An Roinn Caiteachais Phoiblí
agus Athchóirithe
Department of Public
Expenditure and Reform

Circular 12/2014

27th June 2014

To: Secretaries General

A Dhuine Uasail,

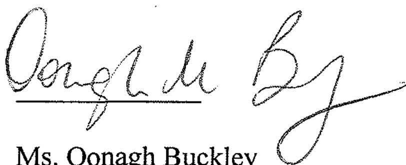
1. I am directed by the Minister for Public Expenditure and Reform to attach at Appendix I a guidance note to apply to the assessment, by the relevant line Department and the Department of Public Expenditure and Reform, of pension scheme funding proposals developed by commercial State companies and any other State bodies with similar pension scheme funding arrangements.

2. The note is to be considered effective from 14 April 2014.

3. This guidance note should be brought to the attention of any commercial State companies and any other State bodies with similar pension scheme funding arrangements under your aegis.

4. Enquiries in regard to the proposed use of contingent assets as part of a pension scheme funding proposal should be addressed to the relevant Vote officer in the first instance.

Mise le meas,



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Appendix I

Assessment of Pension Scheme Funding Proposals

Introduction

There are two main forms of actuarial deficit that can arise in the case of funded Defined Benefit (DB) pension schemes:

(i) a deficit based on the Minimum Funding Standard (MFS) requirements - a technical measure set by legislation, being the shortfall between the current value of scheme assets and what would be required in a wind-up situation to meet the scheme's accrued liabilities at that moment in time, with a potential further allowance to cover a risk reserve; and

(ii) a longer-term actuarial deficit, based on the scheme continuing to operate into the future and taking account of projected future contributions into the fund plus projected investment returns as compared with projected future liabilities of the scheme.

For some sponsoring employers (including many State bodies), this means that cash contributions need to be paid into schemes failing to meet the MFS. In light of this, the Department of Public Expenditure and Reform has examined alternative financing to an immediate cash injection. This includes the use of some of the assets of the sponsoring body to satisfy the MFS or funding deficit and allow for a longer scheme recovery period.

General Principles

The asset or security that is provided can be contingent on the occurrence of specified events e.g. employer insolvency or failure to achieve a pre-agreed scheme funding level. The use of such assets to replace cash contributions into the pension scheme can also be used to support a lengthened scheme recovery plan. An agreement with pension scheme trustees to put in place some form of additional security can be a way of supporting the scheme without causing unnecessary adverse impact on the cashflow of the sponsoring body.

The use of such assets must be used as a last resort and where a **real and unavoidable** obligation on the sponsoring body exists to help the relevant scheme meet the MFS or other funding deficit. It is to be noted that there are complexities involved with the use of contingent assets to meet the MFS. These may include:

- taxation
- accounting
- legal issues
- credit rating

There is no general or blanket policy of approving the use of company assets as contingent assets to meet deficits in DB pension schemes of State bodies. Any proposals to pledge company assets will require **specific Ministerial/shareholder approval** and will, generally, only be considered in the context of a Funding Proposal to address a Minimum Funding Standard deficit or to meet the requirements of the Funding Standard Reserve.

Policy Framework

The following policy framework has now been agreed by the Minister for Public Expenditure and Reform for the assessment of pension scheme funding proposals of commercial State companies and/or other State bodies, involving the potential use of contingent assets:

1. All proposals of State bodies (whether involving contingent assets or not) should, prior to final agreement between the Board and trustees, be submitted for approval of the relevant line Department, given with the agreement of the Department of Public Expenditure and Reform. Only **following** this approval should the funding proposal be submitted for Pensions Authority / Revenue Commissioners approval.

2. In order to consider agreeing to the use of a contingent asset solution, the following tests have to be met:

   (i) There must be a real and unavoidable requirement, as part of a Funding Proposal to the Pensions Board, to incorporate a contingent asset solution on the basis that the trustees and company have exhausted the actions which they could each conceivably contribute towards restoring the funding position of the scheme;

   (ii) There must be a reasonable likelihood that, in the medium/longer term, the pension fund Minimum Funding Standard deficit is capable of being eliminated without requiring the actual transfer of the contingent asset to the pension fund (at which stage the pledge of the asset to the pension fund or contingent asset agreement would be revoked);

and

(iii) The pledging of a contingent asset must form part of a balanced funding proposal, involving an appropriate sharing of the re-adjustment measures between the employer and the scheme members. This topic should be addressed by the State body in the business case submitted. The business case should also address the assessment of the body of the appropriateness of the level of risk remaining within the pension scheme post the restructuring.

Use of a contingent asset, rather than injection of actual cash or assets, may prevent the "trapping" of cash or assets, to be subsequently utilised by pension scheme trustees in a manner which the employer might not have intended. The potential advantage of such an approach should also be considered with regard to use of a contingent asset.

Terms on which assets may be pledged as Contingent Assets

Assets to be pledged to pension funds or utilised within contingent asset solutions may not include:

(i) Assets of national strategic importance (e.g. infrastructural assets); or
(ii) Assets of fundamental strategic importance to the business of the body.

The extent to which assets may be pledged as contingent assets in this way should not, save for in exceptional circumstances, exceed a limit of 10% of the fixed asset base. Where a contingent asset is utilised towards meeting a Minimum Funding Standard deficit, the proposal should be consistent with the self-investment and concentration of investment limits under the Funding Standard.

The relevant Board must satisfy itself and confirm that the financial implications of the contingent assets proposal (in terms of the impact on the company balance sheet, credit rating, ability to maintain existing borrowings and to continue to source new debt funding) do not pose a problem for the continued operation of the business and that the contingent assets proposal is consistent with the any existing covenants to its lenders.

The detail of the structure of the contingent assets proposal will be a matter for agreement between the State body (hereafter the "Body") and the trustees, subject to compliance with the provisions of pensions legislation and final shareholder approval. However, the following principles must apply:

(i) The circumstances under which the trustees' claim on the assets is triggered must be clearly defined and should give equivalent recognition to the capacity of the Body to be able to operate as a commercial organisation and the obligations of the trustees. The Pensions Authority has specified certain scenarios as being necessary so as to incorporate a contingent asset as part of an MFS Funding Proposal.

This is typically focussed around a failure to pay an Employer pension contribution otherwise due, provided the Scheme continues to fail to meet the Minimum Funding Standard (inclusive of Risk Reserve). In such a situation, where the trustees determine that a contribution by the employer is "due" but unpaid, the agreement of the Body that this is the case, within a limited timeframe, should be required (such agreement not being unreasonably withheld) before the trustees exercise their right to trigger a transfer of the contingent asset on this basis.

(ii) The circumstances under which the trustees' claim on the assets will cease to exist must also be clearly set out and these circumstances should be tested at a minimum every three years and formally reported to the Board of the Body. These circumstances will typically be where the Scheme meets the Minimum Funding Standard (inclusive of Risk Reserve), with a potential time limit also being agreed. The contingent asset agreement should include a facility for the entity to reduce the level of contingent asset available to the trustees in the event that the valuation of the asset exceeds the amount ordinarily expected to be necessary for the purposes originally intended.

(iii) The Body must reserve the right to replace the asset which is pledged with an asset or pool of assets of equivalent value. This will allow the Body flexibility to dispose of or reallocate the asset as circumstances may require. The approval of the relevant line Department, given with the agreement of the Department of Public Expenditure and Reform, should be sought in such instances.

(iv) In the event that control of the contingent asset transfers to the trustees, the contingent asset agreement should facilitate the Body making a reparation payment to the trustees so as to reverse the asset transfer.

(v) The Body will agree to maintain the asset to a certain standard over the period of the agreement. For physical assets, the asset would be maintained with the same standard of care as would have occurred had the asset remained under the unencumbered ownership of the Body.