# Defined Benefit Funding

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## 1. Background:

The problems currently being encountered by defined benefit pension funds are in the public domain. These are largely caused by the sharp decline in asset values over the last 12 months and a continuing rise in the cost of pension provision.

In Ireland, it is estimated that 90% of defined benefit schemes would not currently meet the funding standard - i.e. they would not be able to pay the retirement benefits relating to past employment on wind-up. Furthermore, a significant number would not have sufficient assets to secure the pensioner liabilities in a wind-up. In this scenario, those members of the scheme who have not yet retired would not receive any benefits. The current economic environment has greatly increased the likelihood of schemes winding up and not being able to pay full benefits.

Private sector defined benefit schemes have approximately 250,000 active members. It is likely that we will witness the wind-up of pension schemes of both insolvent and solvent companies with potentially thousands of employees and former employees receiving only a fraction of their benefits or even no benefit at all.

## 2. What are the key short-term issues to be addressed?

There are a number of weaknesses and difficulties in the current system. We expand on key short-term issues below and put forward proposals to address them. In effect, what we are calling for is similar to allowing schemes to be put into administration so that they can be restructured in a manner that increases the protection of the participants and allows those schemes to continue on a more solid basis.

We emphasise that these measures will not solve all the problems in the current system. There is an urgent need for reform of the funding regime for occupational pensions, in order to improve the long-term security of benefits and members' understanding of the degree of security. This issue was raised in the context of discussion on the Green Paper on Pensions and we will continue to press for reform in this area.

However, in the context of our current crisis the key motivation is to survive through the short-term with a view to gaining sufficient momentum to embrace a more solid long-term strategy.

### SPONSOR STRUGGLING TO SUSTAIN SCHEME

The cost of defined benefit provision has increased greatly in recent years, with the result that the benefits being promised under the current model are becoming unaffordable for most employers.

Currently, the range of options available to employers, trustees and members as to how to address this issue is limited. Many companies have already exhausted these options. Greater flexibility is therefore needed if pension schemes are to survive the current crisis.

**Proposal:**

***A mechanism should be established that will allow trustees to changethe benefits of active and deferred members[1] where the employer and the members have agreed that this is necessary in order to sustain the scheme, or have agreed to be bound by the findings of an arbitration body.***

The scope to change benefits should include benefits in respect of past employment because, in many cases, reducing the benefits in respect of future service will not be sufficient to sustain the scheme.

Facilitating reductions in benefits would be better than driving schemes towards wind-up in circumstances where there is little or no scope to pay any benefit.

## SCHEME WIND-UP: SOLVENT SPONSOR

There are no provisions in Irish legislation requiring a solvent sponsoring employer that initiates a wind-up of a scheme to ensure that, if there is a deficit in the scheme, sufficient funds are added to enable benefits in respect of past employment to be provided in full. With current funding levels, a wind-up of a scheme in deficit by an employer is likely to result in active and deferred members receiving much reduced benefits.

**Proposal:**

***A debt-on-employer provision should be introduced to prevent solvent employers from reneging on pension commitments.***

If it is considered that debt-on-employer provisions that provide 100% protection for accrued benefits would be too onerous, then an appropriate reduced degree of protection should be implemented. Members have legitimate expectations in respect of accrued benefits and such a measure would improve the security of these benefits.

## SCHEME WIND-UP: INSOLVENT SPONSOR

### Key Issue - *Pensioner priority on wind-up*

In the case of a scheme winding up where the sponsoring employer is insolvent, the assets must be distributed among the members as legislated in the Pensions Act. The liabilities of pensions in payment are first settled and any remaining assets are then distributed to secure the liabilities of active and deferred members. All pensions currently in payment are equally protected, irrespective of the amount.

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1 Active member are current employees. Deferred members are previous employees who have not yet reached retirement age and therefore are not yet receiving a pension.

In some cases, there may be no assets remaining after the distribution to pensioners and the active and deferred members would receive nothing. There is no State protection in existence for those who could lose a significant part or all of their benefits. Under EU law, the State has an obligation to ensure that members' pension entitlements are protected in the event of an employer insolvency.

## Proposals

***Pensioner priority on wind-up should be limited to a specified percentage of the pension currently in payment, subject to a monetary minimum and maximum.***

Nobody wants to see pensioners' incomes being reduced. However, the alternative – continuing to give pensioners' benefits full protection even if this means that active and deferred members receive no benefits – is hugely inequitable. **A** practicable and fair solution must be implemented, and it must be implemented soon.

***A State Pension Purchase Scheme should be made available on a "not for profit basis" for securing the pensioner liabilities where schemes wind up due to employer insolvency.***

This would reduce or eliminate shortfalls in respect of pensioner liabilities (where these exist), and would therefore increase the security of pensioners' benefits. Active and deferred members would also benefit, because the remaining assets available to provide their benefits would be increased.

## CONCLUSION

This is a range of measures that the Irish Association of Pension Funds and the Society of Actuaries in Ireland propose should be implemented immediately. The measures form a package that deals with the immediate issue of the consequences of an underfunded scheme winding up.

We have attempted to formulate a balanced approach that focuses on the central issues. This approach attempts to ensure a more equitable distribution of the assets of the scheme among all of the participants where a scheme winds up in deficit, reduce the risk of a solvent employer abandoning a scheme and allow more flexibility where trustees, sponsors and members wish to continue defined benefit provision.

As well as addressing immediate issues, the proposed package of measures begins to address the ongoing sustainability of defined benefit schemes. However, we emphasise that more needs to be done to improve the long-term security of members' benefits and, in this regard, we will continue to press for reform of the legislative framework.