An tÚdarás Pinsean
The Pensions Authority

FAQs FOR TRUSTEES ON SOVEREIGN ANNUITIES

Disclaimer

The Pensions Authority have made every effort to ensure that this guidance note is correct. However, no liability whatsoever is accepted by the Pensions Authority, its servants or agents for any errors or omissions in the information contained in this guidance note or for any loss occasioned to any person acting or refraining from acting as a result of the information in this guidance note.

Date published: January 2013

An tÚdarás Pinsean
The Pensions Authority

Table of contents

1. What is a sovereign annuity?

A sovereign annuity is an annuity issued by an insurance company which is referenced to bonds issued by Ireland or any other Member State of the European Union (**reference bond(s)**) and payments under which can be reduced due to an event of non-performance (see questions 14 and 15) occurring in relation to those reference bonds.

2. What is the difference between a traditional annuity and a sovereign annuity?

Under a traditional pensions annuity, the insurer guarantees to make the agreed payments for the lifetime of the person for whom the annuity is bought. Under a sovereign annuity, the agreed payments can be reduced if there is an event of non-performance in relation to bond(s) to which the annuity is referenced.

3. What is the role of the Pensions Authority?

The Pensions Authority's (the Authority) role is to certify that the sovereign annuity meets the requirements of the Pensions Act, 1990, as amended (the Act) and the Authority. The following are matters for the insurer and will not be part of the specimen policy which the Authority certifies:

(a) sovereign annuity rates;

(b) the bonds(s) which the sovereign annuity is referenced to;

(c) the percentage of the payments under the sovereign annuity which can be reduced due to an event of non-performance (known as the **reference percentage**);

(d) where there is more than one reference bond, the part of the reference percentage which relates to each bond for each time period.

It is important to note that once a bond has been issued by a Member State of the European Union, it can be included as a reference bond for the purposes of a sovereign annuity and payments under that annuity can be reduced if there is an event of non-performance in relation to that bond. The Authority has no role in assessing the creditworthiness or otherwise of the reference bonds underlying sovereign annuities.

In summary, certification of the sovereign annuity policy by the Authority should not be construed as an approval or otherwise of the appropriateness of any individual policy or its use in any particular circumstances.

4. Is there a register of specimen policies certified by the Pensions Authority?

Yes, the Authority maintains a publicly available register of all specimen policies which it has certified. All sovereign annuity policies should carry a registration number assigned by the Authority when the specimen form of policy under which it is issued was certified by the Authority. Trustees are able to access this register to check that the registration number corresponds with a specimen form of policy certified by the Authority.

5. Who can purchase sovereign annuities?

Sovereign annuities can only be purchased by the trustees of an occupational pension scheme (as defined in the Act). Broadly, this encompasses Revenue approved defined benefit and defined contribution pension schemes.

6. When can trustees purchase sovereign annuities?

The trustees of a scheme can purchase sovereign annuities at any time notwithstanding anything contained in the rules of the scheme. However, sovereign annuities can only be purchased by trustees in respect of a person who is receiving benefits under the scheme or has reached normal pensionable age (sovereign annuities cannot be used for any other scheme liabilities).

Sovereign annuities can either be purchased and held by the trustees within the scheme or used by the trustees to discharge the liability of the scheme for some or all of the benefits payable in respect of a person. Where trustees purchase sovereign annuities in the name of the scheme, the liability to which they relate continues to be a liability of the scheme and that liability will not be affected by a reduction in payments under the sovereign annuity due to an event of non-performance. On the other hand, where trustees purchase a sovereign annuity to discharge the scheme's obligations in respect of a person, the scheme's liability to that person ceases and, if an event of non-performance subsequently occurs which results in a reduction in payments under the sovereign annuity, it is that person who will suffer the reduction.

7. Should trustees purchase sovereign annuities?

It is a matter for the trustees of a scheme in any particular case to decide, having taken appropriate legal, actuarial and/or financial advice, whether or not to purchase sovereign annuities. As mentioned above, the Authority has no role in assessing matters such as the reference bonds to be used and their creditworthiness and the percentage reduction that can be applied under the sovereign annuity. Consequently, trustees will themselves need to assess, having taken such advice as they deem necessary, the appropriateness of both the use of sovereign annuities in any particular circumstances and the sovereign annuity terms offered by an insurer.

8. Can trustees be liable for breach of trust if they purchase sovereign annuities and payments are subsequently reduced?

As mentioned above, trustees need to decide whether or not it is appropriate in all the circumstances to purchase sovereign annuities. The Act gives a court the power, if proceedings for breach of trust are brought against trustees for having purchased sovereign annuities, to relieve a trustee from liability (wholly or partly) where it appears to the court that the trustee has acted honestly and reasonably and ought fairly to be excused.

9. How do sovereign annuities work?

It is important that trustees considering the purchase of sovereign annuities understand how it works and take appropriate advice. In summary, some or all of the payments under the annuity will be referenced to one or more sovereign bonds. The basis on which reductions (and any subsequent restorations) of payments will be calculated will depend on the type of policy issued by the insurer. To date all forms of sovereign annuity policy certified by the Authority operate on what is called the cashflow basis. These FAQs assume that the cashflow basis is being used. Trustees should confirm with their advisers or the insurer concerned that any sovereign annuity which they are considering purchasing will operate on this basis.

10. What is the cashflow basis?

This is the basis of reducing payments under a sovereign annuity where a payment due under a reference bond has not been received in full by its due date and the reduction will only reflect the payment not so received (and, in particular, not any anticipated failure to receive future payments).

The policy will set out the bond or bonds to which the policy is referenced. Each payment due under the bond(s) is known as an expected payment. If an expected payment is not received in full by its due date (allowing for any grace period), there is an event of non-performance (see questions 14 and 15 below) and payments under the policy can be reduced to reflect that event of non-performance.

Any payment received that is not an expected payment (and it does not matter if that payment is received during the life of the bond(s) set out in the policy or after their maturity date e.g. through a replacement security) is an event of recovery (see question 20 below) and there must be a restoration of payments under the policy to reflect that payment.

11. Can payments under a sovereign annuity be referenced to more than one bond?

Yes, a sovereign annuity can be referenced to either a single bond or more than one bond so long as each such bond is issued by Ireland and/or another Member State of the European Union. Details of the specific bond(s) must be set out in the policy.

12. What happens after maturity of the only or last reference bond?

Once the only or, if there is more than one, the last reference bond set out in the policy has matured, payments under the policy cannot thereafter be reduced except in limited circumstances. Those limited circumstances are where so provided in the policy and only for a maximum period of 15 months after the maturity date, to the extent necessary to reflect

(a) payments made under the policy in anticipation of an expected payment which is not subsequently received or received in full; or

(b) to allow for the period after an event of non-performance during which no reduction is permitted (see question 18 below).

It should be clear in the policy whether or not this extension of up to 15 months applies.

13. Can new reference bonds be substituted for existing reference bonds during the term of the policy?

No. A reference bond set out in the policy cannot be changed. It is the anchor both in terms of whether expected payments are received and in determining the period during which reductions can occur due to an event of non-performance. That will be the case even if, in reality, that bond ceases to exist, for example as part of a restructuring following an event of non-performance.

Event of non-performance

14. What is an event of non-performance?

This is an event where the payments due under a reference bond (known as expected payments) are not paid, or are not paid in full, by their due date (after any grace period allowed for under the terms of that bond).

15. What is not an event of non-performance?

Only the event outlined in the response to question 14 is an event of non-performance. An event such as

(a) the issuer of the bond declaring an intention not to make payments due under a bond;

(b) maturity of the bond;

(c) early redemption of the bond in accordance with its terms; or

(d) any anticipated failure by the issuer of the bond to make payments due under a bond

does not amount to an event of non-performance.

16. How is the reduction in payments calculated following an event of non-performance?

The reduction in payments under the policy for any time period can only be such amount as is necessary to reflect the payment not received (subject always to a maximum of the percentage of payments set out in the policy and capable of reduction for that time period in relation to that reference bond).

17. What other requirements are there when an insurer is determining the reduction to be applied following an event of non-performance?

The insurer must

(a) take and have due regard to actuarial advice;

(b) have due regard to the policyholder's reasonable expectations (such expectations to be consistent with the nature of the policy);

(c) take no account of any charges, expenses or indirect costs incurred by the insurer arising out of the event of non-performance;

(d) comply with any guidance issued by the Authority (such guidance will be consistent with the nature of the policy).

18. What are the time limits and notification obligations on insurers surrounding making a reduction following an event of non-performance?

On an insurer becoming aware of an event of non-performance which may lead to a reduction in payments under a sovereign annuity

(a) the insurer must notify the Authority in writing, no later than 14 days before the notice referred to in (b) below, of the occurrence of the event and provide the Authority with the information specified in the undertakings given to the Authority;

(b) the insurer must, within one month of becoming so aware, notify the trustees (if the sovereign annuity is purchased in the name of the scheme) or the member (where it is purchased in the member's name) in writing of the event and explain, in a clear and comprehensible manner, what impact the event may have on payments under the sovereign annuity (but this notice does not need to include the amount of any reduction);

(c) the insurer cannot make a reduction until at least three months have elapsed since the notice referred to in (b) above;

(d) not less than one month before payments under the sovereign annuity are reduced, the insurer must notify the trustees or the member, as appropriate, of the amount by, and manner in, which payments under the policy will be reduced.

Where, following an initial event of non-performance, the insurer can reasonably anticipate that further events of non-performance will occur, the above obligations do not need to be complied with by the insurer so long as the notices referred to above have explained the impact of the anticipated further events of non-performance on payments under the sovereign annuity.

Event of recovery/restoration in payments

19. After reduction, can payments be restored?

Payments can be restored if there is a subsequent event of recovery.

20. What is an event of recovery?

An event of recovery is where, following an event of non-performance, any payment is received other than an expected payment. It does not matter if the payment is received before or after the maturity date of the reference bond.

21. Does the insurer have discretion as to whether or not to increase payments where an event of recovery occurs?

No. Once a reduction has been made following an event of non-performance, the insurer must restore payments to take full account of a subsequent event of recovery. The restoration must be calculated and applied in the same manner as the reduction was calculated and applied following the event of non-performance.

22. What are the time limits for making a restoration following an event of recovery?

The insurer must

(a) notify the Authority in writing, no later than 14 days before the notice referred to in (b) below, of the occurrence of the event and provide the Authority with the information specified in the undertakings given to the Authority;

(b) within one month of becoming aware of the event of recovery, give written notification to the trustees (if the sovereign annuity is purchased in the name of the scheme) or the member (where it is purchased in the member's name) of the event and explain, clearly and comprehensively, what impact it may have on payments under the policy;

(c) within three months of the event, make the restoration and give written notification to the trustees or the member, as appropriate, of the amount by, and manner in which, payments have been restored.

Where, following an initial event of recovery, the insurer can reasonably anticipate further events of recovery, the above obligations do not need to be complied with by the insurer so long as the notices referred to above have explained the impact of the anticipated further events of recovery on payments under the sovereign annuity.

Insurer's treatment of policyholders

23. Must an insurer provide a copy of the policy to the policyholder?

Yes, the insurer must provide a copy of the policy to the policyholder within ten business days of the date of issue of the policy. The policyholder will be the trustees where the payments under the policy are to the scheme and will be the individual person where the scheme is discharging its liability in respect of that person.

24. Are there any obligations on an insurer in terms of its dealings with policyholders over and above existing legal/regulatory requirements?

The regulatory disclosure statement, terms of business disclosures and errors and complaints resolution requirements of the Consumer Protection Code must be applied to the insurer's dealings with the policyholder even if that Code may not otherwise apply to the policyholder. However, this does not require any cooling-off period to be applied where the trustees purchase a policy in the name of an individual person if that is not a legal/regulatory requirement.

25. What happens if a policyholder has any questions or complaints?

The policy, either in the sovereign annuity appendix or elsewhere, must contain information on who a policyholder should contact in the event of any questions or complaints in relation to the policy or its administration/operation. In particular, the insurer must provide the title/position of the point of contact for complaints and details of any procedure for complaints. The policy will also notify the policyholder of their right to make a complaint to the Financial Services and Pensions Ombudsman and contain the contact details of the Ombudsman.

Trustee disclosure obligations

26. Are there disclosure of information obligations on trustees who purchase sovereign annuities?

Regulations and statutory guidance issued under Part IV and Part V of the Act impose disclosure obligations on trustees who purchase sovereign annuities. These obligations vary depending on whether the trustees have purchased sovereign annuities and held them within the scheme or whether the trustees have discharged all or part of a scheme's liability to a person by the purchase of a sovereign annuity.

27. Where can I get more information on sovereign annuities?

More detailed information on sovereign annuities can be found in the FAQs for Insurers on Sovereign Annuities here and the Sovereign Annuity Application Form here.