DB Schemes – they haven't gone away you know…

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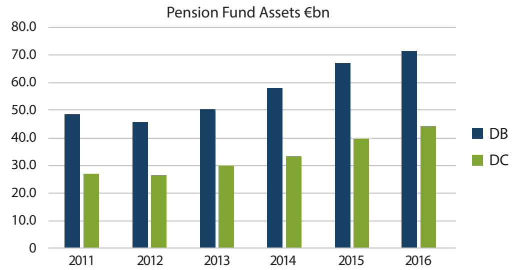
The future for defined benefit schemes is considered by Frank Downey.

Despite the fall in number, the assets held for defined benefit (DB) schemes are still very significant, with a total value of around €72bn in 2016. In fact the share of total pension scheme assets represented by DB schemes has only changed marginally from 64.3% in 2011 to 62% in 2016[1].



The total number of funded DB schemes in 2016 was 666 (excluding schemes in wind up), which represents a reduction of around one third from the number in 2011 and almost 50% from the number in 2006[2]. In addition most funded DB schemes are closed to new members and around 28% are closed to future accrual of benefits.

The total membership of funded DB schemes is currently over 650,000 which is made up as follows:

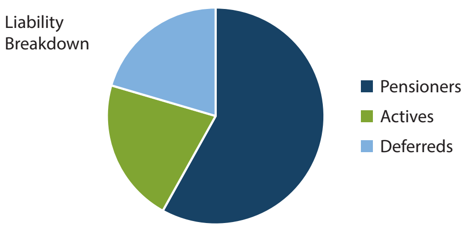
	Number	Average Liability
Pensioners	100,585	€336,000
Actives	121,995	€102,000
Deferreds*	430,518	€28,000

** includes active members no longer accruing benefits*

This shows that very many individuals, especially pensioners, have a significant benefit from and interest in a funded DB scheme.

The number of active members accruing benefits in funded DB schemes has fallen from around 239,000 in 2006 to approximately 100,000 today, which is broadly in line with the percentage decline in the number of schemes. By contrast the number of active members accruing benefits in unfunded public sector schemes has risen from around 258,000 in 2006 to 339,000 in 2016.

Funded DB schemes are increasingly maturing. Currently over 58% of liabilities (as measured under the statutory funding standard) are in respect of pensioners with the balance almost evenly split between active and deferred members.



So what is the future for the remaining DB schemes as we move towards a long run off phase? Trustees and scheme sponsors will generally be seeking to preserve as much as possible the current benefit promises and achieve the best outcome for all stakeholders.

At the end of 2015, 70% of funded DB schemes satisfied the statutory funding standard[3], although larger and more mature schemes were more likely to be in deficit. Of the 203 schemes in deficit, all but nine schemes had a funding proposal in place, most of which would have been "on track" at the end of 2015. So that's all good? Well not quite.

The funding standard itself is not a true measure of the long term cost of a pension scheme. It values pensions in payment on an annuity buy out basis (which might typically involve a "premium" of 20%), whereas liabilities for active deferred members are valued by reference to a now relatively weak standard transfer value basis. This means that as schemes continue to mature, satisfying the funding standard will become an increasing challenge.

The additional funding standard reserve requirement for liabilities not matched by bonds and the obligation to do a funding check at the end of each scheme year highlights other issues with the funding standard. The problem with the latter was well illustrated in 2016. Due to a further fall in bond yields, many schemes would have fallen into deficit or had their funding proposal go off track in 2016 if their year-end date is, say, 31 March, 30 June or 30 September. A positive fourth quarter meant that the position was more favourable at the end of 2016 which helped schemes with a 31 December year-end date. However it hardly makes sense to have to make significant changes just because of an unfavourable result at a particular year-end date.

A fundamental overhaul of the funding standard regime is required and it should be replaced by a scheme specific funding requirement based on the true long term cost of the scheme. In the short term, the funding standard reserve requirement should be removed and more flexibility on annual funding checks should be introduced. These changes may help avoid unnecessary benefit reductions and wind ups. The objective of pension policy should be to help achieve the best outcome for all members and stakeholders. This objective is not served by the current funding standard.

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1 *IAPF Investment Surveys*
2 *Pensions Authority Annual Reports*
3 *Pensions Authority – Defined Benefit Schemes Review of 2015 Statistics*