

## PENSIONS BOARD EXTENDS TIME TO SUBMIT FUNDING PROPOSALS

Current market circumstances mean that three out of four schemes may currently fail to meet the funding standard. This is a significant increase when compared to the one in four as noted in the Government's green paper on pensions in 2007. Irish managed pension funds are down approximately 33% in the year meaning that any scheme which had assets slightly in excess of the funding standard liability could currently be underfunded. As soon as a funding issue is discovered a funding solution must be put in place in the form of a funding proposal.

The trustees of defined benefit pension schemes must put a funding proposal in place in two circumstances:

1. where the triennial Actuarial Funding Certificate (AFC) indicates that the scheme cannot meet its liabilities if it were to wind up on the effective date of the AFC; and
2. if the actuary's statement in the scheme's annual report, 'the intervalation statement,' is negative i.e. where the actuary's opinion is that the scheme cannot meet the required funding standard on the last day of the year to which the annual report applies.

In the first case a funding proposal must be finalised and submitted to the Pensions Board within nine months of the AFC's effective date. In the second case the trustees must arrange for an AFC to be prepared and for a funding proposal to be submitted within 12 months of the last day to which the annual report refers.

In light of the fact that it is extremely difficult to finalise funding proposals in the current climate the Pensions Board has decided to allow additional time for the preparation of funding proposals. The timescale for completion of funding proposals in respect of AFCs with an effective date between December 31, 2007 and December 31, 2008 will be 18 months in all cases. However, this is a temporary measure and the normal deadline (nine months) will apply for AFCs with an effective date on or after January 1, 2009.

It is important to note that the extension applies to the finalisation of funding proposals only. No additional time is being granted for the submission of AFCs which must be prepared and submitted in accordance with statutory deadlines.

### PENSION PROVISION CURTAILED IN TOUGH BUDGET AND FINANCE BILL

#### TAX RELIEF

In what was hailed as the toughest budget in a generation, the Minister for Finance has included provisions which will significantly impact on pension provision for higher earners.

A corner stone of the Irish pensions regime is that individuals get income tax relief on pension contributions made by them. There are, however, limits on the contributions that can benefit from tax relief. These limits are in age bands on a sliding scale. The older the individual, the higher the contribution that can be tax relieved as a percentage of remuneration. The aim of this is to allow older tax payers who have a shorter time span to retirement to make up any pension shortfall.



An income cap was introduced a few years ago so that high earners above the cap would only get tax relief as a percentage of the income cap. The 2008 cap is €275,239. The budget change is that from 2009 this cap is to be reduced to €150,000. The effect of this is to change the limits as follows:

AGE	LIMIT ON CONTRIBUTIONS AS % OF REMUNERATION	2008 LIMIT	2009 LIMIT
UP TO 29	15%	€41,286	€22,500
30 - 39	20%	€55,048	€30,000
40 - 49	25%	€68,810	€37,500
50 - 54	30%	€82,572	€45,000
55 - 59	35%	€96,334	€52,500
60 OR OVER	40%	€110,096	€60,000

This reduction in the cap curtails pension provision for older individuals who are in 'catch-up'; but it does not impact on employer contributions to an occupational pension scheme. Accordingly, there is scope in occupational schemes for additional contributions to be paid by the employer.

The budget measures could have been worse. No radical changes were made to the pensions regime. Furthermore, the lifetime maximum fund an individual can have has not been reduced; it has been kept at €5,418,085 but will remain at that figure in 2009 instead of being increased in line with the normal earnings index.

#### NEW LEVY

The new levy of 1% of income up to €100,100, 2% in excess of €100,100 and 3% in excess of €250,120 applies to gross income, so it will not be possible to use pension contributions to obtain tax relief against this levy. The 3% rate was introduced in the Finance Bill.

#### STATE PENSION

The State pension is to increase by €7 per week to €230.30 per week. This is a modest increase which is going to cast some doubt on the Government's commitment in the Programme for Government to increase the State pension to €300 by 2012.

## POSSIBLE MODELS FOR THE FUTURE SHAPE OF PENSIONS IN IRELAND

In October 2007 the government published its discussion paper on the future of pensions in Ireland. This was followed by a consultation period when comments were invited from interested parties.

During this period, submissions were received from almost 400 individuals and organisations, including pensioners, employees, trade unions, companies, employer bodies, pension professionals and financial institutions. The views expressed varied by background and following is a summary of the potential future models that received support.

For the purpose of clarification, please note that the phrase 'second-tier' (used throughout the Report) means private occupational pension schemes, while 'first-tier' means the State Social Welfare pension.

### STATE EARNINGS RELATED PENSIONS

Where the Social Welfare system would provide additional pensions related to the level of a person's income, probably on a career average basis. This would inevitably call for greater social insurance contributions, which might be seen as an additional taxation on employers and employees. Given the experience of our nearest neighbour with earnings related pensions, this would have to be approached with great caution.

### MANDATORY SECOND-TIER PENSIONS

Where employers would be obliged to provide occupational pension schemes and employees would be obliged to join. Several variations on this theme were put forward, including defined benefit or defined contribution alternatives, level of contribution/benefit, cost sharing and whether it would be best funded privately or through the State.

### INCREASED SOCIAL WELFARE PENSION

The current flat rate State pension is around 34% of average industrial earnings. One proposal would be to increase this to 40% or more. This may also lead to an increase in social insurance contributions, but it may also reduce pressure on integrated defined benefit schemes.

### SOFT-MANDATORY SECOND-TIER PENSION

An individual would be automatically included in an occupational pension scheme on becoming employed or soon thereafter. A person would be entitled to opt-out by signing a disclaimer. It is believed that only a minority of people would exercise the 'opt-out.'

### STATE SPONSORED RETIREMENT SAVINGS

This would be similar to the Special Savings Incentive Account (SSIA) which was a major success a number of years ago. Instead of having a term of five years as with the SSIA, these pension products would be targeted towards a person's retirement age. At retirement the government could provide an annual income in return for the value of the member's accumulated fund.

### PRIVATE SAVING

As an alternative to providing financial security through first or second-tier pension plans, some groups have suggested that more could be done to encourage people to increase levels of private saving, perhaps by introducing new investment options.

### MAINTAIN CURRENT SYSTEM

There was support for continuing as we are, but with some internal enhancements, such as increasing the tax incentives or giving greater access to Approved Retirement Funds as an alternative to compulsory annuity purchase at retirement.

## VARIABLE RETIREMENT

Another important aspect discussed was retirement age. While most schemes have a stated retirement age of 65 and the State pension comes on stream at this age, there is an increasing variation in the time that people actually retire. Increased life expectancy would be expected to result in people retiring later, but earlier retirement remains an aspiration for a large proportion of the workforce. Probably the best way to tackle this dichotomy, would be to have flexible retirement ages, both in the State scheme and in private occupational schemes.

The government's objectives in starting this process were to come up with a formula that would encourage people to participate more in provision for their retirement and to increase the level of income in later age. At present, we await the government's response to these suggestions, as to which model will potentially best fit these objectives.

## ACCOUNTING FOR PENSIONS IN COMPANY ACCOUNTS

The collapse of equity markets around the world will have a big impact on company accounts at year end for companies with Defined Benefit Schemes. The return on the average managed fund for the year to date November 30 is -33%. The investment loss to be reflected in the accounts is the difference between the achieved return and the expected return on the assets. For many Schemes, this will be over half of the value of the assets at year end. The recognition of this loss depends on the accounting standard being applied but under all of the major standards, the loss will reduce the pension asset/increase the pension liability on the company balance sheet.

The investment loss is likely to be the major item of discussion when accounting results are considered. However, there are a number of other material items that would probably get far greater attention in any other year:

### 1. DISCOUNT RATES

The credit crunch has caused a sharp increase in the yield available from corporate bonds. This will cause an increase in the discount rate used to value the pension liabilities and a gain to offset some of the investment losses. The variation in the yields available on AA corporate bonds has increased significantly so there is likely to be an increase in the variance of discount rate used by companies. Auditors are likely to take an increased interest in the discount rate used so early discussion with the auditors is advisable, particularly if there are tight reporting deadlines.

### 2. INFLATION RATES

The long-term market implied rate of future Eurozone inflation has reduced dramatically in the last few months to less than 1.5% per annum from nearly 2.5% per annum at the start of the year. This could result in a reduction in the expected inflation, pensionable salary inflation and pension increase assumptions. This could produce gains that would offset some of the investment losses.

### 3. MORTALITY IMPROVEMENTS

A study recently published by the Society of Actuaries shows that there have been greater than expected improvements over the last few years in the expected life expectancy of Irish pension members. In addition, projected future improvements have increased. Both of these factors will add to the pension liabilities and cause liability losses.

The deterioration in the pension position to be shown on company balance sheets at year end may not be as bad as the losses in equity markets might suggest due to other material changes that need to be considered. The net change could be a combination of four large changes and the auditors will be examining each so it is important that there is early engagement so that there are no last minute surprises.