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IORP II – green light for good governance

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Introduction

On 23 October 2018, the DWP published two sets of regulations designed to implement the second European Pensions Directive ("IORP II") – the Occupational Pension Schemes (Governance) (Amendment) Regulations 2018 ("the Governance Regulations"), and the Occupational Pension Schemes (Cross-border Activities) (Amendment) Regulations 2018 ("the Cross-border Regulations").

Both sets of regulations come into force on 13 January 2019.

Key points

- The Governance Regulations will update the current PA04 duty for occupational pension scheme trustees to establish and operate "internal controls", with a new requirement for the establishment and operation of "an effective system of governance".
- TPR will be required to set out the detail of the new requirement in its codes of practice.
- We would not expect schemes which already have good governance systems in place to have to make too many changes. TPR's 21st Century Trusteeship programme, for example, already reflects many of the new requirements. However, arrangements will need to be reviewed against the codes of practice, once available, and revised as necessary to ensure compliance.
- The Cross-border Regulations will amend various pieces of legislation with the intention of helping to reduce the barriers to cross-border activity and transfers.

Background

IORP II came into force in January 2017, with the aim of improving governance and accountability in relation to "IORPs" (broadly, occupational pension schemes).

EU Member States have until 13 January 2019 to incorporate IORP II into national legislation. This is a deadline for action by the Government, however, and not for pension schemes. Until the relevant changes to the UK legislation and regulation are in force, schemes only need to comply with the UK's current regulatory regime.

Effective system of governance

Occupational pension schemes will be required to establish and operate an effective system of governance, including internal controls. The system of governance must be:

- proportionate to the complexity, scale and organisational structure of the scheme, and to the nature of the risks to which it is exposed
- assessed by the trustees in a documented "own-risk assessment" (see below).

The Governance Regulations do not prescribe how schemes should establish or carry out any of these processes, or how TPR should regulate them. All of the detail will follow in TPR's codes of practice.

In addition, the Governance Regulations introduce the IORP II concept of "key functions", namely, risk management, actuarial and internal audit (the Governance Regulations describing the latter as a function "which internally evaluates adequacy and effectiveness of the system of governance"). Under IORP II, the internal audit function must be carried out by an independent person. The Governance Regulations do not reflect the specifics of IORP II here, so it will be interesting to see how TPR addresses this in its codes of practice.

Exemptions

With the addition of authorised master trusts, those schemes which are currently exempt from the requirement for internal controls (such as public service pension schemes) will, in general, be exempt from the new requirements.

TPR's codes of practice

The Governance Regulations specify an extensive number of matters that TPR must cover in its codes of practice to help trustees discharge their duty to have an effective system of governance in place. These include:

- having effective internal controls
- written policies in relation to outsourcing activities
- remuneration policies
- the "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 (including conflicts, funding, investment and operational risks).

Current governance expectations outlined in existing codes of practice (eg on internal controls, and the DC code) will also be subject to review to ensure they accurately reflect the requirements of IORP II.

Timing of "own-risk assessments"

Whilst TPR's codes of practice will deal with the timing of the own-risk assessment, the Governance Regulations state that the first assessment must be prepared:

- within 12 months from the last day of the first scheme year that begins after TPR has published the necessary codes of practice

- or, if later, within 15 months beginning with the date on which the trustees are next required to obtain an actuarial valuation or by the date on which the trustees are next required to prepare a Chair's annual governance statement.

Subsequent statements must be prepared at intervals of not more than three years.

Cross-border regulations

The Cross-border Regulations make changes in relation to the regime and procedure for authorisation and approval of cross-border activity, cross-border transfers, and information requirements.

Broadly, cross-border activity is when an employer in one Member State chooses to base an occupational pension scheme in another Member State. The Cross-border Regulations implement IORP II's changes to the existing authorisation process (introduced under the original IORP Directive), including reducing the time TPR has to communicate with regulators in other Member States.

The Cross-border Regulations also introduce a new authorisation process for schemes wishing to undertake bulk transfers to a scheme located in another EEA state. This includes ensuring that the cross-border transfer is approved by a majority of members and a majority of the beneficiaries concerned or, where applicable, by a majority of their representatives.

Other IORP II elements

The Government has made clear that, where possible, it intends to comply with IORP II through existing and planned UK practice and regulation.

Another key feature of IORP II is disclosure, with the Directive requiring all members to receive standardised annual "pension benefit statements". The DWP plans to address this with the introduction of the "Simpler Annual Statement" (launched on 18 October 2018), and the Pensions Dashboard (currently under development).

We understand the DWP's intention is to take forward the "environmental, social and governance" ("ESG") investment elements largely through its separate changes in relation to trustees' investment duties – see our Alert on this.

Next steps

We understand that TPR will not consult on its codes of practice until next year, and that any changes are unlikely to take effect before late 2019. The Government has stated that it intends to give schemes sufficient time for familiarisation and planning.

If you have any questions on any of the above, **please speak to your usual Sackers contact**.

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