Providing for Old Age through Private Channels

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Introduction

At a time when a Bill has been introduced into the Dáil containing proposals for the inauguration of a contributory pensions scheme, it seems opportune to review the position generally in regard to the problem of old age and the methods of making financial provision for it through private channels. There have been developments in this sphere in recent years, and interest in it has grown for a variety of reasons. The increasing numbers of persons reaching pensionable ages have contributed to a greater awareness of the need for security and adequate standards of living in old age—an awareness no doubt quickened by the war. The consequent growth of pension schemes and arrangements calls for some study of their effect on the economy, and the fall in the value of money presents other problems. including the question as to whether pension schemes should be funded or not.

My paper does not deal in any way with pension schemes run by the State, nor with the considerable activity which has been manifest in many countries in the comparatively new sciences of geriatrics and gerontology, including measures to assist the old in various practical ways, such as providing institutional care, domiciliary services and social welfare generally. The depersonalising influences of modern urban and industrial life and perhaps the greater selfishness of the age have, in many countries, transferred much of the burden heretofore borne by relatives on to the backs of institutions, private and public. In this country it is always well to bear in mind the very high proportion of the population over the age of 70 who are in receipt of the non-contributory old age pension. The latest figure is about 80 per cent., a proportion which is indicative of the vast scope for the development of private pension schemes and insurance for old age.

Ageing and Retirement

Most people are aware that the expectation of life is increasing and that the population is in consequence ageing, in the sense that it includes an increasing proportion of old people. It is not so widely known that, while the expectation of life at birth has been increasing steadily, the expectation at older ages has not been increasing at all; it has, in fact, been showing a downward trend.

The following table shows for each of our census years for which the particulars are available, the expectations of life at birth and at age 65, and it gives also the numbers surviving to age 65 out of 100 born:—

Census Year	Expectation of life at birth		Numbers surviving to age 65 out of 100 born		Expectation of life at age 65	
	Males	Females	Males	Females	Males	Females
1926 ...	57·4	57·9	52	52	12·8	13·4
1936 ...	58·2	59·6	53	55	12·5	13·4
1946 ...	60·5	62·4	58	61	12·0	13·1
1951 ...	64·5	67·1	64	69	12·1	13·3

In the 25-year period from 1926 to 1951 the expectation of life at birth increased by 7 years—from 57·4 to 64·5—in the case of males, and by 9 years—from 57·9 to 67·1—in the case of females; the female expectation is now 2½ years greater than the male expectation. So also, the proportions surviving to age 65 are increasing. In 1926 the two sexes showed the same percentage of survivors—52—but in 1951 the female percentage had increased to 69 as against 64 for the males. The significant thing about the expectations of life at age 65 is that, contrary to general belief, they have decreased and not increased, so that while people are reaching what may be considered pension ages in larger numbers, and generally speaking in a healthier and fitter condition, they are not enjoying their pensions for any greater length of time. Indeed, it would seem that despite the notable achievements of medicine in the eradication of an increasing number of pathological causes of death, so enabling an increasing number of people to survive to old ages, the toll of the old-age diseases continues and the fundamental problem of senescence remains unsolved.

The increasing proportion of persons who live to reach pension ages has, of course, broadened public interest in the need for financial and other arrangements to provide for the time when physical and perhaps mental powers begin to decline. In consequence, there has been a growth in pension schemes and pension commitments of various kinds, and these developments throw an added burden on the economy at a time when the proportion which those of working ages bears to those beyond such ages is itself declining, as the following table shows:—

Census Year	"Working" Population —aged 15–64 (thousands)	"Retired" Population —65 and over (thousands)	Percentage of "retired" to "working" population
1926	1,832	272	14·8
1936	1,861	287	15·4
1946	1,818	314	17·3
1951	1,790	316	17·7

It can be seen that while in 1926 there were 15 people over the age of 65 for every 100 younger people of working ages, there were 18 in 1951.

The increasing burden of dependency due to old age is causing concern in the world generally and some attention is being focussed on the appropriate age for retirement. The most usual retirement ages in these islands are 65 for men and 60 for women, being no doubt derived from the British national insurance scheme in which they are the minimum pensionable ages. The ages written into private pension schemes often determine the age at which retirement is in fact enforced. These schemes must necessarily specify a minimum age for drawing a pension, in order to function efficiently, as well as to satisfy the requirements of the Revenue Commissioners. While this should not imply—or even suggest—the age for retirement, it appears to have such an effect, especially as it is considered essential in a scheme based on occupational employment, that retirement from a particular occupation should be a condition for obtaining a pension.

In the British national insurance scheme retirement may be postponed and pension deferred after the minimum ages until actual retirement or age 70 (65 for women), whichever is the earlier. Increments of pension are awarded as an inducement to those who postpone retirement. Set up in 1953 to consider the economic and financial problems of the provision for old age, the Phillips Committee recommended[1] that the minimum age for claiming retirement pensions should be raised by 3 years (to 68 for men and 63 for women)—a recommendation that was received with coldness, to say the least. Another of its recommendations relating to the age of retirement was that private pension schemes which fixed pension ages below 65 for men and 60 for women should not be granted income tax relief.

It is interesting to note the retirement experience under the British scheme. A sample enquiry[2] undertaken in 1953 into the proportions retiring or staying on at work and the reasons prompting such action yields interesting material. Out of ten men reaching the minimum pensionable age of 65, four took their pensions and six continued at work. Of the former, a quarter were classified as " chronic sick "; in another quarter of the cases ill-health was given as the reason for retirement; 28 per cent. said they were required to retire by their employer, and three out of four of these said they wanted to stay at work—though not apparently to the extent of looking for a new job (only 1 in 5 of them did this). The existence of a pension scheme was also a factor, as four times as many men covered by such a scheme said they were retired by their employer as those who were not so covered. Of those who continued at work, 45 per cent. gave " financial need " as the main reason, 25 per cent. " felt fit enough " and 20 per cent. " preferred to work." Only 7 out of 1,000 of them stayed on in

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[1]Report of the Committee on the Economic and Financial Problems of the Provision for Old Age. Cmd. 9333 (1954).

[2]Reasons given for Retiring or Continuing Work – Report of an Enquiry by the Ministry of Pensions and National Insurance, 1954.

order to earn increments of pension. Half of them stated that the prospect of extra leisure was an influence *against* giving up work.

Retirement at the minimum age of an optional range of ages (such as 60 to 65), or at least as soon as full pension is earned, was in the past the general custom in Britain for clerical and administrative staff, such as that in the Civil Service. In Ireland, however, employees have tended to be more tenacious of their jobs and in consequence pension burdens were not so high. Could this be explained by the fact that other employment could more readily be obtained by pensioners in Britain or is it related to the later age at marriage in Ireland which has resulted in the fact that men at pension ages often still carry liabilities for completing their children's education?

Despite the growing burden of dependency, the reception of the Phillips Committee's recommendations in regard to pensionable ages is probably a fair reflection of public opinion, which does not take kindly to any proposed raising of the age for retirement, even though in practice—as in the case of the British national insurance scheme—the majority will go on working when they have the option to do so, many feeling instinctively no doubt that there is no health —physical, mental, social or moral—in idleness, and that isolation and inaction, which often increase after retirement, might even be a danger to health and especially to mental health.

Burden of Pensions

It was a recognition of the economic, rather than the social, problems arising from an ageing population which caused the appointment of the Phillips Committee. Side-by-side with it, a National Advisory Committee was established with the object of finding means to retain workers in employment as long as possible. In two reports[3] this Committee (the Watkinson Committee) made a number of suggestions for promoting the employment of older people. Its main thesis was that employers when engaging workers should, as a matter of policy, adopt a test of capacity and not of age, and that as regards retirement, they should allow workers the opportunity, without regard to age, to continue at work if they so wished. It may be noted that the Civil Service Commission in Great Britain now holds special competitions for the recruitment of established clerical workers at ages between 40 and 60. Clearly such problems are urgent only in a state of full—or near full—employment, and they are under serious consideration in many countries of Western Europe. With us here, a prior problem is to provide a sufficient number of employment openings, whether for young or old, and special measures to facilitate older workers would be justified mainly for their humanitarian value rather than for economic reasons.

The Watkinson Committee also drew attention to the fact that pension schemes have an important bearing on early retirement, not only because they specify a minimum pension age, but because

[3]First and Second Reports of the National Advisory Committee on the Employment of Older Men and Women. Cmd. 8963 (1953) and Cmd. 9628 (1955).

they tend as now constituted, generally speaking, to have the effect of limiting the engagement of older applicants for employment, and of unduly restricting the mobility of labour.

The Phillips Committee were asked " to review the economic and financial problems involved in providing for old age, having regard to the prospective increases in the numbers of the aged." Apart from its main recommendation regarding the raising of the pensionable age, the Committee did not find any serious reason for alarm, and expressed the view that " the nation's economic capacity to support its old folk is not doubted." This conclusion is supported by the results of an authoritative study[4] which was made about the same time by a panel of actuaries. This study found that, at the time, the pension burden represented some 4 per cent. of the national income, but that its potential extension—assuming employed persons to receive in 30 years' time on the average a retirement pension (including national insurance) of two-thirds average earnings throughout working life, and widows half their husband's pension—could easily raise the figure to 14 per cent. of the national income, if the latter remained unchanged. If, however, an annual increase of 1½ per cent. in national productivity could be assumed, this would leave room both for an increase in the standard of living and for the growing claims of dependency. Moreover, " about half the amount would in any event be required to maintain the increased number of old people on a minimum subsistence level which will have to be provided whether or not they are entitled to pension."

Whether the liabilities are specifically covered by financial assets or not, pensions represent claims on the future production of the community. A money claim to a pension does not itself create the pension, but rather places purchasing power into the hands of the pensioner and thus gives him a command over the national resources, over the services of the future working population, so that the generation still at work will perforce be obliged to provide for the generation that has passed working age. In the last analysis, of course, paper claims to the future national income cannot be honoured unless the working population produces the goods and services which these claims represent and is willing to release them to those who stake the claims. It follows that unless the welcome social development of a lengthening of life generally can be accompanied by a commensurate lengthening of working life, the increasing proportion of non-workers in the community will impose an increasing burden on the economy which might become serious.

Contributory and funded schemes are, at least in a degree, preferable to non-contributory and unfunded schemes from the point of view of the national economy. In such cases the present generation makes some sacrifice by setting aside its contributions or premiums out of current income, enabling these resources to be placed in funds, and so providing a source of capital investment which may be expected to assist national development. However, as more money pours into the life offices and superannuation funds,

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[4] The Growth of Pension Rights and their impact on the National Economy. The Institute of Actuaries, 1954.

there is evident danger of diminishing the volume of savings seeking investment in risk enterprises, as these institutions are necessarily obliged to play for safety with the bulk of their investments. Some economists in Britain fear that for this reason the proportion of the national income which is controlled by such institutions is becoming too large for the health of the economy.

Growth of Pensions

The granting of pensions by employers grew up as a reward for long and faithful service and it was inspired by the humanitarian motive of making provision for employees after they had ceased to be of value in the business. There were also institutions through which the individual could save for old age, such as friendly societies, savings banks and insurance offices, but it was for the individual himself to make use of these. Today, pensions are the aim of all classes—one of the major domestic preoccupations of western society—and there is a constant growth in pension arrangements, whether individual or in groups. While no doubt some private saving is still attempted, systematic channelling of financial provision is really necessary to ensure adequate resources, and it is inevitable that institutional arrangements, such as insurance or annuity contracts through insurance companies, and superannuation schemes organised in occupations or firms, are the main lines of development.

The growth of occupational pension schemes must be attributed in the main to increasing pressure from employees who have come to regard pensions as deferred pay. In Britain the fact of full employment has also made it necessary for employers to be active in this regard if they are to retain their employees and to attract recruits. Despite the absence of full employment, a similar force operates in this country because of the ready accessibility of the British employment market. The view that pensions are deferred pay could not, of course, apply to a national pension scheme, and it is not universally accepted. Employers are, I suppose, entitled to regard their own contributions to pension schemes as available to the employees only for superannuation purposes, and hence something to which they are not entitled absolutely, that is to say, in any other circumstances. It also seems to me that one might be justified in taking different views of the matter depending on whether a pension scheme is a contributory or non-contributory one. For instance, the pensions in a contributory scheme are in part a return of the employee's own contributions, and to that extent at least could hardly be deferred pay. The philosophical outlook arising from these concepts can lead to various arguments about rights, and so forth. For instance, one hears occasionally such a view as that because the State pays pensions to Civil Servants, the Army, the Police and so forth, a group such as farmers should receive pensions by right in return for the services they have rendered to the country. This viewpoint, of course, naïvely ignores the fact that farmers are not employees of the State and have been working in their own interests, whereas the others are working under the direction of the State as employer and, like many other groups

of employees, entitled on retirement to the benefits of an occupational pension scheme. The recognition of pensions as deferred pay would, of course, clearly point the distinction in this example.

The Phillips Committee regarded the further extension of occupational superannuation schemes as desirable. Their growth in volume and variety has been one of the most remarkable features of the current " age of pensions ". Statistics of the volume of the business in this country are almost entirely lacking, but certain inquiries have been instituted in Great Britain in recent years and there is now a reasonably satisfactory measure of it in that country. The results of a sample survey[5] issued in 1958 by the British Government Actuary indicates that, in Great Britain and Northern Ireland, $8\frac{3}{4}$ million people (7 million men and $1\frac{3}{4}$ million women) have some provision for pensions apart from the national insurance scheme. Of these, about 5 million are provided for under private pensions schemes of firms ($2\frac{1}{3}$ million in non-insured schemes and $2\frac{2}{3}$ million in insured schemes); the remainder ($3\frac{3}{4}$ million) are covered under the schemes of the public services, including the armed forces, and those of the nationalised industries. The number of men so covered represents about one-half the total number of employed men and the number of women a little over a quarter. Over one-half are in schemes administered by insurance companies, and nearly one-third of the members of these do not pay contributions, compared with some 56 per cent. in the non-insured schemes. The average pension is about £190 a year in non-insured schemes and about £100 in insured schemes.

Structural Developments in Pension Schemes

The benefit arrangements in pension schemes are tending to greater complexity, no doubt because of attempts to meet demands for absolute fairness to the individual rather than to see that rough justice based on group solidarity is achieved. Competition between insurance companies and comparisons between private schemes also help the trend in this direction. Among the principal developments are better benefit arrangements for dependants. Distinct widows' and orphans' pension schemes have been relatively slow in developing and in order to provide better benefits for dependants of deceased members within the framework of superannuation schemes it is now not uncommon to find provisions permitting the allocation of part pension in favour of a widow should she outlive the pensioner, or in the case of schemes operated through insurance companies, very large lump sum benefits—much larger than has been customary or than is permissible in approved privately administered funds. It has long been recognised that, as the main purpose of such private schemes is the provision of annuities for employees on their retirement, other benefit provisions, such as lump sums payable in different contingencies, are extraneous, and indeed, because of the fact that they add to the cost of a scheme designed for another purpose, either undesirable or a luxury. Despite this, and despite the fact that, generally speaking, lump sum provisions

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[5]Occupational Pension Schemes—A Survey by the Government Actuary, 1958.

are discouraged by income tax law, the provision of lump sum benefits (themselves payable free of tax) has become widespread. In the case of insured schemes, their advantages have been vigorously sold, with considerable success, by brokers specialising in pension scheme business.

Whether it is altogether satisfactory to combine adequate provision for dependants with superannuation benefits in a single scheme may be open to argument, but it seems to be the current trend. Group life insurance business is well developed and there are evident possibilities for an extension of group reversionary annuity business, which is as yet in its infancy. If this is to be the future line of development, the time may come when the individual insurance contract will decline in popularity.

The post-war British experience of " full-employment " with its difficult labour problems has evoked criticism of pension schemes on the ground that they restrict the mobility of labour. Mobility is generally regarded as desirable in the interests of a free circulation of ideas and talent, but there are advantages also in continuity of service, and it is very often the desire for such continuity which influences employers when considering the establishment of pension funds. Whatever may be the arguments for and against stability or mobility of labour, it is undesirable that the arrangements in pension schemes should be open to criticism on the ground that they present obstacles to staff turn-over, and the Phillips Committee, in fact, recommended that the transferability of pension rights should be encouraged. There is a distinction between the idea of transferability, which in fact is recognised in a number of schemes such as those covering certain groups of professional classes in Great Britain, and that of the preservation of rights. Transferability implies some system of transferring capital (e.g. transfer values) from one scheme to another, and it is clearly unworkable where at least one of the schemes is unfunded. It is, however, rarely found in insurance schemes, which are always funded. Preservation may usually be secured by providing what have been called " cold storage " pensions by means of deferred annuities based on the maintenance of accrued rights. Many employers see objections in principle to such provisions and, in particular, to the release of transfer values from pension funds. If one accepts the " deferred pay " principle, one must accept the corollary that, provided a man has completed a sufficient period of service to repay the initial cost of training him and he is not leaving on account of fraud or misconduct, he should be granted an absolute right to the benefits purchased by the employer's pension payments provided he is prepared to take pension benefits in respect of his own contributions. It has to be added, however, that experience seems to show that employees generally, on transfer of employment, prefer the attractions of lump sum benefits in the form of returns of their contributions, rather than " cold storage " pensions, even though this usually means some financial disadvantage to them. In the light of this fact, it can hardly be contended that existing contributory schemes, most of which provide for returns of contributions, are really restrictive of labour mobility.

With regard to the financing of occupational pension schemes, the general trend appears to be in the direction of non-contributory arrangements, that is to say, arrangements under which the employees make no specific contribution. Such a development is perhaps in keeping with the modern trend in the wages field where the employer is providing an increasing number of amenities and welfare services, such as canteens, recreation facilities, medical attention, and so forth. Much of this, of course, ultimately finds its way into the level of consumer prices.

Despite its obvious attractions from the employee's point of view, it is a serious defect of a non-contributory unfunded scheme that its benefits are to all intents and purposes "non-portable". There is, for instance, no fund from which the employee could, in the event of his resignation, obtain even such a minimum benefit of a funded contributory scheme as a return of his own contributions.

Funding or Non-Funding

Perhaps one of the most controversial developments is the growth of non-funded schemes. It is baffling for the layman, and at least difficult for the expert, to understand how it is that some schemes apparently require a fund to be built up and maintained in a solvent condition, while others can seemingly proceed with impunity on pay-as-you-go lines, otherwise known as assessmentism. On what principle can one rely to justify the existence of a non-funded private scheme while everyone expects an insurance office scheme to be funded? An unfunded scheme has no assets and for this reason the security of its benefits can never be equal to that provided by a private trust fund or an insured scheme. Even where such a scheme is supported by reserves in the employer's balance sheet, it is always dependent on the continued solvency and goodwill of the employer, as the cost is borne only when the relevant payments fall to be made. One would never entrust one's money to an insurance company on a life policy unless one had the assurance that the company was solvent, that is to say, not only that it was in a position to pay emerging claims out of current income but that it carried adequate funds to meet its future liabilities. During the last century, life insurance offices run on assessment lines were quite properly abolished, but it would seem that the principle of their operation has found new favour in many quarters in the field of pension schemes. If a scheme is funded, the cost is borne indirectly through the fund, which, as well as constituting an asset to cover the prospective liabilities, provides income by way of dividends on the investments, thus lowering the ultimate charge. A funded scheme not only avoids subsidising the present at the expense of the future, but is a safeguard against over-commitment, because it does not hide the true cost of superannuation. On the broadest front, a funded scheme means a saving by the present generation, providing assets which can be employed to further the interests of the economy and to allow pensioners their due share without reducing the standards of the active workers. It remains to be added that unless some special circumstance prevails, a contributory unfunded scheme is quite indefensible, that is to say, a

scheme in which contributions are collected from the employees, for which in return they are given a promissary note that could, at any time, become a plaything.

In the case of a national superannuation scheme the same considerations do not obtain. Apart from the fact that contributions in such a scheme are usually compulsory, and for this reason the continuity of the scheme can be assured, it would be virtually impracticable to set aside the very large sums required for adequate funding, and the " fund " on which the scheme has to rely must be the general resources of the country. In short, the problem of financing a national pensions scheme is not only actuarial, but also economic and political.

Currency Depreciation

Funding has come in for criticism on the ground that, as the value of money generally tends to depreciate over time, the real value of the resources built up tends to decrease. The complaint is also made that in inflationary conditions " good " money is paid by the contributor and " bad " money received by the pensioner. This is, of course, a risk to which nearly all savings are exposed. The maintenance of the real value of savings in face of currency depreciation is not guaranteed by any form of savings, individual or group, and insurance contracts and pension schemes are no exception. Life insurance developed at a time of relatively stable currencies and, in the past, the problem did not apparently make itself felt to any serious extent. Contracts of insurance and annuity business, as well as pension schemes, are framed on the basis that they are only concerned with providing monetary benefits; they are fixed normally in terms of currency units, no account being taken of changes in purchasing power. People, in fact, commit their money to titles in money rather than in things, and it may perhaps be worth mentioning that in the event of an appreciation in the value of the currency, there would be no question but that an insurance company or a pension fund would be called upon to meet its stipulated liability. Unhappily the reverse situation is more likely to be the case.

The problem of carrying value forward into the future is one which has been described as the supreme social issue of the times, and it has been suggested that, in the light of continuing currency depreciation, the insurance world should face up to the issue and provide contracts in a form which would help insured persons generally in this situation. On the other hand, it has also been held that any attempt to do this would be a national disservice in that it would encourage a fatalistic attitude towards the problem, giving support to a feeling that the will to resist inflation had disappeared.

It should be realised that the effects of depreciating monetary values are not always as serious as may be alleged. For instance, in the case of an insurance policy or a contributory pension scheme under which premiums or contributions are payable regularly, it would clearly be an exaggeration to compare the real value of the currency at the termination of the contract with that at the beginning, because the premiums or contributions payable throughout

the duration are also subject to depreciation, and the later ones, in particular, suffer almost as much in this respect as the sum assured or pension.

It must also be borne in mind that the contributor normally receives the benefit of interest accretions. Insurance contracts and pension funds are usually framed on an interest assumption. They could, of course, be conducted successfully—but hardly competitively—on the basis of a " nil " rate of interest, and it is perhaps some recompense that, when interest is taken into account, more money is ultimately received than is paid in. Compound interest received counteracts or more than counteracts the effect of creeping inflation. For instance, if over a period of twenty years the purchasing power of the pound were to decrease by as much as ten shillings, the fall would represent an annual compound rate of rather less than 4 per cent. per annum, a rate of depreciation which in many cases would be compensated for by interest earnings.

A further point is that augmentation of the amount of cover from time to time would, of course, help to maintain the value of the expected benefits. This may be thought to be a counsel of perfection—to expect enthusiasm for voluntary savings in a time of inflation. But it is significant that, even in times of inflation, there has been a considerable growth in insurance and pension business. Such a growth is, of course, a valuable brake on the spread of inflation, and pressures for more of this business must be commended from this standpoint. Another palliative would be to encourage types of contract which themselves provide a measure of cover against currency depreciation, such as with-bonus policies. So also, pension schemes in which the rate of pension is related to the salary or wages in the year or years immediately prior to retirement provide a large measure of protection at least up to pension age, because salaries or wages usually progress roughly with cost of living changes.

There are two main aspects to the problem, first to safeguard the real value of the funds against monetary depreciation, and second, to protect or alleviate the position of the individual pensioners. The protection of funds, some critics maintain, is best secured by avoiding their existence, arguing that this constitutes a good case for unfunded (and non-contributory) schemes. Such schemes, however, as I have pointed out, can rarely be considered to be entirely satisfactory. But even where funds are built up, their solvency can be an illusory concept unless there is a reasonably stable currency, for if there is marked depreciation, the benefits although fully secured, will be provided in a currency which may have little or no relation to the pensioners' needs.

It has been suggested that the benefits (and contributions or premiums) might be varied from time to time on the basis of index numbers, such as a cost-of-living index or the price of consols, or that the contracts should be " corrected " for the changing value of money by cost-of-living bonuses on all policies to be made available out of surplus. Such devices would, of course, require, *pro tanto,* that the corresponding funds should be invested to an

appropriate extent in assets which provide some hedge against inflation, such as ordinary shares, real estate, etc., but security, the other main requirement—not always to be found in such investments—should not be forgotten. The need for flexibility in investment policy is a "*sine qua non*" for any action aimed at "correcting" the benefits, and such corrections could not be contemplated, within a solvent scheme, without having surplus assets. Frequent reviews of the finances of a scheme, and appropriate amendments, as may be required, in the levels of benefits and contributions, appear to afford the best method of making such "corrections". They are indeed the best real protection.

In the United States there has been an extensive development of a type of "inflation-proof" annuity contract which carries accretions from time to time based on the results of the type of investment activity which I have mentioned. The annual amount payable is not a fixed sum in terms of money but a fixed number of annuity units, the cash equivalent of which varies from time to time in accordance with variations in the market value of the assets in which the fund is invested—an equity fund to all intents and purposes. This results in an income which is intended to reflect the cost of living, enabling the claim to be made that the variable annuity fund is a "proof against inflation".

However that may be, there is no simple panacea for safeguarding private pension schemes from the effects of depreciation, and, therefore, no completely satisfactory answer to the inevitable sense of grievance. Apart from the danger that devices such as I have mentioned might be tantamount to a proclamation that money will not keep its value, they might also lull a section of the community into a false sense of security, or give them a degree of immunity against the pressure of economic forces which could conceivably be contrary to the public interest.

Pensions and Taxation

Taxation plays a large part in the problem of providing for old age. The conditions on which reliefs of taxation are allowed on assurance premiums, superannuation contributions, invested funds, lump sums and pension payments influence materially the shape and evolution of pension schemes and arrangements, and in recent years there have been some noteworthy developments in this field.

Certain reliefs from taxation in respect of life assurance premiums date from as long ago as 1799, but it is only since 1921, following a recommendation of a Royal Commission, that relief has been granted in the case of pension schemes organised on an occupational basis. In order to secure relief, such schemes have to conform to certain requirements intended to ensure their *bona fide* character and their reasonableness in the sense of not making excessive provision by reference to generally-accepted standards. When approved by the Revenue Commissioners, the contributions paid, whether by the employer or the employee, and the income of the fund are entitled to exemption from income tax. This is a more advantageous immediate relief, it may be said, than in the case of premiums for life assurance, a distinction which might be

justified if only by the fact that in such cases the money is virtually placed beyond reach. Despite the fact that the concession is intended for schemes offering pension benefits only, "partial" approval may be granted in cases where, for instance, certain lump sum benefits are included in addition. It is understood that, generally speaking, schemes which provide a lump sum in excess of one-fourth of the actuarial value of all the benefits on retirement will not receive approval. Until recently, this income tax relief was confined to schemes established for employees engaged in a trade or undertaking, so that other persons such as self-employed persons were limited to life assurance reliefs in respect of any provision they wished to make for old age or retirement.

It may be observed that, as pensions in payment remain subject to tax, the relief afforded may, from the point of view of the contributor, be looked upon as a postponement rather that as a remission or foregoing of tax. The "build-up" in a contributory scheme is exempt, but the tax is payable eventually, although not necessarily of the same amount. The concession is, nevertheless, invaluable as it helps employees to lay aside money for their old age and there is no doubt that a real contribution is made by the taxpayers, especially those of the present generation—a point clearly established by the fact that the concession has to be controlled in order to avoid too great a "leakage" of income tax. It may also be noted that benefit secured by life insurance premiums, save in the exceptional cases when the benefits take income form, are entirely free of tax.

Increased rates of taxation during and following the last war and the growing interest in making provision for old age have led the way to an extension of the field of income tax relief. There was a development of individual pension arrangements, and particularly of schemes appealing to "senior executives" and managerial and administrative staff (popularly known as "top-hat" schemes), but this was accompanied by a rapid growth of arrangements and schemes made by companies and other bodies which enabled their directors and employees to take lump sums rather than pensions at retirement, free of tax. An employer could claim relief of tax as an expense of business in respect of contributions paid under a pension scheme based on Endowment Assurance policies, and an employee could obtain relief on his contributions as for life assurance premiums. At retirement the employee could take his benefits wholly in the form of a lump sum entirely tax-free, thus getting a double relief. There was also a development of arrangements for the re-spreading of the remuneration of employees, designed for the purpose of reducing tax liability. Legislation passed in Great Britain in 1947 checked such abuses and regularised their development.

A Committee, under the chairmanship of Millard-Tucker, was subsequently appointed to consider fully the whole subject of the taxation treatment of provisions for retirement, and it issued a valuable report [6] covering the whole field. Legislation in 1958

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[6] Report of the Committee on the Taxation Treatment of Provisions for Retire ment. Cmd. 9063 (1954).

followed some of this Committee's recommendations, and, in particular, income tax relief was for the first time granted to self-employed persons in respect of premiums paid either on an insurance policy, or into a trust scheme established on lines similar to an employees' superannuation scheme (i.e. organised in professional or trade groups), to enable such persons to secure an annuity commencing at certain ages.

Part V of the Irish Finance Act of 1958 is on the same lines as the British legislation of 1947 and is designed primarily to prevent avoidance of tax in the case of certain arrangements made by companies and other bodies for their directors and employees which are not *bona fide* superannuation but, in effect, merely schemes for the temporary investment of savings intended to be withdrawn later. Such arrangements must now conform to certain requirements, including limitations on the amount of death benefit, on the aggregate value of all benefits on retirement and on the proportion of such aggregate value which may be commuted into lump-sum form. Directors or employees holding more than 15 per cent. of ordinary shares may not be members of such a scheme, it being held that the interest they possess in their business represents to them at retirement the equivalent of the lump sum permitted in other cases. They may also avail themselves of Part VI of the Act which, corresponding to the British Act of 1956, is designed to provide taxation relief for self-employed persons and non-pensionable employees in respect of certain payments made by them to secure annuities for themselves in their old age. It also provides that income arising from the investment of such payments is exempted from tax and that the annuities purchased by them are treated as earned income for tax purposes. The relief extends to payments made to secure annuities to widows and other dependants. A limit of the lesser of 10 per cent. of net relevant earnings or £500 is imposed, but where a person is over 40 years of age at the start, i.e. in 1958 (and so would not have time to build up a sufficient pension), this limit is extended (up to 15 per cent. or £750 respectively). An annuity must in general commence between the ages of 60 and 70 but an earlier age is allowed in cases of ill-health or where retirement for the type of case in question is normally at an earlier age. No retirement condition is, however, imposed, but no commutation is permitted. These provisions apply to individual arrangements, to insurance contracts and to schemes arranged under trust by profesional or trade groups, and the general principles of taxation applying to them may be summarised as follows: that the premiums or contributions paid by an individual are treated as reducing his income for tax purposes, that the income arising from the investment of such premiums or contributions is exempt from tax, but that the benefits must be provided entirely in the form of annuities which are subject to tax. Because of the provisions enabling full provision to be made on premature retirement due to incapacity and for dependants on death, this is much more than merely facilitating saving out of untaxed income. The income tax advantage which now accrues to the self-employed person consists in income of one period being allowed to be deferred to a later period carrying with it all its attendant income tax

liabilities—a means of redistributing income over working life and retirement and, in the process, reducing the tax impact because of the progressive income tax scale.

It is undertood that, apart from the considerable activity which was necessitated for converting existing schemes to bring them into conformity with the law, and despite the ingenuity with which insurance interests are devising attractive contracts for the self-employed, the initial response in the volume of new schemes and arrangements is not great.

The Millard-Tucker Committee made a number of other recommendations, such as that the whole corpus of relevant legislation should be replaced by new provisions which would include the substitution for the existing conditions for approval of a new set of " automatic " conditions (so reducing the discretion now enjoyed by the Revenue Commissioners). It also made a number of suggestions designed to effect uniformity between insurance reliefs and the expenses reliefs in the case of approved schemes. Its most important other recommendation, however, was in relation to the taxation arrangements in respect of annuity business conducted by insurance companies, and effect has been given to this recommendation in the Finance Act of 1956 in Great Britain and the Finance Acts of 1958 and 1959 in this country. It had long been a standing grievance that purchased life annuities were taxable in full despite the fact that each annuity instalment contains an element of capital by way of repayment of the purchase money originally invested in the annuity. In Part IV of the 1959 Finance Act taxation is limited to the interest element only and the capital element is now exempt. It is understood that the capital element in an annuity is regarded as the consideration money divided by the expectation of life, so that the proportion of this capital element in each annuity instalment is taken to be the same for all payments of the annuity. This new legislation, coupled with a revision of the taxation arrangements of the annuity fund (which was effected in the 1958 Act), revives interest in life annuity business, because better terms can now be offered. Annuities have become a more attractive proposition as an investment for old people.

Final Comment

In this survey of some aspects of the problem of providing for old age through private channels, I have offered a number of comments on the various principles which arise. I have not attempted to answer some of the more obvious and more fundamental, but perhaps more elusive, questions such as whether the growth of arrangements being made to provide for the increasing numbers of old people is imposing too great a burden on the national economy, or on posterity. Is too great a share, or is a sufficient share, of the national income being devoted to such purposes? What effect has the diversion of such resources on the level of savings? Are the funds which are being built-up invested, in general, for the benefit of the economy? These questions come to mind when making any study in this field. They are likely to

grow in importance and they ought to receive the attention which they undoubtedly deserve.

DISCUSSION

Mr. Ernest Goulding, in proposing the vote of thanks, said :—

Ladies and Gentlemen, as one who has been interested in the development of pension schemes in this country during the last 20 years, it gives me great pleasure to propose a vote of thanks to our President, Mr. Honohan, for the excellent paper which he has just delivered to us. In doing so I must compliment him not only on the range of his paper but also on the uninhibited way in which he has put forward his ideas and conclusions on the controversial issues which preoccupy those of us in the pension field.

Dealing first of all with the ageing of our population, I must confess that I was surprised to learn that the expectation of life at age 65 has shown a decrease in the Republic since 1926. My first reaction was that the decrease from 12·8 years in 1926 to 12·1 years in 1951 might have resulted from an increased number of "substandard" lives reaching age 65 because of advances in medical science. This can hardly be the explanation, however, as I see in a paper delivered by Mr. Mulligan to the Society in Belfast in 1958 that the expectation of life at age 65 in Northern Ireland has *increased* since 1901, when the figure was 10·5 to 11·9 in 1926 and 12·1 in 1951. I would be most interested to learn from Mr. Honohan his opinion as to why the figures differ north and south of the Border. I notice, for example, that the expectations of life from birth are very similar in both parts of the country. Would the answer be in any way connected with the toll of emigration in the Republic, it being assumed that the more active and healthy people would be those who are likely to emigrate?

Coming now to the question of a retiring age, I agree with Mr. Honohan that there is a tendency nowadays for employees, especially those in executive positions, to remain on in service after age 65, which is the normal retiring age for men. Their doing so causes no difficulty as far as funded pension schemes are concerned because their benefits remain for them in cold storage until they eventually retire, when enhanced benefits can be payable. I would be very loathe, however, to suggest the adoption of a later retiring age for the great majority of the working population, especially for manual workers. I think also that Mr. Honohan would agree that the dangers to physical and mental health which have been experienced in other countries through too early retirement are not likely to arise here because of a different philosophical outlook towards life and leisure. In dealing with the burden of pensions I found myself fascinated by Mr. Honohan's statement that whether the liabilities for pensions are funded for in advance of retirement or are left over to be met when retirement actually occurs, pensions represent claims on the future production of the community, and as such *are a burden* on the services of the future working population. Whilst accepting this argument in the broadest national sense it seems to me that it could equally be applied to all forms of saving for the future. For example, the

man who spends his working lifetime building up a business, the income from which he hopes will support him in his retirement, is in the same sense creating a burden for a future generation; but I think he would be the last to admit this, or to see his efforts in this light. As far as private companies' pension schemes are concerned, most employers will accept that it is sound business economy to make advance provision for pensions in exactly the same way as for depreciation of fixed assets. In this way they ensure that the cost of pensioning their employees ends instead of beginning when the employees retire, and in so doing they throw no burden on the shoulders of the future management. There is, therefore, a very important distinction between funding for pensions and meeting pensions out of current revenue in the case of companies. By the former method it is ensured that the cost of each man's pension is built up during his working lifetime, out of the profits which he helps to create, and is independent of the fortunes or success of the business after he has retired from it and has ceased to influence its affairs in any way. If, on the other hand, companies were to deal with their pensions on an assessmentism basis, there would be no security for the employee and his enjoyment of his rightfully earned pension would depend on the abilities of future management, future staff and future conditions, over which he would have no control.

In dealing with the question of contribution versus non-contribution and the concept of pensions as deferred pay, I think that one can afford to dispense with the terms and recognise that the ultimate source of a man's pension from a company is the work which he does for that company. Whether, therefore, he is given a salary of £X, from which is deducted £Y for contribution towards pension, or he is given £X – £Y in the first instance, he ends up in both cases with £X – £Y in his pocket for current use and a pension on retirement. I think it is in this sense that the term " deferred remuneration " has been applied.

A practical consideration which would seem to favour the adoption of non-contributory pension schemes is that contributory schemes seldom achieve 100 per cent. membership. Those who most need the benefits are often those who fail to join. A contributory scheme forces up the level of salaries and inflates the cost of pensions if these are related to salary, as is customary. Moreover, few schemes remain truly contributory for long. Employees look for a rise in wages to compensate them for the deduction of contributions. The result is that the employer pays the whole of the cost in the long run without getting the credit for doing so.

Under present conditions, in which vested rights to pensions are not given to employees who leave service, a non-contributory scheme can act as a satisfactory retaining influence on staff. A contrary effect is obtained in a contributory scheme where the accumulation of the employee's own contributions (on which he can lay his hands at withdrawal) may often induce an employee to leave service at a time of financial difficulty.

It is difficult to ask employers to accept the idea of transferability of pension rights when not all employers have had the

foresight or initiative to install pension schemes. If they were as common as they should be, then each employer could take the view that what he lost on the swings he would gain on the roundabouts. Personally, I would favour the idea of vested rights on leaving service, as I agree with Mr. Honohan that it is a logical extension of the concept of pensions as deferred pay. Possibly a minimum period of five years' service might be stipulated (In most U.S.A. schemes vested rights are given after 10 years' service). The authors and trustees of privately run, i.e., non-insured pension funds will not enthuse about transfer values, since their calculations of contributions have in many cases assumed a rate of withdrawal profit to the fund.

Lord Beveridge has an interesting story to tell about this. When he left the Treasury in 1919 to become Director of the London School of Economics he was given no pension rights on the basis that, as he was under age 60, nothing could be done for him unless he was physically or mentally incapacitated. His comment was that leaving the Civil Service could not by itself be taken as evidence of a mind unhinged. He had the same problem in reverse when he was asked to rejoin the Civil Service in 1936—as a result he stayed in University life.

I find myself in some disagreement with Mr. Honohan when, in dealing with the structural development of pension schemes, he says that it has long since been recognised that the provision of retirement pensions is the main purpose of a private scheme and that other benefits, such as lump sums, and more particularly death benefits, are a luxury and undesirable. The wider view of retirement benefits schemes is that they should provide income or capital when death or old age makes it no longer possible for the breadwinner to provide for himself or his dependants. The Finance Act, 1958, goes so far as to include death benefits in its definition of " retirement or other benefit ". Recognising the recent trends in provision of death benefits it places a limitation on such benefits of the capital value of the pension which the employee was expecting to receive on retirement (i.e. about 10 times pension in the case of a male employee who was to retire at age 65). The provision of a death benefit on this scale gives an immediate sense of family security to an employee, which, if anything, he values more highly than the prospect of a pension at a remote age such as 65.

As to the desirability of combining the provision of pension and death benefits, I would just like to mention one or two difficulties when they are split. In the first place, cover under death benefits provided by temporary life assurance or reversionary annuity contracts frequently ceases at the normal retiring age and there is difficulty in renewing them in the case of an employee who remains in extended service. Secondly, the ridiculous situation has often arisen in split schemes that a man whose proposal for temporary life assurance was declined through health reasons was, nevertheless, accepted at normal rates for a pension which he had little prospect of enjoying and which was secured by premiums which were non-returnable on death! Neither of these difficulties

apply in schemes where the provision of pensions and death benefits are combined.

I think a word about top hat schemes would be appropriate here. They were so called because of their obvious attraction to highly paid executives and directors who would often forgo heavily taxed remuneration to have it set aside free of tax and accumulated for delivery to them tax-free at retirement, or to their dependants if they died prematurely. It would be a mistake to assume that such schemes were confined to top hat executives and directors and not for cloth caps and trilbys. The fact of the matter is that once attention was focussed on the advantages of framing pension schemes so as to produce *a title to capital rather than just to income* for highly taxed personnel, other equally important advantages which applied to all grades of employees came to light.

An obvious example is the case of *any* employee—be he the most highly paid executive or the lowest paid employee—who has the misfortune to retire in ill-health with an impaired expectation of life A title to the full capital equivalent of his pension rather than to an income, which would cease at his death or at the end of a short guaranteed period, was the only way in which he could be sure of getting value for the funds which had been set aside for him.

Such schemes producing capital benefits at retirement or death were not, therefore, simply a device for tax evasion. Rather were they designed to spread the ownership of capital as widely as possible among all persons who were willing to strive for it. Indeed, the vast majority of the members of such schemes today are staff and wage-earning employees who never see a top hat from one wedding or funeral to the next. In support of this I might mention that of a sample taken of some 400 Irish schemes based on the top hat principle, the average pension was found to be just over £200 per member and the percentage of the members earning £2,000 per annum or more was as little as 3 per cent.

In his reference to funded or unfunded schemes Mr. Honohan rightly points out that national insurance schemes are not funded. In this sense national pensions will always be at the whim of politicians and subject to political pressures. " The contributor (as Mr. Arthur Seldon says in his booklet 'Pensions in a Free Society') is thus an unwilling gambler." If no fund is accumulated, no *rights* to future pensions are built up.

Mr. Honohan comments that currency devaluation is a risk to which all savings are exposed. I do not think that the answer is to ask insurance companies to attempt to provide contracts which are inflation proof. If they were to do this it would probably mean that all their investments would be in equities rather than gilt edged securities. The outcome might be a paralysis of government finance and of investment in debenture shares.

With-profit policies are an excellent medium for investment by the individual, but it does not follow that they are suitable for pension schemes where the emphasis is on security. Moreover, every pension scheme is a dynamic contract and even though it may be on a non-profit basis, there are many opportunities for

insurance companies to improve their rates from time to time and so give the benefits of realised profits to the policyholders. It may also be wrong to compare the experience under private policies with pension schemes. The factor of improving mortality, which has given to increased profits on ordinary whole life or endowment policies, would be expected to operate in reverse on a pension scheme. There is, of course, also the difficulty of making selection between one with-profit policy and another since estimates of profits given may be over optimistic in the case of one office and conservative in the case of another. Neither can be guaranteed.

Again, I would like to compliment Mr. Honohan on his paper. To my mind the sign of a really interesting paper is the thought and commentary which it provokes. I do hope that this has not encouraged me to overstay my time in proposing this vote of thanks.

Mr. A. W. Bayne, in seconding the vote of thanks to Mr. Honohan, urged that pension schemes should be brought under the supervision of a Department of State. The approval required from the Revenue Commissioners was designed solely to insure that the pension scheme was not going to be made too generous at the expense of the taxpayer, and this approval was never intended to operate as a State guarantee that the pension scheme was sound or adequate. Pension schemes should be subject to actuarial investigation and report both when they were established and at regular intervals thereafter. The investment of reserve funds should be controlled, and the supervision of the scheme should be vested in trustees representing employees as well as employers. Contributions by employees not only made possible a very necessary raising of the standards of pension benefits which invariably tended to be too low, but gave employees a legally enforceable right to be heard in the handling of the pension scheme of which they were the prospective beneficiaries.

Mr. Honohan thanked the members of the Society for their reception of his paper and for the vote of thanks. He thought the level of the discussion was of a high order and well informed, but it was a little disappointing that the wider aspects of the subject, such as those referred to in the final paragraph of the paper, did not evoke much comment. It seemed to him that more public interest should be aroused in the subject, more study made of the principles affecting the matter in this country, and more information made available on the statistical and factual aspects. It was regrettable that much of the data on which the paper rested was derived of necessity from sources outside the country.

The falling expectation of life at the older ages was not easy to explain. It was a fairly widespread phenomenon that the generally improving vitality was not found to a proportionate degree at these ages, more especially in the case of men. The contrast of improving expectations of life at older ages in Northern Ireland could not be readily accounted for, but the improvements were small, as indeed were the reductions here.

The custom of providing a lower retiring age for females in pension schemes was encouraged by the fixing of a lower age for women in the British National Insurance Scheme in 1940. The age for females was then reduced below that for males, in order that wives would begin to draw their pensions at about the same time as their husbands, who on average were some years older.

The author agreed with Mr. Goulding in rejecting, for particular individuals or groups, the implications of the thesis that saving for the future merely imposed a burden on the services of the future working population, but the argument was surely valid in the last analysis and in regard to the totality of things.