Reform of Defined Benefit Pension System

Proposals from Society of Actuaries in Ireland, IAPF, IBEC & ICTU

June 2013

Key messages . . .

Urgent action is needed to protect DB pension schemes

- Faced with falls in asset values and rising costs of securing pensions, many defined benefit pension schemes are struggling to survive
- Regulatory uncertainty, particularly in light of the recent ECJ judgment, compounds the dilemma for sponsoring employers
- The number of scheme wind-ups is increasing
- But most schemes do not have enough assets to cover accrued liabilities (pensions in payment, and future pensions for employment to date)
- Pensions in payment have first call on the assets on wind-up
- Consequently, active/deferred members (current/former employees who have not yet reached pension age) are in a very vulnerable position – their benefits may fall far short of their expectations
- **This intergenerational inequity needs to be addressed NOW!**
- **Regulatory uncertainty also needs to be addressed NOW** or there is a real risk that employers/trustees will make sub-optimal decisions that will adversely affect the livelihood of many people. The burden of these decisions will fall on active/deferred members
- Moreover, the State needs to address the potential financial consequences of the ECJ judgment

What the Minister should do NOW

- Reform the “pensioner priority” rule
  - This would improve intergenerational equity
  - The assets available for active/deferred members’ benefits would increase and therefore the State’s exposure in respect of post-ECJ judgment bailouts would fall
- Allow retirees to convert part of their pension to a lump sum
  - This would provide greater flexibility and could reduce the cost of benefits
- Relax the regulatory requirements relating to the amount of capital that schemes have to build up in the near-term
  - Help schemes to survive the current economic crisis and transition to a more sustainable position
- Extend the term of the temporary Pensions Insolvency Payments Scheme
  - PIPS provides some relief in the case of a “double insolvency” (insolvency of the pension scheme and the sponsoring employer)
- Announce how the State will address the implications of the ECJ judgment
  - Reduce regulatory uncertainty

The following slides provide more detail on the issues and the proposed reforms.

Urgent policy decisions are required

- The Minister has promised to address the challenges of sustainability and intergenerational equity and has taken some steps in that regard
- However, certain key reforms have been postponed
- In the meantime:
  - 80% of defined benefit schemes do not meet Funding Standard - the accumulated deficit has been estimated at €17bn at 31/12/2011
  - Increasingly, schemes are dominated by pensioners
  - The system for securing pensions is inflexible and expensive
  - The ECJ judgment has given rise to increased regulatory uncertainties and an as yet unknown State liability
  - Scheme wind-ups are accelerating
  - Trustees, sponsors and their advisers are in an impossible situation with many facing a regulatory Funding Proposal deadline of 30 June 2013

There is a growing risk of a disorderly unravelling of the DB system as stakeholders seek to protect their positions in an uncertain environment.

Objectives

- For the State
  - Mitigate the risk now following the ECJ judgment for insolvent scheme and employer
  - Reduce the future risk from insolvent schemes
  - Minimise anomalous outcomes for members between “double insolvencies” (employer and scheme) and other insolvent scheme wind-ups

- For defined benefit schemes
  - Create an environment in which defined benefit schemes that are going to wind up can do so in an orderly and equitable way
  - Allow ongoing sustainable defined benefit schemes recover and deliver on the reasonable expectations of all their members

Introduce, swiftly, a package of reforms to remove untenable legislative uncertainty in the near-term and deliver on these objectives in the short to medium term.

Reforms required

	Reform	Mitigate State's Liability	Enable Orderly and Equitable DB Wind-ups	Support Ongoing DB Schemes
1.	Amend Section 48 (Pensioner Priority) and introduce a capitalisation option for pensioners on wind-up*	Yes	Yes	Yes
2.	Extend term of Pensions Insolvency Payment Scheme (PIPS) for double insolvencies	Yes	Yes	Yes
3.	Postpone risk reserves requirement until the cyclical conditions are more favourable			Yes
4.	In light of ECJ judgment, define framework for operation of State protection (including level of benefits protected and mechanisms to mitigate future risk to the State)**	Yes		

** As previously proposed by IBEC, ICTU, the IAPF and the Society.*

*** The detail of these changes remains to be worked out.*

Impact of reform of defined benefit schemes for the State

- **Impact on Funding Standard deficit for all Irish defined benefit schemes from results of QIS* (released April 2013)**

All figures in € billions	Pre reform	Post reform	Change
Liability – pensioner	30	24*	(6)
Liability – non-pensioner	29	29	-
Total liability	59	53	(6)
Assets	42	42	-
Deficit	17	11	(6)

* PIPs and capitalisation reduce liability by c.20% (c.€6bn)

- **Comment**
  - Package of reforms reduces potential State liability by c. €6bn
  - In addition to impacts shown in the above table, new priority order would increase assets available for active/deferred liabilities and reduce the State's exposure

**Quantitative Impact Study, relating to European proposals for reform of IORPs Directive*

Impact of reform of defined benefit schemes for members

- New priority order would increase assets available for active/deferred members and improve the security of their benefits
- Lower protection for pensioners – but capitalisation option would provide flexibility and may serve to:
  - Mitigate the real or potential adverse impact of the new priority order for pensions in payment
  - Make the use of sovereign annuities for securing pensions more acceptable than it might otherwise be
  - Reduce funding requirements
- Consistent outcomes for members between “double insolvencies” and other insolvent wind-ups
- Greater regulatory certainty, and lower near-term funding demands, would improve employer confidence and support employers in maintaining DB provision

Residual issues if <u>complete</u> package of reforms is not delivered

- Moral hazard i.e. potential for pre-packaged insolvencies
  - Employer triggers insolvency and pension deficit goes to State
  - Trustees may demand deficit contributions that trigger insolvency of employer and pension deficit is transferred to State
  - Trustees/employers may refuse to negotiate restructure of pension benefits in circumstances where there is a possibility of the State providing the benefits
- Inequity for members of insolvent schemes with solvent employers
  - Employer walks away from Scheme in deficit with members receiving lower benefits than available from the State under a “double insolvency”
  - Highlights issues with the current priority order
- Stakeholders will seek to protect their own individual positions