iapf
the voice of Irish pensions

Discussion Document

THE ADVANTAGES OF A STATE BACKED ANNUITY PURCHASE SCHEME IN THE CONTEXT OF THE CURRENT FUNDING STANDARD

MAY 2005

HEADLINE ADVANTAGES

Prevents excess resources being diverted to pension funds which hurts plan sponsor competitiveness	**Allows for an efficient use of scheme resources in an involuntary wind-up**	**Prevents excess resources being diverted to pension funds which reduces immediate tax revenue**
Prevents unnecessary allocation of total pensions spend towards DB to the detriment of DC	**Reduces Exchequer difficulties in event of removal of Funding Standard derogation for Semi-State sector**	**Prevents build up of non refundable and unnecessary scheme surpluses in line with Revenue Guidance**

HEADLINE DISADVANTAGE

Increases the State's Investment/Mortality Risk

Reality: The State currently manages an enormous pensions payroll (State Pensions and Public Service Pensions) and has underlying obligations in respect of funded pensions (which on their own are of equivalent size to the private sector e.g. Semi-State and Universities Sectors etc). The proportion of private sector pension funds which can be expected to enter an involuntary, insolvent wind-up is not in itself significant. The liabilities assumed by a State Annuity Fund would therefore be miniscule when put in context particularly as this proposal provides for those liabilities to be funded on a long term economic cost basis. Accordingly, we are confident that the proposal outlined in this paper would not add any material additional investment or mortality risk to the State.

BACKGROUND

The Irish Association of Pension Funds proposed, in its response to the Pensions Board Consultation Document on the Review of the Funding Standard, that the establishment of a State backed annuity scheme would enable the Minister to ease the impact of the Funding Standard on the competitiveness of sponsoring companies without any material weakening of the security of members of defined benefit schemes.

The relevant extract from the IAPF response is attached at Appendix 1.

IAPF believe that this is necessary as the application of the current Funding Standard is having the effects outlined below which are extremely detrimental to the interests of pension scheme members which the Standard was designed to protect.

IAPF now believe these effects to be widespread and that the matter requires urgent consideration.

IAPF is also very concerned that the derogation from the funding standard enjoyed by state sponsored bodies may not be allowed to continue consequent upon EU Directives. If it is correct that (following the IORPs Directive) the schemes of State sponsored bodies can only continue to enjoy derogation from the funding standard provided the underlying benefits are guaranteed by the State then the extent of any State guarantee for such underlying benefits will have to be confirmed.

If these state sponsored bodies are required to meet the current funding standard the rate of State funding for these bodies will come under enormous and immediate strain and will impact upon the State's capacity to develop national infrastructure projects and health, social and educational policies.

The table below shows an extract from the Pensions Board Annual Report 2003 recording the number of schemes (and scheme members) currently impacted by the Funding Standard and also the number of schemes (and scheme members) who currently enjoy derogation from the Funding Standard i.e. State Sponsored Schemes.

	No. of Schemes 31.12.2003	**No. of Members** 31.12.2003
Subject to the Funding Standard	1,541	230,685
Excluded from the Funding Standard	85	249,735

IAPF points out that the continuation of the current Funding Standard without the introduction of a State Annuity Fund, unnecessarily increases the contributions payable to pension funds which depresses short term tax revenue.

The effects of the current funding standard are:

a) Schemes which pay pensions from scheme assets (as opposed to buying annuities) are nevertheless required by the current funding standard to seek contributions from their sponsoring employers that target funding on the significantly more expensive annuity purchase basis even though annuities will never be purchased. This has a number of effects:

   i) It results, in many cases, in a statutory requirement to fund pension schemes at a higher level than deemed necessary by independent actuaries.

   ii) This excessive funding inhibits national competitiveness, development and growth by requiring an inefficient use of capital (this applies particularly to utility companies, banks, semi-state, educational and institutional bodies);

   iii) It serves to accelerate the decline of defined benefit pension provision as employers realise that the excessive funding required to satisfy the current Funding Standard does not generate employee appreciation compatible with the cost.

   iv) The excessive funding will only be released into scheme surplus as pensioners die – this can mean tying up funds needlessly for over twenty years, or, where scheme rules prevent refund of surpluses - forever.

      <u>Illustration</u>
      When a pension scheme matures and all remaining liabilities are pensioner liabilities the current funding standard requires that it hold sufficient assets to buy annuities for all those liabilities.

      Due to the inflated expense of annuity purchase the logical policy for a stable pool of liabilities would be to pay pensions from scheme assets. This would result in an expected funding requirement (actuarially calculated to reflect the expected cost of paying those pensions) of a significantly smaller amount than the actual amount required by the funding standard to be reserved. This will result in a surplus within the pension trust which, due to restrictions on refunds of surpluses and extensive powers of augmentation, may be irrecoverable by many employers.

   It is of little comfort to employers that the funds may be released, if at all, over such a lengthy time horizon when companies are forced to be competitive in their marketplaces over the short term.

   Furthermore, the nature of the Irish trust model is such that in many of the affected pension schemes the sponsoring employers may ultimately be denied any benefit from the surplus monies unnecessarily generated.

   v) Tax revenues in the short term are depressed as the excessive contributions payable to support the Funding Standard are relieved against personal or corporation taxes as appropriate.

b) Some employers are being forced to reduce benefits for existing and new members of their schemes.

c) Some employers are being forced to close their defined benefit schemes to new entrants. These schemes are typically being replaced for new entrants by defined contribution schemes with poorer benefit design.

d) Some employers are being forced to wind-up their defined benefit schemes and provide future pension benefit accrual on a less generous defined contribution basis.

In the cases of c) and d), the overall private sector pension provision is reduced which may in future years create pressure for the State to increase State pension benefits to make up for the decline in private sector provision.

PENSIONS BOARD VIEWPOINT

The Pensions Board report, in December 2004, to the Minister for Social and Family Affairs on its Review of the Funding Standard stated:

> *"… the Board recommends that the introduction of a State Annuity Fund be explored thoroughly. There was some support for the view that the implementation of such a fund would cause the benchmark annuity cost for option A (the funding standard) to be reduced. <u>The severity of the Funding Standard would thereby be eased for schemes generally without reducing the security of scheme members."</u>*
>
> {emphasis added}

and,

> *"If a State Annuity Fund is not implemented, the Board agrees that a further review of the Funding Standard may be required in light of experience in the meantime."*

The difficulty with this position is that <u>*experience in the meantime*</u> will be the closure and wind-up of schemes and the reduction of benefits for scheme members.

IAPF do not believe that we have the luxury to react after the event when experience proves that this funding standard was too severe and was detrimental to members whose interests it is seeking to protect.

The Pensions Board Report considered some of the perceived advantages and disadvantages of a State Annuity Fund and for ease of reference the relevant extract is set out at Appendix 2. Summary views of the IAPF in respect of these advantages and disadvantages are set out in Appendix 3.

THE ANNUITY MARKET

There are significant structural difficulties in the annuity market at present which underpin the importance of having a State Annuity Fund:

a) At present there is limited capacity in the annuity market with only a small number of insurers willing to provide annuities and their capacity to meet any significant demand very limited. As such, if the necessity arose to secure a significant amount of pension liabilities by annuity purchase (say because of the wind-up of a large pension scheme) it is questionable as to whether supply would be sufficient to meet demand.

b) In addition, there is even less supply available for index linked annuities leading to significant concerns as to availability and price if demand arose. As such, the logic of protecting security by setting funding standards at rates available for individual annuity purchases seems to ignore the realities of the marketplace.

c) Due to the small number of annuity providers in the marketplace, and their apparent low appetite for trade, the market is seen to be relatively uncompetitive and consequently product pricing is expensive.

   This low appetite is evidenced by the manner in which insurers vary their annuity rates from time to time to satisfy a calculated and finite acquisition of risk. This mechanism seems to be used by insurers to deliberately make their quotations uncompetitive once periodic appetites are satisfied and competitive again once their appetite recurs.

d) Due to the nature of their business, insurers are conservative in the manner in which they reserve against their liabilities. Accordingly, mortality assumptions adopted by insurers when quoting for annuity purchases can be excessively cautious as the insurers build in margins for further improvements in mortality and their selection assumptions can be excessively cautious to allow for anti-selection by healthier prospective annuitants.

e) As annuity costs are closely correlated to returns on long bonds current interest rates, at historically low levels, have made annuity purchase significantly more expensive than any time in the past. It is difficult for insurers to make allowance for future improvements in long bond interest rates due to the regulatory environment within which they are required to operate.

f) Insurers will include a margin within the annuity cost quoted for the cost of capital that they are required to reserve against their annuity liabilities which might otherwise be used to generate profits within other business operations.

g) Naturally, insurers will include a margin within the annuity cost quoted for profit and administration expenses and it is difficult to identify whether these margins are competitive or efficient from the perspective of the annuity purchaser.

The differences between the cost of an annuity and an independent actuarial best estimate assessment of the cost of a particular pension over the long-term assuming investment in a mix of assets is summarised below.

There are two types of difference

Margins	**Excess return from investing in long-term assets**
• Insurance companies will assume conservative mortality (not expected mortality) • Insurance companies will allow for expenses/profit/contingency margins • Insurance companies will seek recompense for the capital utilised to write annuity business	• Insurance companies invest in bonds. Traditionally, pension funds have invested in a broad range of assets to generate a higher return than bonds. The State Annuity Fund could invest in a range of assets. • 50% equities; 30% bonds; 15% property and 5% cash would conservatively **increase the expected return available by 1.67% p.a.**

Over the long-term (100 years), even allowing for the very poor returns of the 2000-2003 period, equities have generated a return of 4% in excess of bonds. We do not believe that it would be prudent to assume that the scale of excess return from equities will be repeated. However, conservatively, most analysts agree that over the long term equities will achieve a return of 3% in excess of bonds, property will perhaps 1½% in excess of bonds and cash in the region of 1% below bonds.

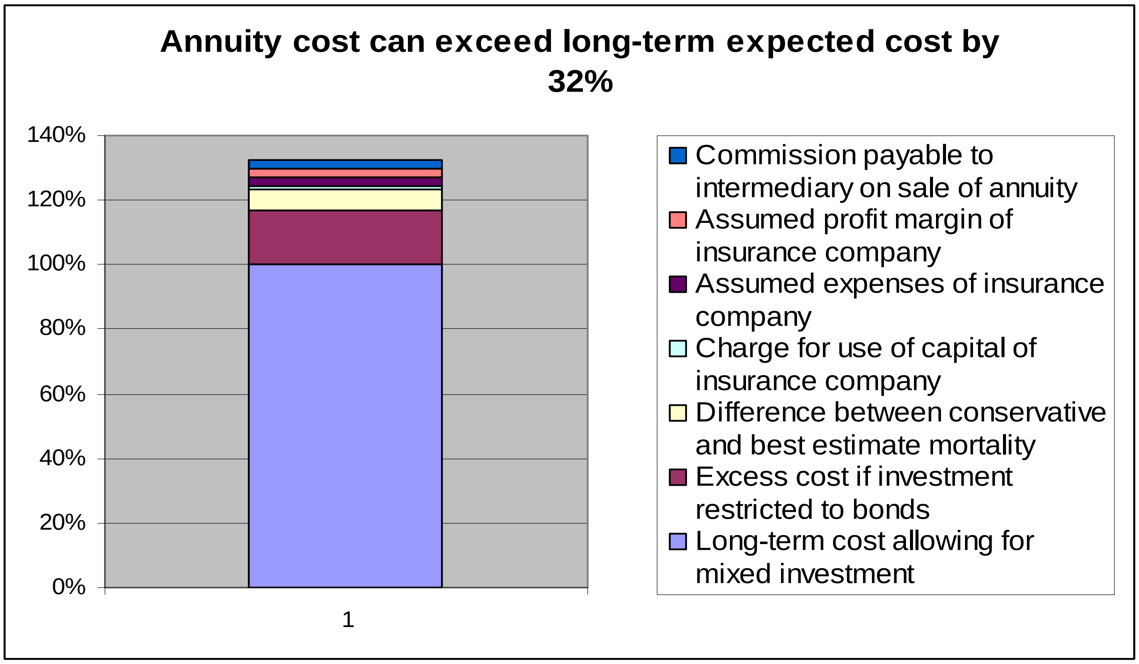
A Barclays Capital survey of UK returns shows the following real returns up to 31.12.2003 (i.e. returns in excess of inflation, annualised). The UK cycle of interest rates is somewhat out of sync with the Eurozone so the short-term returns will differ materially but we believe that the long-term lessons are valid.

	2003	***10 year return***	***20 year return***	***50 year return***	***100 year return***
Equities	16.9%	3.2%	8.0%	6.9%	5.1%
Government bonds	-1.2%	4.6%	6.1%	1.6%	1.1%
Corporate bonds	6.7%	6.7%			
Index linked	3.9%	3.7%	3.9%		
Cash	0.9%	3.1%	4.4%	1.8%	1.0%

Allowing for the asset distribution suggested above, a State Annuity Fund could be expected to produce a return of 5.67% versus bond returns of 4%.

This would mean that a State Annuity Fund could provide for pensions in specified circumstances at a cost well below the cost of buying annuities. For each long term cost of €100, the cost of buying an annuity is in the region of €132 and the differences are outlined in the graph below.

While we are not privy to the exact pricing parameters of insurance companies, and therefore the figures underlying this table cannot be taken as completely accurate, we are convinced of the broad validity of this analysis.



Long-term cost allowing for mixed investment	**€100.00**
Excess cost if investment restricted to bonds	€17.07
Difference between conservative and best estimate mortality	€6.05
Charge for use of capital of insurance company	€1.32
Assumed expenses of insurance company	€2.65
Assumed profit margin of insurance company	€2.65
Commission payable to intermediary on sale of annuity	€2.65
Total cost of annuity	**€132.38**

We would emphasis that the bulk of the difference between the expected cost of providing for pensions and the annuity cost is caused by the requirement of insurance companies to invest in bonds and their use of a higher level of mortality improvement than expected by independent actuaries (conservative vs. best estimate).

We have no evidence that annuity providers over charge for this type of product.[1]

[1] The prohibitively high cost of purchasing annuities is one of the principal reasons why the IAPF support the extension of the ARF/AMRF option to all defined contribution members. For defined contribution members the requirement to purchase an annuity at retirement also represents economically inefficient use of capital. When the investment period post retirement may be as long as the pre retirement investment period it is anomalous that pre retirement investment tends to be predominantly in equities and property where as in retirement there is a requirement that all of the investment must be in fixed interest investments.

STATE ANNUITY FUND

A State Annuity Fund can replace open market annuity purchase much more efficiently and cheaply than the open market for many reasons as illustrated by the tables produced above.

However, the most significant support for a State Annuity Fund lies in the fact that the monies paid to a State Annuity Fund in consideration of each annuity can be invested more freely by the Fund than they could otherwise be invested by an insurer providing an annuity in the open market. Accordingly, a State Annuity Fund could provide the same pension as an insurer but require substantially less money from the prospective annuitant to do so.

Insurers are led by regulation, designed to protect annuitants against the insolvency of the insurer, to holding conservatively calculated reserves and to closely match annuitant liabilities by holding fixed interest assets of similar duration.

A State Annuity Fund would not be so limited and could develop investment strategies designed to meet its liabilities over the long term. This would enable a State Annuity Fund to invest in a mix of assets including real assets which can be expected to produce significantly greater returns than fixed interest assets of matching duration.

If one assumes a return premium of 1.67% over fixed interest returns for a conservatively diversified investment strategy that might be adopted by a State Annuity Fund then one could expect the cost of an annuity to fall by approximately 17% based on this factor alone.

OPTION TO CONTRIBUTE ON ONGOING BASIS IF EMPLOYER ACKNOWLEDGES PENSION DEBT

The IAPF have long argued that the only realistically affordable way of supporting the defined benefit system as we know it is to establish an ongoing funding test as the statutory benchmark. The current funding standard differs from this approach principally because of the increased cost of funding for annuity purchase over the cost of funding for pensioner liabilities on an ongoing basis.

IAPF note and understand the reluctance of the State to weaken the current funding standard and believe this to be based on a presumption that to do so would reduce member security.

IAPF argue the reality to be that failure to complement the current funding standard with an option to fund on an ongoing basis will be enormously detrimental to many members of defined benefit schemes who will find their schemes wound-up or their benefits reduced as a result.

IAPF believe that member security can be maintained and member benefits protected (simultaneously) by complementing the current funding standard with an option for employers to elect an ongoing funding standard (with trustee and Pensions Board consent) if on doing so they also accept an obligation to fund the difference between those funding levels from employer assets in the event that the pension scheme is ever wound up in deficit.

Thus in circumstances where a scheme is wound up in deficit by a solvent employer the employer will become responsible to fund the difference between the ongoing valuation of liabilities and the current funding standard valuation of liabilities if the employer opted for the ongoing funding standard as the schemes statutory benchmark. In this fashion, the security of members provided by the current funding standard is not lost on insolvent wind-up in such circumstances.

One could argue that member security would be enhanced in such circumstances as the severity of the current funding standard has forced the Pensions Board to allow significant extensions of time for employers to restore funding standard solvency. This means that where member security is threatened by investment performance or market conditions the current standard and the current approach to its enforcement leaves members exposed to scheme deficits for extended periods. In an environment where an ongoing funding standard is available to complement a discontinuance funding standard greater investment freedom can be enjoyed by scheme sponsors, and if elected by an employer, security of member benefits can be restored more quickly.

Of course if the sponsoring employer is also insolvent at a time when its pension scheme, funded on an ongoing basis, winds up in deficit then there may be insufficient employer assets available to make up the discontinuance deficit. It is in these circumstances that the State Annuity Fund would be required to accept assets from the pension scheme and provide annuities to the schemes pensioners in return.

The value of assets transferred to the State Annuity Fund would be calculated on an ongoing basis (as defined by the Society of Actuaries in Ireland in consultation with the

State Annuity Fund) to match the cost to the State Annuity Fund of providing the annuities for the schemes pensioners.

This would result in a significant increase in the assets available to discharge the liabilities of active and deferred members of the scheme and may be of sufficient assistance to allow those benefits be discharged in full (where the scheme was solvent on an ongoing basis at the point of wind-up). Where there is an insufficiency of assets available to meet liabilities for active and deferred members those benefits would be scaled back as under the current regime.

An employer electing to adopt the complementary funding standard proposed by the IAPF under this arrangement would not be required, under these proposals, to fund excessively for an annuity purchase which it would not ultimately require and some of the negative effects of the current funding standard set out on pages 2 and 3 of this paper may be avoided.

APPENDIX 1

Extract from IAPF Response to the Consultation Document on the Review of the Funding Standard (September 2004)

2.8 State backed annuity purchase scheme

The IAPF believe that there is merit in the State providing a vehicle to take on, in rare incidences, pensioner liabilities in return for the payment of a capital amount based on the actuarial value of such benefits on an ongoing basis.

A State backed annuity purchase scheme would enable the Board propose an advance funding system on a discontinuance basis but with the flexibility to allow employers elect (with trustee and Pensions Board consent where the best interests of the members dictate) an ongoing funding approach with additional security such as a voluntary lien on employer assets.

The State backed scheme would then provide an additional safety net in instances where involuntary insolvent wind-ups occur and where the employer has insufficient assets to satisfy the difference in assets between the ongoing liability in respect of pensioners and the annuity cost for such purchase.

Under this framework the State could agree to accept assets at the ongoing valuation rate in exchange for the payment of the pension to the member and this would allow the State at a no cost basis to provide the protection necessary in order to underpin the defined benefit system.

In this environment it would also be possible to envisage that in insolvent wind up pensioners could be offered the option of transferring their benefits to an ARF at the actuarial valuation or ongoing value of those liabilities rather than the annuity cost. This may well suit some pensioners and would also relieve the position regarding the funding of deferred members and active employees.

It is probable that the system, in such circumstances, would have to also be amended to allow ARF options for pensioners on solvent wind up to ensure that the range of options available for members of an insolvent wind up is freely available to all, i.e., that pensioners on insolvent wind up are not preferred.

The advantages of a proposal in this regard are to allow employers to elect to fund schemes on an ongoing basis. In return, it is proposed that employers’ commitment to continue to fund such schemes is underpinned by a voluntary assumption by the corporate entity of a “lien on employer assets”. This lien would apply in circumstances where the scheme is subsequently wound up and has insufficient assets to secure annuities for pensioner liabilities.

In addition the current funding standard framework would not require a significant alteration as the existing funding standard would remain in place and an ongoing funding standard would merely be an option for the trustee / employer election subject to Pensions Board consent under Section 49(3).

The establishment of a State backed annuity purchase scheme can be supported by the following arguments.

- It will only apply in the event of involuntary insolvent wind-ups (i.e., where the employer has gone into liquidation) and where there are insufficient corporate assets to satisfy the “lien on employer assets”. The incidence of such events could reasonably be expected to be low.

- It would not necessarily require any substantial State funding and therefore as an alternative to a pension protection fund, avoid the imposition of levies on either the taxpayer or the pensions system.

- It would operate on a basis where, on the insolvent liquidation of a sponsoring employer, an insolvent scheme would transfer to a State backed fund the actuarial equivalent (calculated on an ongoing basis) of the pensioner liability.

- The fund could be invested on an ongoing basis with an equity/bond mix and should not be subject to EU Life Directive regulations or IORP’s investment principles. As such the fund ought to be able over the long term to satisfy the pension liabilities from the assets paid into the fund.

- The incidences of involuntary insolvent wind-ups are unlikely to be materially significant (in terms of the number of such occurrences arising).

- There are numerous third party administrators who would be willing to operate a pensions payroll system, thus eliminating any administrative burden on the State.

- Costs associated with this administration would be included in the actuarial basis for determining the costs of benefits.

- Equally, the investment of the fund’s assets could be managed by private sector trustee and investment manager appointments to further eliminate administrative burden on the State, or otherwise by the NTMA using the NPRF. Costs associated with this operation and investment management fees would be included in the actuarial basis for determining the costs of benefits.

- The existence of such a scheme may be seen to prefer members of defined benefit schemes. As such, it may be appropriate to simultaneously recommend the extension of the ARF regime to all defined contribution members.

APPENDIX 2

Extract from Pensions Board Review of the Funding Standard – Report to the Minister for Social and Family Affairs (December 2004)

7.38 Arguments in favour of a State Annuity Fund include:

(a) The benefits of such a fund would be that it would not incur the margins that commercial insurers include on their charges. The savings could potentially arise from a number of sources:

(i) Although the fund charges would include appropriate allowance for administration costs, there would be no margins for profit or solvency or other contingencies.

(ii) The mortality rates assumed by the fund might be less cautious than a commercial insurer, as the fund would only be seeking to break-even.

(b) Although such a fund would only be available to schemes that are wound up, the existence of the fund would allow the Funding Standard for pensioners to be lowered. The standard would be based not on the commercial insurance cost, but on the charge made by the fund in the event of a wind-up; and

(c) It is noted that the State bears a considerable longevity risk in respect of Social Welfare and public service pensions, so that the real additional quantum of risk represented by an annuity fund as described would not be significant.

7.39 Arguments against a State Annuity Fund include:

(a) In the absence of any detailed examination of the subject, it remains to be proven that pensioner insurance would be provided at less cost by the State Annuity Fund than by commercial insurers. Annuity prices reflect low interest rates and greater longevity and the State cannot hope to avoid the impact of such developments. In addition, if the State were to establish such a Fund, the Fund would have to take responsibility for the payment of pensioners out into the future and, inevitably, it would have to incur real extra costs in acquiring pensions-related expertise hitherto confined to the private sector;

(b) Being operated under the auspices of the State, it would be unrealistic to assume that the Fund would not be subject to intense pressure to pay pension increases (even where they were not guaranteed under the original scheme) and to make good shortfalls in pension funds of companies involuntarily wound up. It would be exceedingly difficult for such pressure to be resisted;

(c) It should not be assumed that the Fund could be confined to members of defined benefit schemes connected with involuntarily-wound up companies, especially if the members involved were found to be in a more favourable position than members of other DB schemes, let alone, of course, members of DC schemes and PRSA holders. Demands for parity of protection from the State against the vagaries of the pension marketplace (involving some form of State guarantee, perhaps) would be inevitable and, on grounds of equity, could well be difficult to resist, at potentially very substantial cost to the Exchequer. In addition, State involvement in the annuities business, through the Fund, could well be mirrored by a corresponding disengagement on the private sector's part over time, on the basis of the latter's perception that the State would play an ever-increasing part in the area. This would have substantive consequences for both the State and the pensions industry generally;

(d) The contention that the real additional quantum of risk represented by an Annuity Fund would not be significant requires to be proven. Already, the cost to the State of a partial pre-funding of social welfare and public service pensions is extremely significant at 1% of GNP per annum, i.e. about 10% of social welfare expenditure at present. The cost to the State of an Annuity Fund, even on the scale envisaged by its proponents, let alone any extensions on the lines suggested in paragraph 7.38, could only be a tangible addition to the burden already borne by the Exchequer; and

(e) There is concern that the expedient of establishing a State Annuity Fund is being proposed in the comparatively narrow context of devising a viable Funding Standard for defined benefit schemes. Insufficient regard is being paid to the possible consequences for the wider pensions area, for example, or the Exchequer, which through very sizeable tax foregone on an annual basis (estimated to be of the order of at least €2.5 billion at present), already provides a very significant degree of support for the sector. All the implications of the initiative would need to be explored fully before a proposal for action were submitted for approval to relevant Departments, the Government and the Oireachtas.

APPENDIX 3

Summary views of the IAPF in respect of the advantages and disadvantages listed by the Pensions Board in their report to the Minister extracted in Appendix 2

Arguments in favour of a State Annuity Fund

IAPF agrees fully with the arguments set out in section 7.38 of the Pensions Board report as extracted at the start of Appendix 2 and believes that the asset allocation flexibility which a State Annuity Fund can adopt provides further significant advantage.

Arguments against a State Annuity Fund

7.39 (a) The main argument here is that there is no evidence that the State could out guess the market price of annuities. IAPF would point out that the State imposes onerous solvency requirements on insurance companies which require them to price guaranteed annuity products cautiously and to invest cautiously. In the context of a private insurance company guaranteeing a future income to an individual, this is clearly a desirable approach but IAPF is convinced that in limited circumstances the State could offer superior value by pricing on a best-estimate rather than conservative basis and by investing to achieve the superior long term returns available from assets other than guaranteed assets (which insurance companies are required to invest in for solvency purposes).

The second point made is that the State would incur expense in acquiring additional expertise to manage a State Annuity Fund. However, it is likely that much of the resource necessary is already available through the NTMA and its services to the NPRF. Additional administrative costs required could be costed into the valuation basis for the pension liabilities assumed and thus ensure that the annuity operates on a financially neutral basis. Efficiencies of group administration will reduce these costs in any event. Even if the administration costs were not factored into the annuity price, IAPF feels that the costs associated with acquiring this expertise should be viewed against the costs of not acting i.e. that the existing defined benefit market will contract significantly unless action along these lines is taken.

(b) IAPF believes that pressure to pay benefits which are not supported from funds available can be resisted by two simple rules – (i) the fund will only take on a pension on a financially neutral basis and if insufficient funds are available the pension will be scaled back and (ii) the fund will only pay benefits in line with the original benefit promise and therefore no discretionary decisions will be made by the administrators of the fund.

(c) IAPF agrees that pressure could emerge for the extension of the State Annuity Fund to situations where there is not an involuntary wind-up of the scheme, and that the implications of any future potential policy change would need to be understood in advance.

IAPF believe that the extension of the ARF regime to members of all defined contribution schemes would reduce pressures on the State Annuity Fund to extend beyond its initial remit as those members would then have the same access to long term investment returns which would be supporting the benefits payable to annuitants under the State Annuity Fund.

(d) IAPF view the State Annuity Fund, in the manner described (which differs materially from the more open protection schemes of other countries), as financially neutral by definition – each new pension established would be supported by a fund of equal value. If a scheme winds up with insufficient assets to back the pensions promised, the scheme promises would be scaled back to match the funds available.

(e) IAPF wholly rejects the argument that the State Annuity Fund would prove a drain on the Exchequer. The establishment of the State Annuity Fund would reduce the level of funding required for pension schemes at this stage – this would lower the level of relief (deferral of tax) claimed by pension schemes.

Therefore, over the short-term, the establishment of the State Annuity Fund would improve the Exchequer's position.

Effectively, the distribution of contributions paid (and hence tax relief claimed) over the short and long term would be more balanced if the State Annuity Fund was established. This is crudely illustrated in the graph below.

Illustration of higher contributions required and hence higher tax relief claimed in the case of a scheme with a 10 year funding proposal