** Do you have any dependent children living with you?

Yes	1
No	2

**Q.3** Which of these descriptions fits you best?

A PAYE worker	1
A self-employed person	2
Retired	3
Or do you not work for pay	4

**Q.4** To what extent do you find you worry about any of the following things nowadays. If you give each one a score from 5 to 1. 5 would be something you worry a great deal about. The less you worry about that item the lower the score you would give.

	Worry a lot			Don't worry		OK
	5	4	3	2	1	0
Your health	5	4	3	2	1	0
Maintaining your standard of living	5	4	3	2	1	0
Paying monthly bills	5	4	3	2	1	0
Paying housing costs	5	4	3	2	1	0
Job security	5	4	3	2	1	0
Making minimum credit card payments when they are due	5	4	3	2	1	0
Having enough money set aside for retirement	5	4	3	2	1	0
Your health insurance cover	5	4	3	2	1	0
The rising cost of living	5	4	3	2	1	0

**Q.5** To what extent to you tend to agree or disagree with each of the following statements?

	Strongly agree	Tend to agree	Neither agree nor disagree	Tend to disagree	Strongly disagree
I would be very nervous if I felt my pension arrangements were not sorted out at this stage	1	2	3	4	5
I am one of those people who believes in saving for a rainy day	1	2	3	4	5
I wish I had begun to save earlier in my life	1	2	3	4	5
I still have plenty of time to put my pension arrangements in place	1	2	3	4	5
I have a deep interest in the stock market	1	2	3	4	5
I am a careful person who plans and budgets for things	1	2	3	4	5

**Q.6** If you compare yourself to the people you grew up with would you say you have saved

A great deal more than the average	1
A little more than the average	2
About average	3
A little less	4
Much less than the average	5

**Q.7** At what age would you like to retire? WRITE IN

**Q.8** At what age do you think you will retire? WRITE IN

**Q.9** Do you have a pension plan in place for your retirement?

Yes	1
No	2

**Q.10** Is that pension plan paid for by you personally, by your employer or by both you and your employer?

Personally	1
Employer	2
Both	3

**Q.11** *What age were you when that pension plan was put in place?* *WRITE IN*

**Q.12** *And when you do retire, do you think your income will be ....* *READ OUT*

**Thank respondent, then collect classification details of age, gender, county of residence – and whether they live in a city, large town, small town or rural area.**





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