

IORP II - the new Pensions Directive

Alert | 24 January 2017



Introduction

A new [European Pensions Directive](#) (the Directive) came into force in January 2017. As with much of the recent financial sector legislation to emerge from the financial crisis of 2008, the Directive aims to improve governance and accountability in relation to workplace pensions.

Key points

- Many of the new Directive's provisions are aimed at better protecting the benefits of members and beneficiaries.
- The rules for schemes operating cross-border have been tweaked, with a view to reducing barriers to cross-border activity.
- The Directive does not include solvency measures for pension schemes, but we may not yet have heard the last of such proposals.
- EU Member States have until 13 January 2019 to incorporate the Directive into national legislation.

Background

The original Pensions Directive (also known as "IORP I") introduced a number of new rules for "IORPs" (broadly, occupational pension schemes). Implemented in the UK through the Pensions Act 2004, these new rules included the statutory funding objective and enhanced supervisory powers for the new regulator, TPR, from 6 April 2005.

The latest Directive (also referred to as "IORP II") was nearly three years in the making, with the EU Commission's [initial proposal](#) for a new Directive having been published in March 2014. With the implementation period running slightly ahead of, but largely in parallel to, the UK's Brexit negotiations, it is not yet clear how (if at all) the Directive's provisions will be introduced into UK law.

Information requirements

One of the EU Commission's main aims is to introduce clearer and more consistent member communications across EU Member States.

Aimed at both DB and DC schemes, the new "Pension Benefit Statement" will require standard key information to be given to each member, such as a benefit projection using standard assumptions. Although less prescriptive than the original proposals, the new requirements could prove more onerous in some respects than those which currently apply in the UK.

Investment related changes

ESG is firmly on the agenda in the Directive, as IORP II builds on the requirement for IORPs to invest in accordance with the "prudent person" rule. There will be a new obligation on Member States to "allow IORPs to take into account the potential long-term impact of investment decisions on environmental, social and governance factors".

Trustees' investment decision making processes will also need to build in ESG factors and, as currently required in the UK, the SIP will need to state how the investment policy takes ESG factors into account.

Member States will have discretion (not an obligation as originally planned) as to whether to require DC schemes to appoint a depository (custodian), with responsibilities that include the safekeeping of assets and oversight duties. However, if a custodian is not appointed, a scheme will need to make arrangements "to prevent and resolve any conflict of interest in the course of tasks otherwise performed by a depository and an asset manager".

Cross-border pensions

The Commission remains keen to encourage cross-border pension provision – a key aim of IORP I which, to date, has not been realised in any meaningful way.

Transfers

Cross-border transfers of pension scheme assets and liabilities will be permitted (in whole or in part) provided that the costs are not passed on to the members and beneficiaries remaining in the transferring scheme, or those in the receiving scheme.

Such transfers will be subject to the prior approval of a majority of the transferring scheme's members and beneficiaries (or, where applicable, their representatives) and that of the sponsoring employer (where applicable). They will also need the prior consent of the transferring scheme's regulator, and must be authorised by the receiving scheme's regulator. There will be a number of safety checks as part of the cross-border transfer process.

The "fully funded" requirement

The obligation for schemes operating cross-border to be fully funded at all times has always been contentious and one of the bigger obstacles to cross-border activity. It was therefore no surprise that the issue inspired much debate as the Directive was negotiated. The new provision which has emerged is therefore slightly more flexible, allowing schemes that operate cross-border to have a deficit and put a recovery plan in place for a limited period, subject to regulatory supervision.

Governance

The Directive places much emphasis on improving governance and transparency in pension schemes. Overall, schemes will be required to have a proportionate, effective system of governance in place which provides for “sound and prudent management of their activities”. Whilst some of the new governance provisions are already catered for in existing UK legislation, for example the requirement for schemes to make available their annual report and accounts, others are new or likely to require some tinkering with existing provisions.

Risk assessment is an important element of the Directive’s governance focus, with the introduction of a requirement for an “own risk assessment”, under which schemes will need to identify long and short-term risks that could affect the scheme’s ability to meet its obligations.

The “fit and proper” test

Collectively, trustees will need to have suitable qualifications, knowledge and experience to enable them to carry out their role. (There is not, as originally feared, any requirement for trustees to hold a professional qualification.) The existing [TKU requirements](#) already address this to some extent and, following [TPR’s 2016 consultation on 21st century trusteeship and governance](#), this issue is already clearly on TPR’s radar.

Remuneration policy

Schemes will need to establish and apply a “sound remuneration policy” for all those effectively involved in running a scheme, those who perform “key functions” (see below), and for “other categories of staff whose professional activities have a material impact on the risk profile of the IORP”. The policy will need to be publicly disclosed and reviewed every three years.

Key functions

A new concept of “key functions” is introduced in relation to risk management, internal audit and actuarial functions. Apart from the internal audit function (for which the person responsible must be independent), the key functions may be carried out by a single person or organisation. However, generally speaking, the person carrying out a key function cannot be performing a similar role for the sponsoring employer. But there is scope for exceptions, where the management of conflicts of interest is explained.

The common framework balance sheet

Part way through negotiations on the Directive, the proposed introduction of quantitative capital requirements for schemes was shelved. The Directive’s text now explicitly states that the further development of solvency models “is not realistic in practical terms and not effective in terms of costs and benefits, particularly given the diversity of IORPs within and across Member States”.

That said, with EIOPA still carrying out work on its “own initiative” on a “[Common Framework for Risk Assessment and Transparency for IORPs](#)” – a tool with the aim of enhancing risk assessment and transparency – it remains to be seen whether this element has been shelved for good.

Next steps

Member States have two years to bring the Directive's provisions into national legislation. Until the UK actually exits the EU, it remains under an obligation to do so.

Given work in recent years by the UK Government and TPR to improve standards of governance, particularly in the DC sphere, many of the Directive's requirements are already covered, at least to some extent, by existing UK pensions legislation. Whilst we wait to learn how (and if) the UK Government will implement provisions not already established in UK law, there are no immediate actions for trustees or employers, except to maintain a watching brief.

Sacker & Partners LLP
20 Gresham Street
London EC2V 7JE
T +44 (0)20 7329 6699
E enquiries@sackers.com
www.sackers.com

Nothing stated in this document should be treated as an authoritative statement of the law on any particular aspect or in any specific case. Action should not be taken on the basis of this document alone. For specific advice on any particular aspect you should speak to your usual Sackers contact. © Sacker & Partners LLP January 2017