SECTION 48 – The Priority Order

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Agenda

- Current framework
- Principles for a new framework
- Potential structure

Introduction

- Section 48 sets out method for distributing assets of a defined benefit scheme on wind up
- Department of Social Protection currently reviewing it
- Enshrined in legislation in 1991 - good reasons for it
- Pension plans were in a very different position then!

Current Framework

- Pensioners (current level) are bought out before active and deferreds get any benefits
- As a result, actives and deferred lose out when an insolvent scheme winds up

Note, increases to pensions in payment were moved down the priority order in 2009 – only impacts a minority of schemes

The case for change - now

- The current framework is not compatible with inter-generational solidarity
- Framework is not helped by current economic conditions
- Is the concept of a 100% guaranteed income in retirement still appropriate?

The case for change – looking ahead

- "…The risk carried by the shrinking population of active and deferred members will become more pronounced over time…"

- "…Active members who may have increased their contributions and/or agreed to benefit reductions could receive no benefits on a scheme wind-up in the future…"

But change will not be easy

- Any change in such a sensitive area will be problematic
- There is no perfect or easy solution
- Fairest structure might be to share the risk equally between all members but this is unlikely to be achievable
- Sometimes, there may simply not be enough assets

Principles for a new framework

- Risk should be shared between all members
- Priority to pensioners for a minimum level of pension
- For pensions above the minimum, Trustees may avail of settlement options other than annuities – so option similar in nature to an ARF

Potential structure

Society of Actuaries in Ireland Strawman

Priority	Pensioners		Active/Deferred
	Pension <€6k	Pension >€6k	
1	100% Annuity	75% converted to ARF	-
2			75% transfer value
3		25% converted to ARF	25% transfer value

Example

- Mature Scheme
  - Pensioner liability €100m
    - Liability for pensions <€6k = €50m
    - Liability for pensions >€6k = €50m
  - Active and Deferred liability €100m
  - Total liability €200m

Example

Assets / Funding level	Status Quo		New structure		
	Pens	Act/Def	Pens		Act/Def
			Annuity	*Annuity/ARF*	
€100m / 50%	100%	0%	81%	*89%*	19%
€140m / 70%	**100%**	**40%**	**81%**	***89%***	**59%**
€180m / 90%	100%	80%	88%	*96%*	92%

Wider Application

- Schemes which are not sustainable and will wind up
- Schemes which are or can become sustainable and continue to operate
- Schemes which are ‘in the balance’

Wider Application

- The ARF-like option should be made available in ongoing schemes.
- The Minimum Funding Standard (MFS) should reflect a proportion of the pension will be on ARF terms.
- Some schemes may be able to avoid wind-up and become sustainable.

Not a panacea

- Lower protection for pensioners but increased flexibility
- Some potential challenges
  - Minimum amount of pension might favour low pensions from short service rather than long serving members
  - Tighter consumer protection needed to protect pensioners moving into ARFs…..
- Detail needs to be worked out

Conclusion

- Reform of Section 48 is essential and urgent
- We urge the Minister to explore the principles in depth before deciding on a replacement framework
- Potential to achieve a more equitable distribution of assets on wind-up
- The Minimum Funding Standard should be amended to ensure consistency with Section 48