18 April 2006

Mr. Brendan Kennedy
Actuarial Adviser
The Pensions Board
Verschoyle House
Lower Mount Street
Dublin 2

Dear Brendan

Review of the Funding Standard for defined benefit schemes

We are responding to your letter of 28 March 2006 in relation to specific suggested changes to the Funding Standard as applies to defined benefit pension schemes.

As requested, this letter represents the written response of the IAPF to your letter and the views of the Association on this topic. As you can appreciate, this is a highly complex area and we would welcome the opportunity to meet with you to discuss this topic in further detail.

The IAPF believes that the Funding Standard should represent the realistic economic cost of providing the pension benefits through a pension scheme. As a consequence of constraints within the annuity market, the current standard requires many defined benefit schemes to fund benefits on a basis greater than that which might be required in the long term. This is in order to ensure that these schemes will have the capacity to purchase annuity contracts in the event of actual wind up. The reality for a great number of schemes is that the prospect of annuity purchase, due to the constraints in the annuity market, is remote.

The IAPF recommends that the Funding Standard be amended to represent the accrued valuation of the scheme's technical provisions and would once again reiterate its proposal for the establishment of a State Annuity Fund to provide the additional support mechanism to this approach in the event of actual wind ups.

The IAPF believes that further communication is required to educate all stakeholders within defined benefit schemes as to the funding and relative security of the benefits provided.

Impact of previous amendments to the Funding Standard

We believe that the recent changes to the Standard have had little meaningful impact and our members have told us that the continuation of a standard imposing constraints at a level similar to those currently in place would pose a serious threat to the continuation of defined benefit provision.

In addition, it should be noted that the proposed changes to the calculation of transfer values effective 1 May 2006 (the second such change in the past six months) will further increase the level of technical provisions which schemes are required to hold and may cause a flood of additional schemes to fail the funding standard.

A robust and sustainable system

The IAPF believes that the Funding Standard should create a robust mechanism for testing the funding position of defined benefit schemes on a periodic basis. It should identify schemes which require remedial action to bring the funding of benefits for members to an acceptable level but should not endanger the continuation of well managed schemes through excessive compliance or actuarial reporting requirements.

Annual certification

As has been outlined previously, the IAPF believes that one area of the funding standard which requires amendment is that any Funding Proposal in place should remain in place for a period of three years following approval by the Pensions Board. The Funding Proposal process is a significant process involving the sponsoring employer, trustees and members and the IAPF believes that, once the trustees and sponsoring employer have committed to agreed remedial action, there should not be a requirement, under legislation, for them to revisit the proposal for a specified period of time.

Fluctuations in investment markets, interest rates and inflation can, in the period of a single year, deviate from a reasonable long term “norm” and currently such fluctuations can result in the stakeholders being forced to revisit prudent funding proposals. We believe that such short term reviews and reassessments are discouraging sponsoring employers and members from continuing to support defined benefit provision.

The IAPF therefore believes that the Pensions Act should not require a revised proposal to be prepared during this period unless the Trustees and sponsoring employer determine to do so. The IAPF would support the disclosure of information to pension scheme members on the scheme’s funding position each year during this period.

The IAPF believe that this amendment should be made regardless of any decision to change the basis for placing a value on pension scheme liabilities under the standard.

Valuing scheme liabilities under the Funding Standard

The IAPF believes that the Funding Standard should constitute a mechanism to ensure that sponsors of defined benefit schemes maintain a responsible level of funding in respect of the benefit promises made. We are of the view that such a standard should recognise that, even within defined benefit schemes, the benefits cannot be 100% guaranteed (as such levels of security would make those benefits unaffordable in the main). Hence the standard should not stipulate the very high level of security that is required (and is unaffordable) under the current standard.

The current funding standard requires all schemes, from the smallest to the largest, to value pensions already in payment by reference to the cost of purchasing an annuity contract from a life office. The Irish annuity market has very limited capacity and there are questions as to whether there will be a sufficiently liquid annuity market in existence in 10-15 years time. Regardless, proportionately few schemes actually buy out benefits via annuity purchase.

Defined benefit pension schemes operate on the basis of pooling risks across a group of members with most schemes being operated on a basis whereby long term considerations take priority over short term issues. The great majority of defined benefit pension schemes have liabilities that will emerge over an extended future period of time and the investment strategy followed for the majority of the schemes reflects this fact.

The IAPF believes that the funding standard should recognise the emergence of the liabilities of the scheme over this long term period and require schemes to hold assets sufficient to meet benefits from the scheme's resources as they fall due. The standard should not be a wind up standard requiring all schemes to benchmark their pensioner liabilities against annuity rates.

We would suggest the adoption of an approach similar to many European countries which calculate minimum statutory technical provisions based on a member's accrued entitlement. The IAPF would propose that these technical provisions for pensions in payment be calculated including allowance for future statutory revaluation and guaranteed pension increases, discounted using a fixed discount rate of, say currently 4%, or, a rate derived from long bond yields. This would result in the calculation of technical provisions closer to the economic cost of providing the pension from the scheme's resources.

The technical provisions for active and deferred members could be set equal to the transfer payment which would be required to be made based on guidance issued by the Society of Actuaries in Ireland with allowance for yields to retirement from an appropriate portfolio of assets.

Availability of ARFs on wind up

We suggest that such a standard should be implemented in tandem with the introduction of an ARF facility or option to pensioners in the event of insolvent wind up. This would result in the pensioner receiving, in the event of an actual wind up where an annuity is not being purchased, a level of assets sufficient to provide him/her with the same level of pension via an ARF as he/she had been receiving from the scheme.

The ARF has proved to be an attractive vehicle for the investment of pension assets post retirement age. As has been seen by the figures contained in your report on the National Pensions Review, the cashflow into annuity contracts is, on average, €90,000 (equivalent to a pension of €5,000 per annum) whilst the average ARF investment (if allowance is made for assets held by stockbrokers) is perhaps double this amount.

Given our concerns in relation to the long term viability of the annuity market (we understand that one of the country's largest insurers is no longer taking on liabilities for annuity contracts, preferring to reinsure their entire exposure via the UK), we believe that the availability of ARFs (or other vehicle) on actual wind up will potentially become a necessity.

Excessive short term funding is not desirable to the continuation of defined benefit provision

The IAPF believes that an environment where defined benefit schemes are maturing, forcing such schemes to fund at a rate higher than necessary on an ongoing basis will detract from national competitiveness by requiring companies to utilise capital in an inefficient manner.

It may also act as hurdle to a policy objective of enhancing defined contribution adequacy if companies' overall pension spend is weighted towards inefficient funding of annuity costs where the purchase of annuities is not anticipated.

In commercial semi state bodies with funded pension schemes, similar issues exist and could restrict much needed infrastructural development and investment.

Priority on actual wind up

The IAPF believes that the first priority (after the expenses of winding up the scheme, AVCs and DC transfers in are met) for the assets of the scheme should be the value of pensions in payment (including future guaranteed pension increases) based on the technical provision held under a revised funding standard (see above). The value of accrued benefits for active and deferred members should rank after meeting these liabilities. The next priority should be pensioner annuity buy out after allowing for the earlier priority re pensions in payment (though this value would not be incorporated in our proposed revised funding standard).

This approach, combined with the availability of ARFs on wind up, would provide pensioner members with a level of assets sufficient to enable them to receive their pension via an ARF as well as providing enhanced security for active and deferred members. Such an approach would therefore provide a greater level of equity between members within the scheme.

If an alternative approach is to be favoured

Where the proposals put forward by the IAPF are not adopted, the IAPF would support an approach suggested by some representative bodies that future pension increases should rank as a lower priority in the event of an actual wind up.

Contingent security

The IAPF believes that contingent security, such as letters of credit etc, given or arranged by an employer should be capable of being considered by the pension scheme in meeting the funding standard. Sponsoring employers find it difficult to justify unnecessarily tying up funds in pension schemes that could be applied more effectively for the benefit of the business and ultimately its employees.

Answers to specified questions

1. As outlined earlier in this letter, the IAPF would favour the use of a funding standard which places a valuation on the technical provisions of defined benefit schemes sufficient for pensions in payment to continue to be paid from the resources of the scheme. **We are therefore in favour of option B** on the basis that the value placed on a scheme's technical provisions should be based on the long term economic cost of providing the benefits promised under the scheme rules.

   We recommend the introduction of an ARF facility or option to pensioners in the event of insolvent wind up.

We require the removal of the requirement, under legislation, to amend funding proposals other than every three years. We would continue to favour the disclosure of the funding position of defined benefit schemes on a wind up basis alongside the requirement for scheme's to meet the Funding Standard on the revised basis.

2 Our proposals in relation to a revised funding standard are outlined earlier in this letter.

3 The IAPF is not in favour of a mandatory debt on the employer. The UK experience has suggested that the debt on the employer has interfered with economic life to the point of preventing, discouraging or delaying the purchase and sale of businesses. The use of contingent security, rather than employer debt, creates a more controlled environment within which business can work and still manage its pension responsibilities

4 The IAPF believes that contingent security, such as letters of credit etc, given or arranged by an employer should be capable of being considered by the pension scheme in meeting the funding standard.

We look forward to discussing the proposed revisions to the Funding Standard with you.

Yours sincerely,

J.V. Byrne

Joe Byrne
Chairman