Employer Pensions Alert
OECD report on long term pension policy in Ireland

What you need to know

At the request of the Minister for Social Protection, the OECD in April 2012 commenced a review of long term pension policy in Ireland.

The report on the OECD review was published on 22 April 2013 and covers all components of the pension system: State, private personal and occupational plans and schemes for public-sector employees. It builds on the considerable body of work undertaken in Ireland on the analysis of the pension system, and the different proposals for reform put forward in recent years.

The report puts forward a series of recommendations, many of which have already been flagged, including proposals to:

- Reform the State pension system
- Reform the public service pension scheme
- Expand private pensions coverage and retirement savings
- Improve the design of defined contribution (DC) arrangements
- Enhance benefit security in defined benefit (DB) schemes

The key proposals and recommendations are summarised overleaf.

What it means for employers

For employers who do not currently contribute into a pension arrangement, or who contribute at low levels, auto-enrolment is likely to add to operational costs. Implementation may however be several years out.

More pressing, and with the potential for much greater impact, is the recommendation that “healthy” employers guarantee 90% of pension liabilities, and that those liabilities are calculated on a prudent basis. If this measure gains government support, it is likely to spell an abrupt end to DB pension provision in Ireland.

This report from the OECD comes at a time when many dark clouds are gathering over DB pensions. Following a long suspension, the funding standard, including a new risk reserve requirement, has been restored, requiring insolvent schemes to submit funding proposals by 30 June 2013 and forcing many employers to re-evaluate DB pension provision.

From a regulatory perspective, an EU directive on occupational retirement provision is expected in the coming years, which could, based on initial working paper proposals, fundamentally alter the funding of DB schemes, imposing reserving requirements similar to those applying to insurance companies. The ruling by the European Court of Justice, that Ireland did not have in place sufficient measures to protect employees’ pension rights on the insolvency of Waterford Crystal, may give rise to a more comprehensive pension protection fund and additional funding requirements on schemes. In addition, upcoming changes to IAS and FRS accounting standards will increase the pension expense recognised in employers’ financial statements and increase volatility in their balance sheets.

While it remains to be seen which of the OECD recommendations are implemented and in what manner, there remains much uncertainty in relation to future regulatory and funding requirements for Irish pension schemes. It is important for employers to understand the nature of the risks facing their schemes, and the potential impact on their pension funding and operational costs.

Recommendation	Deloitte Commentary
Reform the State pension system	
Restructure State pension provision A radical shake up of State pensions is encouraged, with the following options identified: 1. A new flat rate basic state pension for all, financed by taxes and contributions and supplemented with compulsory provision or auto-enrolment scheme. 2. A single means tested pension, including the household benefits package, financed out of general revenue, and best supplemented with compulsory private provision.	It is important that the issues of sustainability of and funding for future State pensions are addressed. Transition to a means tested system may cause intergenerational inequity, whereby individuals who have paid substantial social insurance contributions will receive little or no State benefit. In setting the level of the basic State pensions, the government should at a minimum provide a safety net for lowest earners.
Increase State pension age The State pension age could be linked to life expectancy after 2028, and could facilitate decrements and increments for early or late retirement. More flexibility could be provided in allowing retirees to combine income from employment and receipt of pension.	Linking State pension age to life expectancy will provide a predetermined control mechanism for future costs, and permitting flexibility in the age at which the State pension is drawn down will go some way to accommodating anticipated future changes in work patterns.
Reform the public service pension scheme	
Accelerate introduction of new scheme There should be faster phase-in of the new public sector career average scheme, by including existing public servants retrospectively based on age or length of service.	Retrospective application of the new scheme will be difficult, particularly in the context of Croke Park II negotiations.
Expand private pensions coverage and retirement savings	
Increase pension coverage Compulsory pension saving would be the less costly and most effective approach to increasing pension coverage, however it is recognised as "politically difficult". Automatic enrolment (with opt out) would be the "second best" option.	An automatic enrolment pension system has been proposed by both the current and previous governments. In December 2012, the Minister for Social Protection reiterated the Government's intention to introduce auto-enrolment, but noted that implementation may take several years. While auto-enrolment will certainly increase operating costs for many smaller employers, the opt-out facility may provide some mitigation. A key issue for employers will be the level at which their minimum contribution is set.
Tax incentives The current tax system provides the greatest level of incentives to those with the highest level of income. International evidence suggests that subsidies and matching contributions increase incentives for low to middle income earners.	Several studies have shown that the current net cost of tax reliefs is in fact proportionally higher at lower incomes. Higher earners, while benefiting from a greater degree of tax relief on contributions, also pay more tax on benefit drawdown. This does not appear to have been acknowledged by the OECD review. Notwithstanding this, the scaling back of tax reliefs for high earners has already been promised, with a €60,000 limit on tax relieved pensions expected to be implemented with effect from 1 January 2014. It is of concern that arguments for additional tax credits for middle and income earners may result in further scaling back of general pension tax reliefs, particularly given the progressive nature of the current regime.

Recommendation	Deloitte Commentary
Improve the design of defined contribution (DC) arrangements	
DC design	
The design and institutional set-up of DC pension plans needs to improve in line with OECD guidance. Annuitisation is encouraged. Consideration should be given to permitting early withdrawals only in the event of significant financial hardship.	Early access to pension funds has already been legislated for, albeit on a limited basis and in relation to Additional Voluntary Contributions only. It is difficult to support the assertion that annuitisation should be encouraged. While the purchase of an annuity at retirement will indeed be an appropriate choice for some scheme members, there are significant advantages for others in a more flexible drawdown of funds.
DC investment	
DC schemes should provide investment choice, as well as a default life-cycle investment strategy. Specialised private institutions should manage assets. The establishment of an autonomous public option could be envisaged to provide competition.	Many of these recommendations are consistent with the requirements of the Pensions Act, and investment guidance issued by various parties including the Pensions Board and the IAPF. The establishment of a public agency to manage pension scheme assets as an alternative to public sector providers is likely to raise issues of independence, governance and competition, and as such may be an unlikely prospect.
Enhance security in defined benefit (DB) schemes	
Employer guarantee for DB schemes	
The biggest surprise in the report is the recommendation that there should be greater risk sharing between plan members and plan sponsors, and that healthy sponsors should not be allowed "walk away" from DB schemes unless assets cover 90% of liabilities (calculated using "prudent standard actuarial valuations").	This recommendation was not flagged in advance of the report, and as such comes as somewhat of a surprise. If implemented, this "debt on employer" measure has the potential to effectively eradicate the provision of private DB pensions in Ireland. Given the current substantial deficits in DB schemes, and difficult operating conditions facing many companies sponsoring DB schemes, few if any employers will have the capacity to assume the pension deficit (in particular, a deficit calculated on a prudent basis) as a legally binding employer debt. The financial stability, and in many cases the very solvency, of an employer may be compromised if this provision is introduced. The prospective introduction of debt on employer provisions may also undermine an employer's negotiating position in a pension review process, and may result in employers accelerating such reviews, and in more severe outcomes for members.
Priority order on wind up of DB schemes	
The priority currently given to pensioners if a scheme closes because of sponsor bankruptcy should be eliminated. There should be greater risk sharing between plan members and pensioners (as well as plan sponsors).	Many would argue that the current wind up priority rules are inequitable, disproportionately favouring pensioners to the detriment of other members. Minister Burton has already indicated her intention to amend wind up priority rules and legislation to this effect is expected to be included in the Social Welfare and Pensions Bill due to be published in May. It is expected that a certain amount or proportion of pensioner benefits will remain a priority, and it remains to be seen at what level this protection will be set.

What do employers need to do?

- Ensure that the long term risk of exposure to further regulatory change, and the associated potential impact on costs, is fully understood.
- Consider current pension coverage across all employee groups, and whether extended coverage may be required in future.
- Review the design of defined contribution schemes to ensure best practice investment strategy is reflected, and consider issues in relation to member communication, understanding, and adequacy of benefits.
- Anticipate extended working lives, to age 68 and possibly beyond, and consider restructuring pension arrangements to accommodate more flexibility in retirement ages.

Talk to Deloitte now to help understand the potential impact of these recommendations on your scheme and company. For more information please contact a member of our Pensions team.

For more details please contact:

Patrick Cosgrave
Director
T: +353 1 417 2422
E: pcosgrave@deloitte.ie

Sarah Fee
Senior Manager
T: +353 1 417 2237
E: sfee@deloitte.ie

Naomi Reville
Senior Manager
T: +353 1 417 2418
E: nreville@deloitte.ie