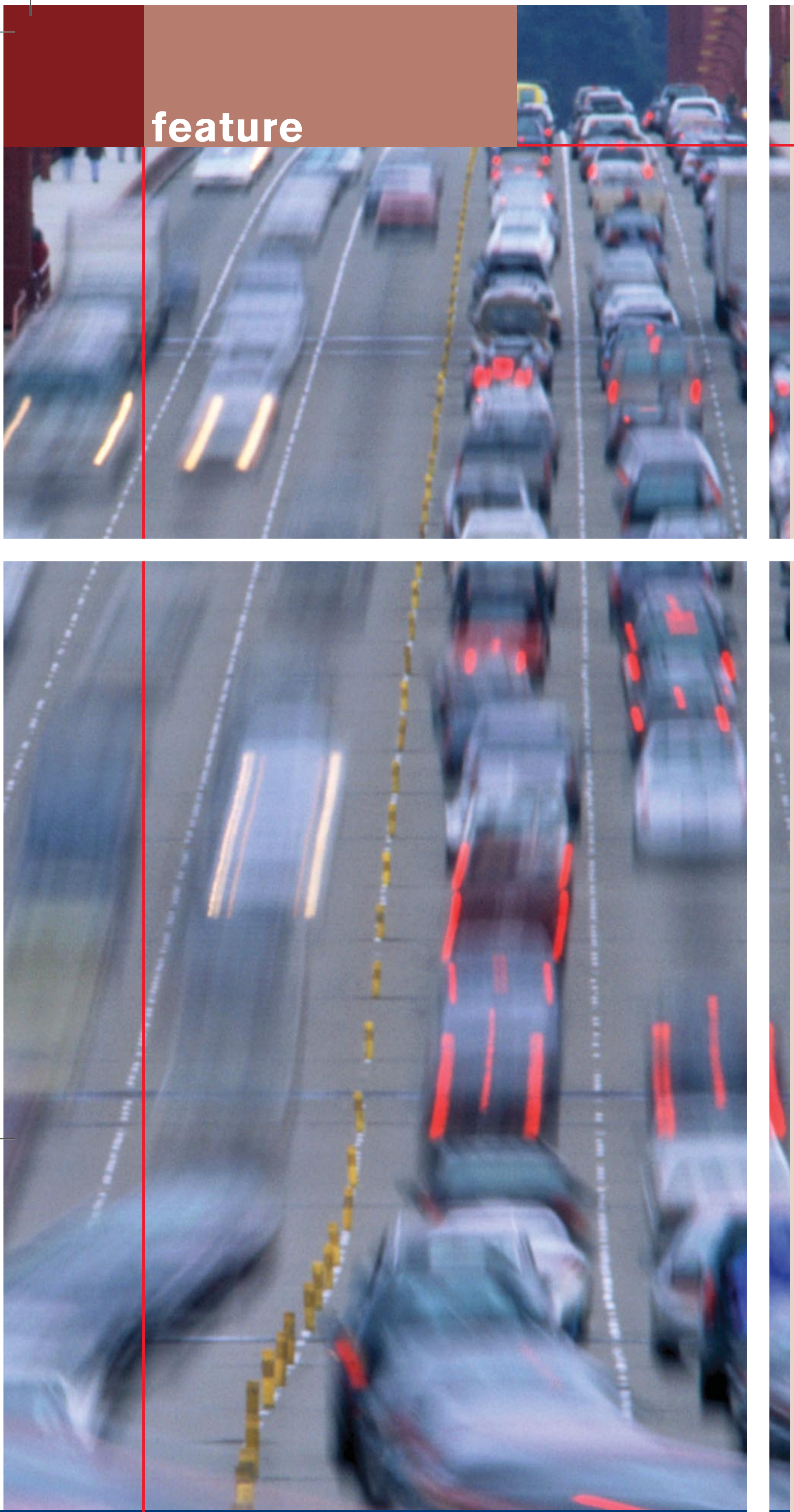

A TOUGH YEAR AHEAD FOR THE PENSIONS BOARD

by Jill Kerby

Between the review of the national pensions strategy, which is being brought forward by 16 months to June, the implementation of the EU Pensions Directive by September; the impact of the new funding standards (as introduced by the Social Welfare Bill) and another report for the Minister on the role of trustees, the Pensions Board and its staff face one of the busiest years ever, admits Board chief executive Anne Maher.

The list of priorities for her office that Ms Maher takes out of its file is nearly a dozen points long, but within a week of our interview the first task – seeing through the ratification and then the implementation of the European Pensions Directive, which includes cross-border pension investment, the vetting of trustees, supervision of pension fund investment – has been superceded by the Minister's decision to bring forward the major review of pension coverage that was announced when the PRSA's were introduced, but was only scheduled for September 2006.

Slow progress towards the end of decade target of 70% coverage – it is now at about 52.4% overall says Maher and at 59% for over-30s – and the urgency to divert the billions that will mature in Special Savings Incentive Accounts in 2006-7 – has hastened the progress of this report.

The latest PRSA figures for the last quarter of 2004 show more modest growth in numbers, and more compliance from employers who are obliged to register and set up occupational PRSAs for their employees. "But complying with the law doesn't mean they (the employers) are making any contributions," acknowledges Ms Maher.

The INDECON report into ways to incentivise pension coverage that was commissioned at the end of last year is now before the Board, she says, and its recommendations on how to increase cover will now be included in the preparation of the report to the Minister that must be completed by June.

WIDER PICTURE

Since the PRSAs were first introduced, and the higher pension targets set, the wider pension picture has become cloudier with the problems about funding standards growing in the pension community and further contributing to the concerns about the attractiveness and efficacy of pension membership amongst employees.

The funding standards changes announced in the Social Welfare Bill will go some way to fulfilling the requirements in the EU Directive and in trying to solve the increasingly serious problem of under funding by Irish pension schemes, she says.

In 2004, the Pensions Board received 589 Actuarial Funding Certificates (which is about a third of total DB schemes subject to the Funding Standard and fits in with 3 year valuation cycle). Of those, says Ms Maher, 349 or 59% satisfied the Funding

Standard and 240 (41%) failed the Funding Standard. Eighty-nine of those 240 applied for extensions of up to10 years to meet their funding obligations.

"Of the 151 that did not submit an extension application most can get back to meeting the Funding Standard within the three and a half years allowed under the Pensions Act. A few are discussions with us or are in the process of changes (e.g. mergers). A few have really serious problems."

Mercer Consultants now estimates that the combined pension deficit is €3.3 billion at 31st December 2004 for the ten largest Irish plcs, measured using the new accounting standard IAS19 and information from last year's published financial statements. The combined pension scheme deficit has increased dramatically from an estimated €1.9 billion at 31st December 2003, it says, with the estimated total deficit of €3.3 billion represents more than 5% of the market capitalisation of the top 10 Irish companies.

Anne Maher says it is "a healthy sign" that so many companies are seeking extensions. "The ones that worry me are the ones that we never hear from. A company that puts forward a proposal to return to full funding is a good thing. That said, we would have some concern for some whose plan to get back is very tight and doesn't allow for anything to go wrong in the 10 year plan – and 10 years is the typical extension.

"Ten years can be a very long time. For example, this year it came as a disappointment to many trustees that while investment growth was better than expected – many were predicting 7% returns and they got over 10% - the liabilities have gone up by even more than was expected and that has nullified the investment return.

"Anyone operating on tight assumptions for 10 years is a matter of concern and we'll be monitoring their annual trustee report to see if they are still on their target funding position."

The Directive also requires that trustees be monitored, that their expertise is adequate, and that they personally are of good repute, and as outlined in the Social Welfare Bill, this will be another responsibility of the Pensions Board which will be providing a report on the state of trustees to the Minister by June, says Ms Maher.

Perhaps even more significantly, the Pensions Board will be required to monitor the investment activity of pension funds, all the while keeping an eye on the financial cost to schemes of this added layer of supervision.

"We have not been supervising pension investment up to now, and clearly returns in recent years have not been what they should be," she explains. "One thing we have also become aware of is that the investment profiles of a number of schemes is mismatched with age profile and the ratio of active members to pensioners. There has been too high a focus on equity exposure." Unsure whether this is due entirely to trustee lack of risk awareness or to the quality of the advice they receive, she says it is "an area of concern".

Regulations will be addressing this issue, says Anne Maher, but in the meantime, "I do believe that people are now aware that there is no such thing as a guaranteed pension. Trustees main pre-occupation in the 1990s was double digit and top quartile performance returns and not liability risk. I think that awareness has increased. This higher awareness of risk and performance means that employers with DB schemes now have a clearer appreciation of their commitments. Many are still committed as we have seen by the very high contributions that they have made into their schemes and by the number of applications for funding standard extensions."

However sincere the effort is to tackle the funding standard problem here, the Pensions Board does not support the idea of a UK-type Pension Protection Fund, she says.

"There are a lot of concern in the UK about the cost of this fund," she says, "and compliant employers are very worried that they will be paying for non-compliant ones, about how the contribution will be calculated and also about the moral hazard issues that might arise: trustees could end up saying, 'oh well, if this doesn't work out it will end up with the Pension Protection Fund'. Also, and most worrying is that there is no government guarantee if the money runs out. This happened in the US after a huge number of claims left the fund empty.

"There is enough pressure on Irish employers to get their pensions funded up to standard – it would be the last straw to ask them to fund a protection fund."

CROSS BORDER

The Pensions Board has been at the forefront of developments in cross border pensions that are central to the new Pensions Directive and while the new 100% funding standard requirement for cross border pension schemes will discourage the defined benefit schemes there is scope for DC schemes to be set up, she says.

"Many multi-nationals have set up task groups and while nothing will be happening until the last quarter of this year – the tax implications are immense – we will obviously see all these regulatory changes be put into practice." Pension protocols between the 25 EU pension supervisors are being set up now and will be in place by September.

One proposal that a number of bodies had supported – the creation of the State annuity fund – was not included in the Social Welfare Bill, but it is on the Board's agenda for consideration this year, says Ms Maher who believes a cost-effective state-administered annuity scheme would be of considerable interest to smaller pension funds in particular.

Finally, the Pensions Board will be looking carefully this year at the way it uses it's own resources. "Our supervisory role for occupational pensions has evolved,, rather than being designed while our role in the delivery of PRSA is a product of design not evolution," she says. "We now have to assess if we are spending our time and resources – which result in compliance costs to schemes – in the best possible way. Initially we found a large number of schemes that were not doing what they should, but that number has fallen and compliance has improved." Big companies, she notes, don't just have compliance officers these days, they have compliance units."