

IAPF Trustee Forum

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presentation by

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I would like to thank the Irish Association of Pension Funds for the opportunity to speak at the Trustee Forum. The Forum is a valuable resource for trustees, and The Pensions Board welcomes the opportunities it provides to speak directly to trustees and to hear their views.

My objective this evening is not to make any announcements or to give instructions. Instead, I would like to use the opportunity to share some perspectives on the position and responsibilities of trustees of defined benefit schemes, and to give you something to think about. I would also welcome your questions and comments.

Let me start by talking about where we are at present:

- In mid-October, The Pensions Board deferred the deadline for the submission of funding recovery plans, or applications for benefit reductions. This was in response to the Government announcement that they were accelerating a review of all defined benefit issues raised in the National Pensions Framework. This review will include alternative defined benefit models, scheme governance and the funding standard. Because these are all issues relevant to the decisions that scheme trustees and sponsoring employers have to make about how to deal with deficits, the Board decided to defer the funding standard deadline.
- As a result, we are in the position that there is no funding standard in effect at present, and there has not been since 2008. Obviously this is not a position that The Pensions Board is comfortable with, and it is our intention to set a revised date as quickly as possible. However, we cannot set a new

deadline until the details of the intended changes are clear. There is a great deal of work being done in the background on the defined benefit review, and I hope that we will be able to announce revised dates in early January. But for the moment, we cannot be certain.

- When the funding standard deadline is announced, the time allowed to trustees will be as short as is reasonably possible. It is therefore important that trustees use the time they have available now to think about the management and the future of their schemes, and prepare themselves for the decisions that will have to be taken. In recent years, most trustees have spent their time worrying about the next actuarial funding certificate, and many have not had the opportunity to sit back and take a longer view of their scheme. Now is that opportunity. I suggest that trustees use this opportunity to consider the topics of risk and long-term cost.
- The trustees of the typical Irish defined benefit scheme are facing not one dilemma, but two: the deficit in the scheme – the shortfall in the cost of past service benefits – and the cost of providing future benefits.
- I will not say much this evening about deficits. You do not need to be told about how serious and difficult an issue it is. It is self-evident that the deficit can only be tackled by reducing the commitments to scheme members or by increasing contributions, and there is nothing that The Pensions Board or anyone else can do to change this. Trustees have in many cases to face the difficult task of identifying the most acceptable solution, in consultation with the sponsoring employer and in many cases with members and trade unions.
- However, even if the deficit were solved tomorrow, you would still be facing a significant challenge. This is because the ability of most defined benefit schemes to respond to adverse events is much less than it used to be.
- In the traditional defined benefit scheme, when conditions are good, employer contributions are reduced, and when conditions are poor, employer contributions are increased. However, we are now in the situation where very few employers are able or willing to increase contributions further. Even an employer who is prepared to agree to contribution increases now cannot be assumed to be willing to increase them in the future. In many schemes member contributions have increased: in some, they will increase shortly. But the scope for increasing member contributions is usually very limited indeed.

- So in most schemes, contributions are now or will shortly be as high as they can go, and the contribution rate will in effect be fixed – a defined contribution arrangement. However, in a normal defined contribution scheme, in bad years the value of benefits falls. This cannot or should not happen in a defined benefit scheme. So, if you cannot increase contributions, and you cannot reduce benefits, how will you deal with the risks that the scheme will inevitably face? There will always be some years where investment returns are poor; it seems likely that life expectancy will continue to increase. But unless trustees have a strategy for dealing with such risks, they are not managing their scheme properly.
- I am not trying to tell you the answer: there is no single answer. But it is very important that trustees consider this issue and identify the best answer for their own scheme. It is important also to make one point: hoping it won't happen or hoping that something will turn up is not a risk management strategy.
- The other issue for trustees to consider is the long term cost of the scheme. This doesn't depend on the funding standard deadline, and is arguably more important anyway. As a trustee do you know the cost? How optimistic is the calculation? How much might it vary? Are you depending on high equity returns? What happens if you don't get them?
- In thinking about cost, it is important to be as objective as possible, and not to be influenced by the answer you might like. It is especially important not to begin in terms of whether the current contribution rate is adequate. That should be the final part of the consideration, not the first. It is important also to remember that there cannot be one single answer: you should examine a range of costs, and consider what you will do if the higher figures turn out to be correct.
- The role of trustee is demanding, especially in current circumstances, and often trustees do not get enough credit for their heavy responsibilities. In carrying out the role, you have an obligation to be as informed as possible, and to be objective. It is not the task of trustees to facilitate optimism of employers or members, or to tell them what they may want to hear. In the long run, trustees will do themselves and all others concerned with the scheme most good if they look at scheme funding from all angles.
- It is certainly not the objective of The Pensions Board to reduce or damage defined benefit provision: on the contrary, we are trying very hard to make it work and to ensure that it has a future. But defined benefit will only have a

long term future if those involved, and especially trustees, thoroughly understand the pressures and vulnerabilities of schemes, and if they think about risks and how to deal with them, and if necessary, evolve more flexibility structures to provide benefits for scheme members.

- Thank you for your attention.