Technical Feasibility Assessment of Alternative Auto-Enrolment Proposal

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Executive Summary

The purpose of this study, funded by the Pensions Council, was to investigate the technical feasibility of an Alternative Auto-Enrolment (AE) Proposal.

The Alternative AE Proposal was found to offer a number of significant advantages over the current AE proposal, but concern arose about the management of several aspects of the risks involved.

The primary advantage was that the Alternative AE Proposal would likely produce pensions more than double the size of those projected under the current AE proposal. This reduces the effective cost to produce adequate post-retirement income and would likely result in:

- Less resistance / more acceptance of AE.
- Pension coverage of a wider proportion of the Irish population.
- A reduction in future pension inadequacy and the burden on the State.

Given the potential upsides from the Alternative AE Proposal, it was necessary to investigate if the concerns were fixable or otherwise. During the course of this research several approaches were discovered to manage risks that were of concern.

The use of the Buffer Account in the Alternative AE Proposal as a risk management tool was not considered sufficiently robust, but four alternative methods were found to prudently manage the funding level risk. These require further research to determine the optimum approach. The risk of the scheme becoming unattractive to new contributions was found to be fixable by adjusting the smoothing approach so that an equal approach was applied to all individual contributions. The governance risks were found to be material, but precedents were found highlighting how strict governance measures could be implemented.

A simplified version of the Alternative AE Proposal is set out that would be prudent for the State to launch immediately once the governance of the scheme is established. This would have 100% equity investment (or equivalent), smoothing of returns and risk sharing. The work on determining the optimum risk management framework could begin straight away, but this does not need to delay the launch of AE. Most of the further work involves the post-retirement period and there are international precedents of not initially defining this, for example, when Australia launched its pensions superannuation scheme. After the optimum risk management approach was determined, the State could decide on the final operation of the scheme, within the fixed parameters outlined and communicated to the public in advance.

The outcome of the assessment was that a simplified version of the Alternative AE Proposal was found to be materially better than the current AE proposal. The decision to implement the simplified Alternative AE Proposal might be considered analogous to the introduction of the Euro. There are considerable upsides, but it requires prudent governance, the risks need to be managed and it needs to be stood behind during times of turbulence. It is likely a public good and all reasonable efforts could be made to implement it in the public interest.

5. Conclusions

The Alternative AE Proposal would likely produce significantly higher pensions for those contributing into the scheme. There are significant upside benefits for those who would opt to stay enrolled, with estimated pensions being roughly twice as high as from schemes in other OECD countries.

From the State's perspective, higher projected pensions would also increase expected future income tax revenue. The Alternative AE Proposal would likely be more attractive than approaches in other OECD countries and would likely result in higher levels of members opting to stay enrolled, resulting in higher future pension coverage.

The risks arising are analogous to those arising from the introduction of the European single currency. There is considerable upside, but the risks need to be managed, and most importantly the scheme would need to be stood behind in times of turbulence, just like with the Euro. There are several options available to the State to (directly or indirectly) stand behind it that would enable prudent management of the risks involved, either providing a backing itself, or using the market to hedge the risk or appointing a person of appropriate character to manage it, or a combination of these.

On the issue of the provision of social protection, the current AE proposal might be considered to be one of social exclusion, hindering or practically preventing ordinary people from prudently investing like those on higher incomes. It would likely contribute to increasing inequality in Irish society. The current AE proposal might be misguided and counterproductive. It might contribute to increased emigration, reducing the birth rate and reducing home ownership, thereby creating more problems for the State than it fixes. In contrast, the Alternative AE Proposal has a more inclusive and 'in it together' approach which is likely to achieve more social protection.

It might be sensible to offer an opt-out from the AE scheme for those who are saving for a home. Auto-enrolling them would likely result in a poorer financial outcome and a less secure outcome for individuals and for the State. Having a Choice-Enrolment might also be considered a wiser option in the long term.

A simple version of Alternative AE Proposal is described that would be considered as feasible (as feasible as was the creation of the Euro with which it is analogous). It is recommended that further work be carried out to establish the optimum risk management approach to achieve smoothing of returns and risk sharing.

The Alternative AE Proposal, in this regard, would likely be significantly better than the current AE proposal.