



# **THE SOCIETY OF ACTUARIES IN IRELAND**

## **Response to Minister Ó'Cuív's announcement on the National Pensions Framework**

## **Background**

On 13<sup>th</sup> October 2010, Minister for Social Protection, Éamon Ó Cuív TD announced that the Government has decided to expedite the proposal to move to a new defined benefit model for pension schemes as outlined in the National Pensions Framework, with the aim of introducing the new model on 1<sup>st</sup> July 2011. He added that his Department would look at issues regarding the governance of defined benefit schemes, the basis for the Funding Standard and areas such as risk management, smoothing out effects of changes in the bond markets and strategies for transitioning schemes to the new model.

## **Introduction**

The Society of Actuaries in Ireland stresses that it is vital that the ambitious deadline that has been set for this potentially far-reaching review of defined benefit pension schemes is delivered upon and a new protection system is put in place promptly.

A fundamental review of the defined benefit pension system is long overdue, and is of critical importance if confidence is to be restored to a supervisory system that, despite frequent study and analysis, has changed little since it was first introduced 20 years ago. Radical steps will be required to address the funding crisis faced by trustees and sponsors in the current difficult economic environment.

However, the inevitable uncertainty created by this review, coupled with the deferral of the Funding Proposal deadline, could impact negatively on the security of members' benefits. In this regard, we propose that the compulsory disclosure of information in annual benefit statements should be expanded as a matter of urgency to include information on security of benefits in the event of a scheme wind-up.

## **Governance of Defined Benefit Schemes**

The decision to review the governance of defined benefit pension schemes, and in particular the Funding Standard, is particularly welcome. The direct link to annuity buy-out costs for pensioner liabilities has in current market conditions created significant affordability and equity issues. We are pleased that this will be addressed as part of the review. The "sovereign annuity" idea<sup>1</sup> put forward by the Society and the Irish Association of Pension Funds was primarily a response to our concerns that, in the current economic environment, the Funding Standard is no longer fit for purpose.

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<sup>1</sup> The basic concept suggested by the Society and the IAPF is that Irish pension schemes could be enabled to meet their obligations in respect of pension payments by purchasing Irish sovereign bonds of appropriate duration, or special annuities issued (by insurers) on the basis of such bonds and providing benefits linked to the payments under the bonds. The concept was suggested, not as a long-term solution to the issues faced by pension schemes, but as a tactical measure to help alleviate funding deficits by reducing the cost of securing pensions. The concept is explained in a Society of Actuaries in Ireland [Briefing Statement](#).

Any review of the Funding Standard needs to be framed in the context of greater emphasis on risk management processes. The effective management of investment risk and the transition over time to matching assets such as bonds is of particular importance and we believe that the revised Funding Standard should look to incentivise or reward trustees and sponsors who agree to implement significant investment de-risking exercises.

We also believe that the sustainability and security of defined benefit schemes would be improved if the statutory funding process was more counter-cyclical. A process that incentivises enhanced funding payments when sponsors are best placed to meet these additional costs would allow trustees to better manage the risks and costs associated with running a defined benefit scheme.

### **New Defined Benefit Model**

The alternative defined benefit model outlined in the National Pensions Framework is an interesting option that facilitates greater risk-sharing between members and sponsors than traditional defined benefit and defined contribution models. We welcome the fact that the review will ‘flesh out’ in detail how this option will operate in practice.

We believe that the concept of a combination of basic core benefits that enjoy a high level of guarantee with additional non-core benefits that are contingent on economic conditions has a significant role to play in the provision of affordable defined benefit provision going forward.

As well as being an option for future service benefits, it may be intended that this new model will serve as an alternative benefit design structure to be considered by sponsors and trustees in the context of achieving sustainability of pensions related to past service. If this is the case, there will be significant benefit design and legal issues to be addressed if the new model is to be a viable alternative to the current “Section 50”<sup>2</sup> benefit reduction regime.

### **Member Security**

The deadline for submission of Funding Proposals is now ‘on hold’ at least until 1<sup>st</sup> July 2011. This fact, coupled with the uncertainty created by the Government review, is likely to paralyse the decision-making process around the negotiation and submission of Funding Proposals. The effective suspension of the policing of insolvent schemes has potentially serious implications for the security of members’ benefits, if it is used by sponsors as an excuse to defer making enhanced funding payments to defined benefit schemes.

In general, the financial risks associated with underfunded defined benefit schemes are poorly understood by members. We believe that the Government review should focus on addressing this issue through more effective disclosure of information. Active and deferred members’ benefits are particularly exposed. We believe that disclosure about the amount of benefit ‘at risk’ in the event of a scheme wind-up should be made available in the annual benefit statements.

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<sup>2</sup> Section 50, Pensions Act, 1990 (as amended)

## **Conclusion**

We believe the review of defined benefit schemes announced by Minister Ó Cuív provides a valuable opportunity at this critical time to address the key shortcomings of the existing defined benefit governance system. We would be pleased to work with the Department to complete this review.

### ***Enquiries on this Briefing Statement should be referred to:***

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### ***Society of Actuaries in Ireland***

*The Society of Actuaries in Ireland is the professional body for actuaries practising in Ireland. Actuaries provide advice and relevant solutions for financial, business and societal issues involving uncertain future events. Most of the Society's members work in the financial services industry, and the profession has a statutory role relating to the supervision of pension schemes and insurance companies. The Society seeks to make an impartial contribution to public debate on social policy and public interest matters where an actuarial perspective can add value.*



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