Pension provision under auto enrolment

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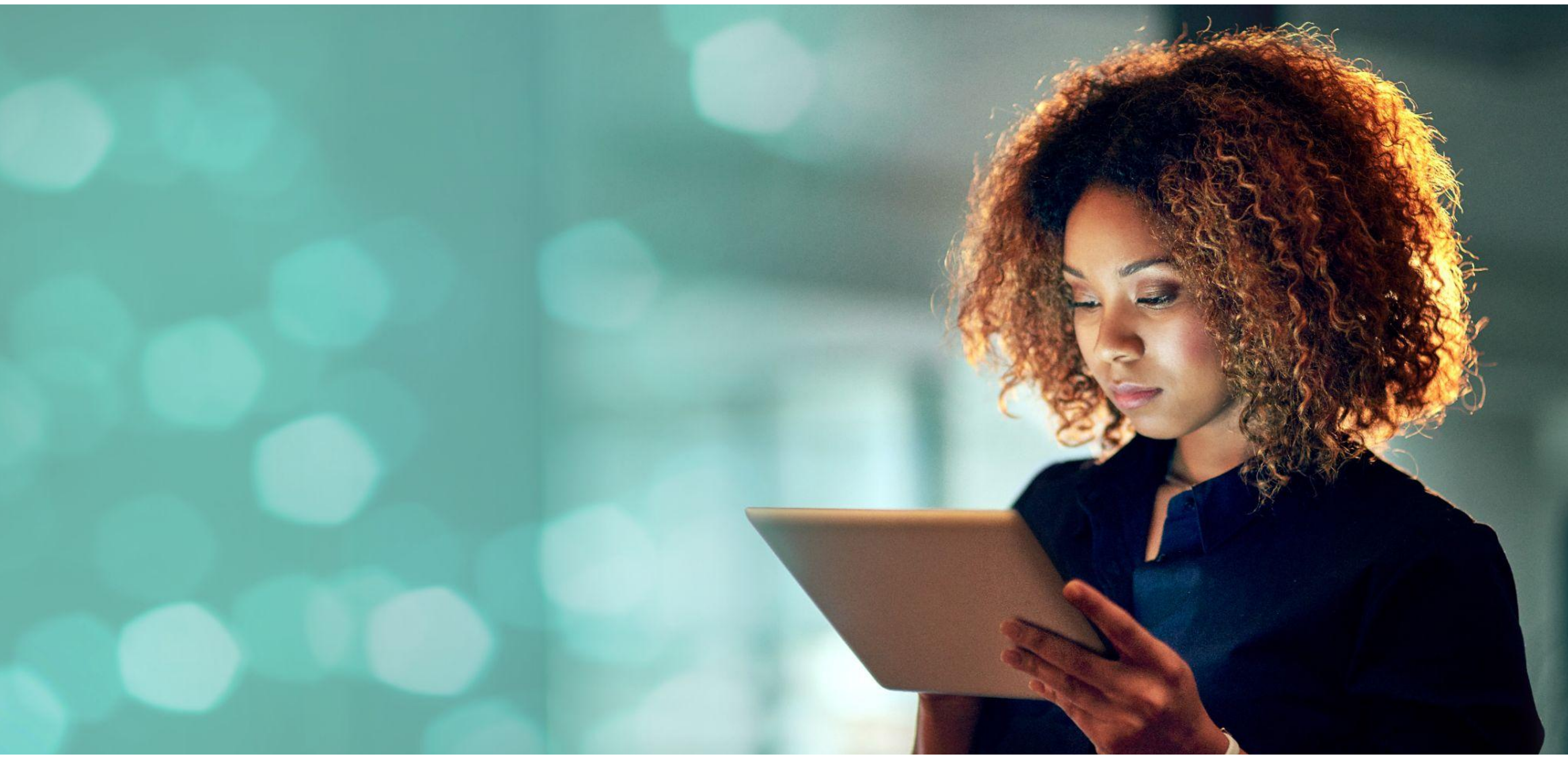
Agenda

Background

The Minister for Social Protection and Rural & Community, Minister Humphreys, has committed to implementing auto-enrolment in Ireland - in October 2022, the Government approved the components of the Automatic Enrolment Retirement Savings System Bill 2022 which has just completed pre-legislative scrutiny. The ambition is for legislation to be published in 2023 with a view to the first enrolments taking place in 2024.

This will be another monumental change for Irish pensions as it continues to undergo significant transformation across State, workplace and private pension provision.

All organisations will need to offer pensions to all of their eligible workforce and as the planned design of the auto-enrolment regime is very different to that of the existing occupational pension system (e.g. design, contributions, taxation, governance structure); now is an opportune time for employers to consider their wider pension strategy and overarching objectives.



Auto-enrolment - a summary

Overview of the key requirements of the auto-enrolment system

Below is an overview of the core components to the auto-enrolment regime as outlined in the Automatic Enrolment Retirement Savings System Bill 2022 and whilst there remains some unanswered questions, it is helpful for employers to understand who is likely to be impacted and the potential costs.

Who will be impacted?

Currently pension provision in Ireland is not mandatory with the only obligation being for employers to give employees access to a Personal Retirement Savings Account (PRSA) where they are not enrolled in a pension scheme.

The auto-enrolment system will mean that any employees who are aged between 23 and 60 and earning over €20,000 (across all of their employment) will be automatically enrolled to the Government established pension scheme. Employees who are automatically enrolled can 'opt-out' on month 7 or 8 as well as in years 4,7 or 10 (when contributions increase). There is also legislation being put in place to place a fine on employers of €5,000 if they seek to encourage employees to opt out or penalise employees who opt in.

What will it cost?

Contributions will be phased in over a decade with employers making contributions of 1.5% p.a. of gross earnings at the beginning and increasing over time to 6% p.a. from year 10 onwards. Contributions will be calculated on the gross earnings of an employee up to €80,000 p.a.

Employee contributions are not relieved for tax, USC, or PRSI (the government top-up is effectively the tax subsidy for member contributions) and the earnings limits will be reviewed over time.

Years from launch of system	Employer Contribution p.a.	Employee Contribution p.a.	Government Contribution p.a.	Total Contributions p.a.
1 to 3	1.5%	1.5%	0.5%	3.5%
4 to 6	3.0%	3.0%	1.0%	7.0%
7 to 9	4.5%	4.5%	1.5%	10.5%
10 plus	6.0%	6.0%	2%	14.0%

Where will money be invested?

A Central Processing Authority (CPA) will be established by the Government for the collection of contributions from employers. There will be up to 4 investment managers appointed and each manager must provide 4 fund types - Conservative, Moderate Risk, Higher risk and a default.

When and how can members access their benefits?

Retirement will be aligned to the state pension age (currently age 66). Prevailing retirement options will be provided to members including a tax free lump sum and the option to purchase an annuity or invest in an Approved Retirement Fund Regime ("ARF").

Pensions

A key part of reward strategies

In February 2023 the Central Statistics Office published research on pension coverage for 2022[1]. Two of the key findings included:

1. For those workers with no occupational pension coverage from their current employment, more than half (52%) stated that their employer did not offer a pension scheme.
2. Of workers eligible for auto enrolment in the planned Government Auto Enrolment Retirement Savings scheme, almost one in five (18%) were aware of the scheme, and of these, almost two thirds (65%) said that they would stay in the scheme if automatically enrolled in it.

The low coverage of workplace pension savings in the private sector will change with the implementation of auto-enrolment, it can be expected that “pension savings” will get greater prominence at a national and societal level, all resulting in pensions becoming a core feature of the employee benefits package.

Against the backdrop of soft mandatory pension provision, employers will be able to differentiate from their peers on pension strategy and we consider four possible approaches below, alongside some pros and cons of each option.

[1] https://www.cso.ie/en/releasesandpublications/ep/p-pens/pensioncoverage2022/keyfindings/

Pension strategy

Four possible approaches

1. **Use the auto-enrolment system for all employees**

   For employers who simply want to operate in line with the legislative requirements (from a cost and operational perspective), the auto-enrolment regime would support this with employer contributions as outlined above.

   Employers will need to ensure payroll can accommodate the changes and that processes are in place to ensure all eligible employees get enrolled in the system (including potentially managing any subsequent opt outs and re-enrolments) when the system goes live.

   The relationship then exists between the employee and the CPA.

   Employers should be aware of the likely legislation to fine employers €5,000 if they seek to encourage employees to opt out or penalise employees who opt in.

Pros	Cons
• Government backing, management and oversight • Cost effective • Tax benefit for lower rate taxpayers	• Tax differences relative to occupational pension schemes • Potential operational challenges (e.g. opt-outs, payroll)

2. **Dual system of auto-enrolment and occupational pension scheme**

   The proposed design of the auto-enrolment system is such that the contributions are deducted from net pay with the Government making a contribution on behalf of employees. In effect, it represents a 25% level of tax relief for the employee. Where employers have a large cohort of employees who pay the lower rate of income tax (20%), the auto-enrolment system would offer a greater tax benefit than the occupational system where employees are subject to tax relief at the standard rate of tax at 20%.

   That being said, the limits on earnings and contributions in the auto enrolment system, as well as the fact there is likely to be no ability to make Additional Voluntary Contributions, impose a lower threshold on the level of contributions that can be made compared to an occupational pension scheme.

   For those who are subject to the higher rate of income tax at 40%, they would receive greater tax relief in the occupational pension system. The taxation of the investment growth and drawdown on retirement is expected to be the same for the auto enrolment system as it is for occupational pension schemes. Should higher rate taxpayers join the auto enrolment system there is potential that they would incur a higher rate of tax in retirement when they draw down their benefits compared to what they get in the accumulation phase.

   This, in theory, could lead to the operation of two pension structures - the auto-enrolment system for those who are subject to the standard rate of tax and an occupational pension scheme for those subject to the higher rate of tax. Employers who may wish to consider this will, however, need to factor in the cost, risks, operational and communication aspects to managing two pension structures.

Pros	Cons
• Maximise tax reliefs for lower and marginal rate taxpayers	• Cost of running two schemes • Operational differences for AE and occupational scheme (e.g. payroll, opt-outs, eligibility for both) • Potential tax hike for marginal rate tax payers in retirement • Communication to employees

3. Use of occupational pension scheme for all employees

Auto-enrolment can be thought of as a response to a market position where many employers and employees were unable to access low-cost, good quality pension provision. The Government's auto-enrolment system will effectively have a public service obligation to accept all employers and employees, including those that private providers may consider to be unprofitable business. The auto-enrolment system does have restrictions that will apply, in terms of contribution rate structures, investment options and the tax incentives that will apply to employee contributions. It will offer the same charges to all participants.

Some employers may wish to operate a single occupational pension scheme, thereby allowing all employees to participate on similar contribution terms.

For those employers who wish to offer a strong pension value proposition which is competitively priced, where the governance is outsourced and that provides additional support to employees, the occupational pension system offers this through the range of Master Trusts available in the market. A Master Trust is a single pension scheme established under one governing Trust in which multiple unconnected employers can participate in. Consistent with other jurisdictions where Master Trusts have been introduced, there is evidence that they are likely to become the dominant vehicle in the Irish pension market across the coming years - consistent with government policy which is towards the consolidation of the number of pension schemes in Ireland.

Pros	Cons
• Consistency of pension proposition across all employees • Regulatory compliance/supervision by the Pensions Authority • Wider investment range • Additional flexibility around member support, AVCs etc	• Potentially results in higher employer contributions • Tax relief on contributions for lower rate taxpayers

4. Personal Retirement Savings Accounts (PRSAs)

A further alternative is a PRSA, a contract based arrangement between an employee and an insurance company. The regulations for PRSAs are quite prescribed which can limit innovation and can result in higher charges than occupational pension schemes. Their lack of attractiveness has been partly due to the adverse tax treatment of employer contributions (where they have been treated as a benefit in kind).

The Finance Act 2022 removed the benefit in kind charge applying to employer contributions to PRSAs and aligned the tax treatment with occupational pension schemes. This is a further step towards PRSAs becoming more attractive and more central to the Irish pension regime.

The changes to the BIK rules have had the effect of removing limits on employer funding to PRSAs, which may be relevant for certain employers.

Pros	Cons
• Greater level of contributions can be made • Employer contributions unlimited • Wider investment range • Regulatory compliance/supervision by the Pensions Authority	• Charges may be higher • Tax relief for lower rate taxpayers • Member engagement less frequent

Overleaf we consider the implications of each of the four possibilities across cost, operations, employee engagement, retirement, taxation and portability.

Pension strategy and considerations for employers

	Auto enrolment	Auto enrolment and occupational pension scheme	Occupational pension scheme	PRSA
Cost	Likely to be least cost for employers; set up and any additional payroll costs need to be considered. Annual Management Charges ("AMCs") unknown at present - will be dependent on administration and investment costs.	Employer costs will depend on the contribution design of the occupational scheme and proportion of workforce in each system; operating costs for managing two systems will need to be considered. AMCs unknown at present for auto-enrolment; AMCs in occupational schemes will depend on scale and maturity of membership and appetite for employer cost sharing.	Costs will be determined by scale and maturity of membership, contribution design and level of cost sharing with members.	Employer costs will depend on the contribution design. AMCs for members are likely to be higher than other options and will be determined by scale and maturity of membership.
Operations	Payroll, employment contracts and HR policies and procedures all need to be reviewed			
Employee engagement	Communications driven by the Government's Central Processing Agency; employee opt out will need to be monitored.	Communications driven by Government's Central Processing Agency and occupational pensions administrator - differences likely.	Communications driven by pension providers through annual member engagement plans.	Communications typically only those as prescribed under PRSA regulations and from PRSA providers.
Retirement	Retirement age aligned to State Pension Age (early retirement may not be available) and benefits on retirement in line with existing occupational system - lump sum, annuity and Approved Retirement Fund.	Occupational pension retirement age can be set between age 60 and 70 (early retirement available from age 50).	Occupational pension retirement age can be set between age 60 and 70 (early retirement available from age 50).	Ability to take PRSA benefits between age 60 and 75 (early retirement available from age 50).

Taxation	Employer contributions fully deductible for corporation tax relief; member contributions made from net pay. Government top up contribution to pension to compensate for lack of tax relief on employee contributions	Employer contributions fully deductible for corporation tax relief; member contributions made from net pay for auto enrolment (with government top up) and income tax relief at marginal rate for occupational pension (subject to age related limits on contributions)	Employer contributions fully deductible for corporation tax relief; member contributions get income tax relief at marginal rate for occupational pension (subject to age related limits on contributions)	Employer contributions fully deductible for corporation tax relief; member contributions get income tax relief at marginal rate for occupational pension (subject to age related limits on contributions)
Portability	Unable to transfer pension savings out of the auto-enrolment system as currently designed. Pension benefits under auto enrolment system apply across all individual employments which operate auto enrolment system	Ability to transfer occupational pension savings but not those in the auto-enrolment system.	Ability to transfer pension savings.	Ability to transfer pension savings.

Summary

With the onset of auto enrolment in Ireland, pensions will play a much greater role in the employee benefits package and with an array of pension structures in the market, employers should carefully consider their future pension strategy, overarching objectives and what this means from an HR, operational and finance perspective.

At PwC we can bring you a unique impartial market perspective to support you make important strategic pension decisions in an evolving pensions landscape.

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Thank you

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