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

<table>
<thead>
<tr>
<th>Reform</th>
<th>Mitigate State’s Liability</th>
<th>Enable Orderly and Equitable DB Wind-ups</th>
<th>Support Ongoing DB Schemes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Amend Section 48 (Pensioner Priority) and introduce a capitalisation option for pensioners on wind-up*</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>2. Extend term of Pensions Insolvency Payment Scheme (PIPS) for double insolvencies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>3. Postpone risk reserves requirement until the cyclical conditions are more favourable</td>
<td></td>
<td></td>
<td>Yes</td>
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<tr>
<td>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)**</td>
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</tbody>
</table>

* 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)

<table>
<thead>
<tr>
<th>All figures in € billions</th>
<th>Pre reform</th>
<th>Post reform</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liability – pensioner</td>
<td>30</td>
<td>24*</td>
<td>(6)</td>
</tr>
<tr>
<td>Liability – non-pensioner</td>
<td>29</td>
<td>29</td>
<td>-</td>
</tr>
<tr>
<td>Total liability</td>
<td>59</td>
<td>53</td>
<td>(6)</td>
</tr>
<tr>
<td>Assets</td>
<td>42</td>
<td>42</td>
<td>-</td>
</tr>
<tr>
<td>Deficit</td>
<td>17</td>
<td>11</td>
<td>(6)</td>
</tr>
</tbody>
</table>

* 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 complete 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