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Issue 3

Employer Pensions Alert
Defined benefit pensions – next steps!

What you need to know

Changes to the funding standard for defined benefit schemes (DB) with the aim of enhancing the security of member benefits and increasing equity between members of DB schemes have been announced. The key changes are outlined below.

Funding Standard

Restoration of current Funding Standard (amended)

The existing Funding Standard (amended to allow for the purchase of sovereign annuities) will be restored, giving underfunded DB schemes 3 years to recover their funding levels.

Schemes that cannot recover within a 3 year timeframe immediately become subject to the revised Funding Standard.

Introduction of revised Funding Standard

The revised Funding Standard will require a risk reserve to be held (an additional level of protection against future volatility in financial markets). Schemes will have approximately 10 years to meet this new standard. It is estimated that the risk reserve will add a further 10% to the funding requirements (and consequently higher contribution requirements).

Three possible measures to mitigate the risk reserve requirements are:

- moving investments from equities to bonds
- purchasing of sovereign annuities
- possibly relying on an enforceable guarantee from the sponsoring employer

Recovery plan submission

On 10 November 2011, it was announced that recovery plans submitted to The Pensions Board by 12 noon Friday 16 December 2011 will continue to be considered by the Board under the current funding standard and guidance.

For later submissions, The Pensions Board expects to publish updated guidance by the end of 2011. The earliest date for submissions under the revised guidelines will be 1 July 2012.

Revaluation of scheme benefits

The Pensions Act will be amended to change the revaluation rate to deferred members to achieve greater equity between active and deferred members in the accrual of pension rights.

Power to wind-up a scheme

Powers will be given to The Pensions Board to instruct the trustees to wind-up a scheme in certain circumstances.

Priority order on wind-up changes

The new priority order will change the 100% priority given to pensioners to a more equitable outcome amongst all members. Whilst subject to clarification, we believe the order will be along the lines of:

1. Current pensions in payment will be protected to the greater of €30,000 or 75% of the benefit
2. Assets would then be allocated to active and deferred members to the same limits
3. Pensioners would then get priority on the remaining assets (flat pensions) before any are allocated to active and deferred members
4. Any remaining assets will then be allocated to cover pension increases for all members

Deloitte commentary

Whilst the restoration of a funding standard is welcome, the reintroduction of the current funding standard, which ultimately has failed many schemes, will not solve the problem of poor protection of members' benefits.

Since the funding standards suspension, most pension schemes have seen a large deterioration in funding levels due to investment losses and a jump in the cost of annuities. The planned higher funding target may become a tipping point for the wind up of many defined benefit schemes.

The final details in relation to the revised Funding Standard are not yet available; therefore it is impossible to say what exact impact the proposals will have. Indications are that it will add a further 10% to the funding requirement (should your current strategy and operation of the scheme remain unchanged).

It is certain however, that it will lead to a further substantial increase in employer cash contributions if scheme benefits are to be maintained.

Whilst it may appear that underfunded schemes have 3 years to "fund up" to the current standard, this is not the case. Should a scheme fail to demonstrate now that it can fulfil this requirement, the scheme is automatically subject to the new revised funding standard. The development of a strategy to build up sufficient risk reserves over the next 11 years becomes an issue which sponsors and trustees need to consider/address now.

For some, it may be considered a positive that no changes were announced which would create a legislative debt to the employer or a mandatory requirement to hold insurance against the deficit. However there has also been no update on a suggested new model for future DB pension provision.

What do employers need to do?

Our Employer Pensions Alert Issue 1 – (click here), highlights that the introduction of a potentially more robust and expensive funding standard will further delineate the roles and objectives of the employer and trustees. We strongly advise that you take advice that is impartial and independent from the trustees.

You should investigate what your options are for mitigating the impact of rising cash costs, derisking and managing your liabilities in the future and review your pension strategy in order to arrive at a durable and sustainable solution for future retirement provision.

Such steps would include:

- Assessing the ability of your scheme to meet the current funding standard within the next 3 years.
- Considering and developing a strategy to build up the required risk reserve under the new funding standard.
- Considering the use of sovereign annuities as an option to manage contribution cashflow requirements.

If you are undertaking a corporate transaction, you should ensure that the impact of the recent announcements is taken into account in any cashflow projections.

Talk to Deloitte now regarding the options available to you to address the recent changes that have been announced. For more information please contact a member of our Pensions team.

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