

CHAIRMAN'S MESSAGE FROM PATRICK BURKE

WHEN GOVERNMENT INTERVENTION BECOMES AN IMPERATIVE



Patrick Burke

There are a number of significant institutions and sectors within the economy where, in order to protect the common interest, government and regulatory policy are inextricably linked to, and dependent upon, private sector infrastructure. This means that in times of crisis Governments and regulators must take bold steps to overcome threats to the sustainability of such institutions and sectors. Failure to deliver adequate support where the risk of institutional collapse is imminent can threaten the public interest which the Government is elected to protect.

Over recent weeks this has been clearly illustrated across the globe by Government and Central bank supports to the banking and financial services sector. The actions of our Minister for Finance, Brian Lenihan T.D., in providing an interim guarantee to the Irish financial system have been broadly praised and yet, at this point, the impact of this guarantee on the public finances – relative to its positive impact on our ability to continue to trade - has been limited.

Occupational pension schemes in the private sector are estimated to have lost over one third of their value in the last 12 months, approximately €25bn, and anecdotal evidence suggests that at least three out of every four defined benefit schemes are in deficit when measured against our current Funding Standard.

Over the next nine months the vast majority of these schemes and their sponsoring employers will be required to develop funding proposals which will make good these deficits. In the teeth of a global recession and significantly depressed forward earnings many employers will be unable to meet the demands of this regulatory framework. It is simply unrealistic to expect that losses of this magnitude can be restored within the short term timeframes of the current funding standard.

As a consequence, we expect some schemes will collapse leaving active and deferred members (regardless of age and circumstance) with substantial shortfalls.

The Government must now focus its attention on the private sector defined benefit system and must urgently decide how it will support the system in this crisis. It is clear that intervention is essential to secure the common good and, as with the banks, it may be possible for the Government to provide some of the support required without significantly impacting public finances. Adjustments to the Funding Standard, enhanced security (targeting a socially desirable minimum level/proportion of benefit) and the development of a State Annuity Fund – on a cost neutral basis – are each central to the interventions that are now required as a matter of urgency.

While there are many opinions on how the Funding Standard might be improved to protect the security of member benefits and the sustainability of the system there seems to be unanimity that change is required. We have spent many years debating the point and, given the extent of recent market losses, we now have a very short window to conclude. In this context, IAPF will intensify discussions with kindred organisations including the Society of Actuaries to develop the broadest possible consensus on the changes that should be implemented.

There are many criticisms levelled at the cost and sustainability of public service pensions. However, the system itself has one significant advantage which warrants consideration in the context of the crisis facing private sector defined benefit schemes. The public service pension system effectively runs a State Annuity system for its pensioner liabilities, spreading the burden of mortality improvements on an inter-generational basis and enabling significantly enhanced efficiencies relative to private sector annuity costs.

IAPF believe that the State should extend this principle to the private sector – on a nil cost basis. Extending this annuity mechanism (in limited circumstances) would enable a safety net for a socially desirable minimal level of pension, in the event of insolvent collapse, and would amount to a partial restoration of the equilibrium between private sector and public service pensions.

Such a move would also facilitate an adjustment of the funding standard to measure the economic cost of pensioner liabilities as opposed to the annuity cost. It would also serve to facilitate the strengthening of the security of this socially desirable minimal level of pension beyond current solvency standards (which measure the security of all benefits) allowing remaining benefits to operate with more flexible solvency requirements. In the interests of member security, any re-structuring along these lines may necessitate measures to strengthen the employer covenant and to prevent abuse.

As Minister for Social and Family Affairs, Mary Hanafin TD is facing a crisis point where private sector defined benefit schemes urgently require State support. The Minister has committed to bringing the Green Paper process forward in a Framework document before the end of the year and it is essential that the Funding Standard is comprehensively addressed at this point. However, it is essential that she is not alone and that her Cabinet colleagues recognise the extent of this threat to the public interest before the current weakness is exposed in real terms. There are 250,000 private sector workers dependent upon the Governments response.

IAPF Guide

A consumer-friendly guide to planning for retirement aimed at those who are in or considering a defined contribution (DC) scheme has been launched by the IAPF (see www.IAPF.ie for details.)