

Eoghan Gavigan

Die is cast for demise of defined benefit schemes



If I asked 10 people on the street how long they thought pensions had existed, what do you think they would say? Since the 1960s, the formation of the state, or Victorian times? Pensions have been around much longer, since the year 13BC when the first Roman emperor, Augustus Caesar, established a pension that granted a lump-sum payment of 13 times a legionnaire's salary to those who had served a minimum of 20 years in his forces.

Some speculate that the reason was to quell possible revolt by retired soldiers. Yet in AD6, Augustus even had the foresight to set up a fund called the "aerarium militare" to meet future liabilities. This arrangement

would now be called a non-contributory funded defined benefit scheme.

Perhaps indicative of future problems, Augustus's scheme contributed substantially to military spending, which became one of the many reasons for the fall of the Roman Empire.

Despite being part of some workers' remuneration packages, it has been decreed that a defined benefit pension is a promise, not an obligation of the employer, and this promise can be broken without consequence. If the employer hasn't the will or, in the case of the Roman Empire, the ability to meet shortfalls in funding, the scheme creates only the illusion of security in retirement. While

pensions have become more complex since Roman times, the principles are largely the same. The 20 years of service required to maximise the member's lump sum hasn't changed since the reign of Augustus, but a multiple of 13 times final salary may have been too generous.

Augustus may have overpromised because he projected that the percentage of workers who would collect such a benefit would be low, in such a dangerous occupation. Greater than anticipated longevity has proved to be part of the undoing of modern defined benefit schemes, too.

Life expectancies have increased in recent times because of advancements in medical science, thereby

putting a strain on scheme resources.

Today's retirees receive a lump sum at retirement equivalent to only one-and-a-half times their final remuneration; not enough to motivate one to carry out the duties of a centurion, but a valuable staff-retention tool nonetheless.

Augustus paid the pension in full at the point of retirement, perhaps to prevent a coup. I regularly see the disappointment in a client's face when they are told that they have to place a portion of their pension in an approved minimum retirement fund, from which withdrawals are restricted for a period of time. I'm not sure if I would like to deliver the same news to a heavily armed

centurion. Some 2,000 years later, we are still trying to design the perfect pension scheme. Like legionaries, our public servants are well catered for; less so for the general populace.

Defined benefit schemes are in decline, having become too big a draw on funds in recent years, and despite the generous tax relief on offer to savers in defined contribution schemes, not enough people have deferred their consumption to provide a replacement income for when their earned income ceases. Given the unsustainable nature of the state pension, plans have been afoot for several years to introduce auto-enrolment to stimulate saving. Yet the effects of the pandemic on

employers will surely slow down progress.

If and when auto-enrolment does happen, under current proposals it will start with a combined worker and employer contribution of only 3% of qualifying earnings each year, rising to 12% after nine years. As such it is likely to be part of the solution only for younger workers, who have time on their side. It won't bridge the pension gap for most older workers, many of whom will be approaching retirement by the time it is fully operational.

Having been classified as a promise, the die has been cast regarding the demise of defined benefit schemes. In the future, they would be largely impractical anyway

given worker mobility. Yet for many workers of a certain age, they still form a sizeable part of their retirement planning provision.

Nobody can force employers to maintain the funding of the schemes that remain and whose – mainly older – members won't have time to make alternative retirement provisions. Government supports granted to large companies in response to the pandemic could be made conditional on undertakings from them to keep their defined benefit promise.

Never waste a good crisis, as they say.

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