Spotlight

Hewitt

A retirement and investment update from Hewitt Ireland

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Government proposals on pensions

The Government has announced proposals to amend the way in which the assets of defined benefit schemes are applied on winding up. These and other proposals have been included in a Bill currently before the Oireachtas. There may be further changes to the Bill before it is passed into law, particularly as pensions is one of the key issues being considered in the partnership talks.

The Government has brought forward Committee Stage amendments to the Social Welfare Bill 2009 (one of which is to rename it the Social Welfare and Pensions Bill 2009) to give effect to the changes announced by the Minister for Social & Family Affairs on Sunday evening. It is proposed to amend the provisions of the Pensions Act to

- Reduce the priority of post-retirement pension increases on winding up.
- Give greater powers to the Pensions Board and to Trustees to reduce accrued benefits where a scheme has insufficient assets to meet its liabilities.
- Institute criminal proceedings against employers who do not remit employees and, for defined contribution arrangements, employer contributions to the Trustees in accordance with the requirements of Section 58A of the Act.

In addition, the Bill provides for the establishment of a Pensions Insolvency Payment Scheme which is intended to provide annuities to enable trustees of schemes which are winding up in circumstances where the sponsoring employer is insolvent to secure pensions in payment on more favourable terms than are available on the open market.

Under the existing provisions of Section 48 of the Pensions Act, benefits for those in receipt of pension, or who have passed normal pensionable age, must be secured in full before any assets are used to provide benefits for active members and deferred pensioners on wind-up. The Bill proposes an amendment to Section 48 whereby post-retirement increases for current and future pensions are given a lower priority, with pensions in payment and benefits for active and deferred members (in both cases excluding any provision for post-retirement increases) being provided in full before assets are applied to provide for post-retirement increases on these benefits. If the assets available are insufficient to provide for post-retirement increases in full, they must be used on a pro rata basis to provide some level of increase to all benefits.

If enacted, this amendment will provide what might be considered a more equitable allocation of assets on the wind-up of a scheme which provides for post retirement increases, and where there are insufficient assets to provide the benefits in full. However, it will impact only on those schemes where increases are guaranteed in the rules.

The Bill also provides for the amendment of Section 50 of the Pensions Act, giving the Pensions Board power to direct the Trustees to reduce the accrued benefits of members entitled to deferred pensions, and the future increases to pensions currently in payment, to enable a scheme to satisfy the funding standard, if no funding proposal has been submitted, or to meet the funding standard at the end of the period of a funding proposal where one has been submitted. The current provisions of the Act permit a reduction in the accrued benefits of current active members only.

There is also a new Section 50A to be inserted in the Act which gives power to Trustees, with the consent of the Pensions Board and subject to disclosure to members in accordance with regulations to be issued, to "make such amendments as they consider appropriate…. for the purpose of ensuring a winding up of the scheme will not be required by reason only of the scheme not having sufficient resources to enable the liabilities of the scheme to be discharged". Amendments made under this power do not require the consent of the members.

These two amendments give greater flexibility to reduce accrued benefits in order to enable a scheme to continue as an alternative to winding-up in deficit. To date, the Pensions Board have used their powers under Section 50 very infrequently, and it remains to be seen how they will use their extended powers if this amendment is enacted. Trustees who elect to use the new Section 50A provisions will clearly need to consider carefully whether this is an appropriate course of action before proceeding.

The Bill also enables the Minister for Finance, after consultation with the Minister for Social & Family Affairs, to establish the Pensions Insolvency Payment Scheme which will provide payments to pensioners and to other members who have passed normal pensionable age of "eligible pension schemes" certified by the Minister for inclusion in the scheme on application to him by the Trustees. The scheme is eligible if it is in the course of winding up, if "the resources are insufficient to discharge the liabilities of this scheme on the date of the commencement of the winding up" and "where the employer concerned is insolvent for the purposes of the Protection of Employees (Employers' Insolvency) Act 1984". There is little detail on the operation of the Scheme, although it appears that the assets of schemes will not be transferred to a separate fund managed by the NTMA and that payments of pension will come from central funds. The Bill specifically provides that

- There will be no provision for future increases in pensions.
- The pricing of the annuities will be delegated to the NTMA.
- The scheme will be reviewed not later than 3 years after its inception.
- The payment of pensions may be delegated "to such persons as the Minister considers appropriate".

In her press release, the Minister for Social & Family Affairs stated that "this new scheme will provide for pensions at a lower cost, leaving more funds available for those who have yet to retire". In addition, the Minister for Finance stated that the scheme would be "cost-neutral to the Exchequer", and this appears to be the intention of the amendment which states "the payments and expenses advanced out of the Central Fund in respect of a particular participating pension scheme will not be greater than the sum paid, in accordance with the Pensions Insolvency Payment Scheme, by the Trustees of any participating pension scheme to the Minister".

The extent of the reduction in annuity costs depends on the approach to pricing the annuities provided from the Pensions Insolvency Payment Scheme. This could be significant if the rate used to discount the future pension payments reflects the rate being paid by the Irish Government to borrow funds on the international markets. This is currently significantly higher than the rates used by insurance companies to price annuities, which reflects the lower yields available on other Eurozone Government stock. In addition, there should be some saving from the elimination of expense and profit margins, and the cost of capital incorporated in insurance company pricing.

Where a scheme winds up with an insolvent employer, the Trustees will be able to secure the pensions in payment through the Pensions Insolvency Payment Scheme (with no increases in payment in accordance with the new priority rules), thereby leaving a larger residual pool of assets available to secure benefits for active and deferred members.

There are no proposed amendments to Section 44 of the Act, which sets out the benefits to be taken into account for the purpose of the minimum funding standard, so that the change in priority rules and the use of Pensions Insolvency Payment Scheme annuity prices do not apply to the assessment of the funding standard position, but only on actual wind-up. The only amendments which deal with the shortfall in schemes which are ongoing are the powers introduced in Sections 50 and 50A.

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