The Actuarial Profession
making financial sense of the future

Pensions, benefits and social security colloquium 2011
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The Irish Pensions Scene

Surviving the financial crisis

25-27 September 2011

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Structure of presentation

- Ireland – general economic background
- Irish pension system – long term challenge
- The impact of the financial crisis
- Irish pensions in crisis – the Regulator's view
- The future for Irish pensions
- Questions and views from the floor

Ireland - the "Celtic Tiger"

- The late 1990's/early 2000's were a period of very strong economic growth in Ireland
- Inward migration (both returning Irish and foreign nationals – particularly from new EU member states)
  - Population increased from 3.5m in 1991 to 4.6m in 2011
- Easy availability of credit and low interest rates led to high borrowing, both personal and corporate
- Banks' loan books grew rapidly (risk controls?)
- Tax revenues strong, mainly property-related
- Public expenditure increases – public sector numbers and salaries, State pensions and other benefits, development
- Price and labour cost inflation above EU levels

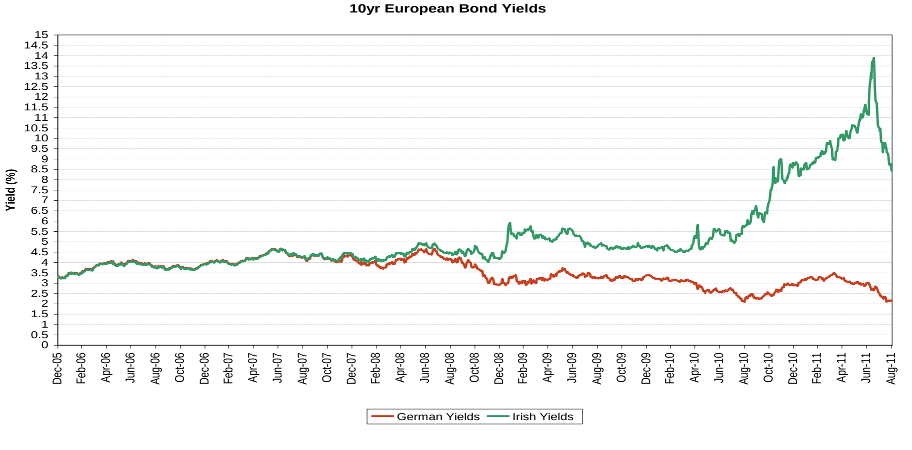
Where did it all go wrong?

- International financial crisis led to concerns about Irish banks
- Government guaranteed all bank debts on 30 September 2008
- Banks unable to raise capital or borrow – Government intervention (now all but 1 nationalised – total cost up to €80bn)
- Property prices collapsed – many developers became insolvent and NAMA established to buy "toxic loans" from banks
- Recession – GDP fell by almost 10% in 2009
- Unemployment increased from 4.5% to 14% in 4 years
- Huge budget deficit as tax revenues collapse
- State unable to borrow on international markets (yields > 12%)
- EU/IMF/ECB "bailout" in November 2010

Where are we now?

- National Recovery Plan agreed with EU/IMF/ECB
  - Reduce budget deficit to 3% of GDP over 4 years
- New Government elected in February
- Some reduction in public sector costs – salary cuts, pensions related deductions, voluntary redundancies, recruitment moratorium
- Tough budgets expected in next 3 years (at least)
- But some positive signs
  - Recovery Plan targets being met
  - Reduction in borrowing costs under bailout
  - Record trade surplus in June 2011
  - Fall in yields on Irish government bonds

German v Irish 10 Year Yields



The Irish pensions system

- State Retirement Pension - €12,000 (£10,600) p.a.
- 50% supplementary coverage
- DB/DC mix
- 80,000+ active schemes
- Defined benefit
  – No formal employer liability
  – Funding recovery plans
  – High equity exposure

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The role of the actuary

- Historic focus on “recommended contribution rate”
  – a single number, not a range
  – more emphasis on reward than on risk management
  – reliance on “sponsor covenant” in balance of cost plans
- Investment risk
  – more diversification as Eurozone became “domestic” market but still strong Irish bias (financial stocks, property…)
  – asset liability modelling, some de-risking
- Future mortality improvements
  – addressed in mid 2000’s (“standard transfer value basis”)
- Increased importance to companies of accounting requirements

Long term challenge

- Adequate and sustainable pensions for all
  - Basic State Pension as first pillar
  - Supplementary pensions (occupational, personal) to achieve desired level of retirement income
- Pressure on State pensions
  - Increasing longevity and reducing dependency ratio
  - Less severe than many other countries
  - National Pensions Reserve Fund
- Supplementary pensions
  - Increase coverage
  - Improve security

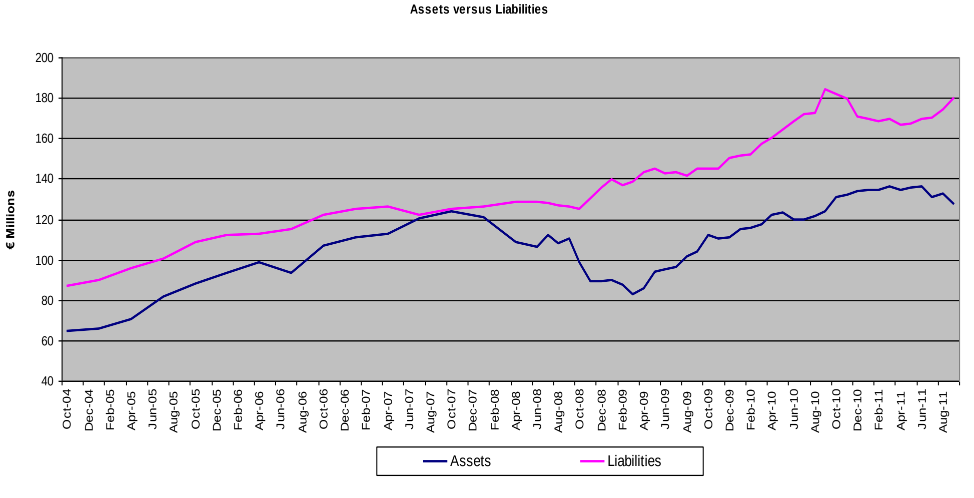
Green Paper consultation – September 2007

- SAI response focused on
- Adequacy
  - increase State Pension rather than mandatory second pillar
- Sustainability
  - raise State Pension Age from 65
- Security
  - Current DB system over-promises and under-funds
  - Current employees exposed to greater risks
  - Provide increased transparency

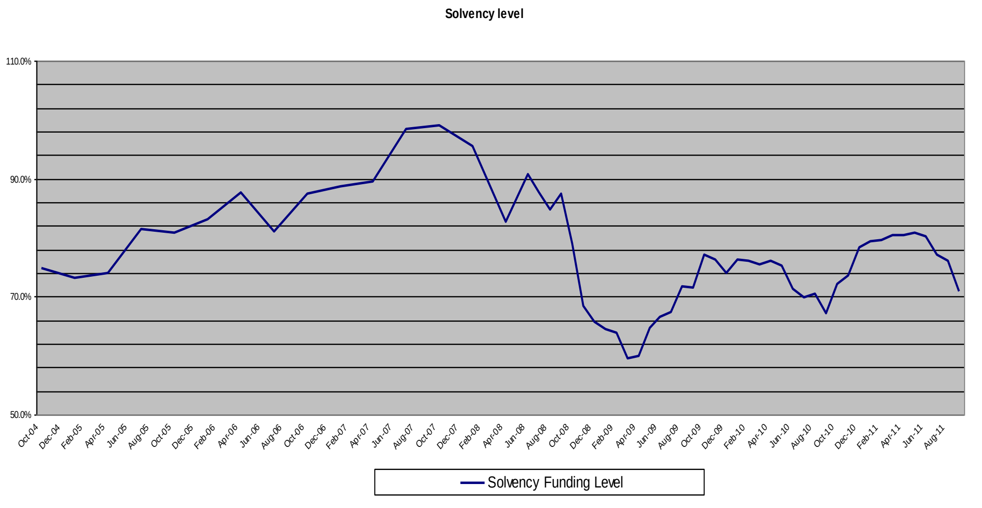
National Pensions Framework - March 2010

- State pension to maintain real value relative to earnings
- Increase State Pension age
- Auto enrolment scheme for those without pensions
  - From 2014, if economic circumstances permit….
  - 8% contribution on band of earnings (includes tax relief)
  - Choice of funds with low risk default
- Tax relief on member contributions to be harmonised at 33%
- Retirement lump sums over €200,000 to be taxed
- Career-average pensions for new public sector employees
- New model DB scheme – more flexible and sustainable

The impact of the financial crisis



Impact on solvency funding level



Proposals to address crisis in DB schemes

- Joint approach to Government by SAI and IAPF in late 2008
- 4 key proposals:
  - Extend power to reduce accrued benefits
  - Introduce debt on employer provisions to prevent solvent employers abandoning their pension commitments
  - Reduce extent of priority for pensioners
  - State to provide “not-for-profit” annuities on wind-up
- Insolvency of Waterford Crystal in early 2009
  - active members’ benefits significantly underfunded

Legislative change

- Pensions Insolvency Payment Scheme – mid 2009
  – annuities provided by State in "double insolvency" cases
- Social Welfare and Pensions Act 2009
  – reduced priority for future pension increases on wind-up
  – greater powers to amend accrued benefits (Section 50/50A)
- Still reliant on "voluntary" sponsor covenant but more explicit (extended funding proposals, Section 50 applications)
- Sovereign annuities – pass sovereign default risk to pensioners
  – Enabling legislation late 2010
  – Products not yet available
- State Pension age raised from 2014

The crisis

- 1990s
  – High equity returns
  – Large surpluses
- 2000
  – Large increase in contributions
  – Strong economy
- 2007
  – Large losses

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Responses

- Legislative
  – Reduction in accrued benefits (‘section 50’)
- Regulatory
  – Longer recovery periods
  – Suspended filing deadline

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Current situation and outlook

- Consideration of new DB model
- Review of DB solvency standard by Government
- Reimposition of filing deadline
- Current debate
  – Risk management
  – Sustainability
  – Balance between provision and security
- DC?

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Impact of financial crisis on pension provision

- Reduction in asset values (DB and DC)
- Fall in high quality bond yields and impact on liabilities
- Pressure of recession on employers/individuals
- Reducing retirement provision
- Focus on unfunded public sector pensions
- Use of National Pensions Reserve Fund to support banks
- Curtailment of tax reliefs for pension saving
- “Pensions levy”

The future….

- Less generous supplementary pensions
  - DC or hybrid rather than “final salary”
  - Less risky/lower reward investment strategies?
  - Tax incentives reduced
  - Retire later
  - Greater reliance on State?
- More onerous regulation
  - EU driven following the financial crisis
  - Solvency II style capital requirements?
  - More formal sponsor covenant?
- The role of the actuary?