

A NEW PENSIONS DIRECTIVE – JUST IN TIME FOR BREXIT?

A revision of the EU Pensions Directive, formally known as the Directive on the activities and supervision of institutions for occupational retirement provision (IORPs), has been in discussion for some years.

The final text for the revised Directive, nicknamed “IORP II”, was agreed in the last days of June between the European Commission, the European Parliament and the Council of the European Union. It is expected to come into force in the autumn of 2016 and to require implementation by Member States within two years.

This means that the UK may need to implement IORP II as it may well not exit the EU under Article 50 of the Lisbon Treaty until later. IORP II may also need to be implemented in any event under any access agreement governing the relationship between the UK and the EU going forward. The DWP have stated an intention to implement it.

Funding

IORP II has been controversial in the making.

The original proposal was to adapt Solvency II, the EU Directive on insurance regulation, and apply it to pension funds. This included applying the solvency and capital requirements for insurers with a few relaxations, and recognising sponsor support as an asset on the pension fund's “holistic balance sheet”. These plans were dropped by the European Commission after being opposed by trade unions, business groups, industry bodies and the governments of the UK, the Netherlands, Germany, Ireland and Belgium.

The final version of IORP II does not include insurance-style solvency and capital requirements.

Cross-border schemes

Another key battleground has been the funding requirements for cross-border schemes.

Pension funds that operate only within one Member State are permitted to be underfunded, provided there is an external sponsor and that they have in place a recovery plan under which the sponsor will make good the underfunding over a defined period. Cross-border schemes have been required to be “fully funded at all times” so that immediate full funding of the deficit is required, if an employee moves to work in another Member State without exiting the pension fund. This has severely limited cross-border pension provision, something which the directive was intended to encourage.

The final version of IORP II makes allowance for cross-border schemes to be underfunded provided “appropriate measures” are drawn up under supervision of the scheme's local regulator, to ensure members and beneficiaries are “adequately protected”.

It also clarifies the meaning of “cross-border activity” so that it does not apply if pensioners or deferred members move. Any national regulator blocking cross-border activity also now needs to give reasons for their decision.

Cross-border transfers

To further encourage cross-border activity, there are more detailed provisions for cross-border transfers. These require any sponsoring employer, and a majority of members and beneficiaries to consent and the approval of the national regulators for both the receiving and transferring schemes. Again, any national regulator refusing approval must give reasons and the European Insurance and Occupational Pensions Authority (EIOPA) is given power to carry out non-binding mediation between national regulators.

Fit and proper management

Those who effectively run the pension scheme or are responsible for key functions, namely the internal audit, actuarial and risk management functions, and anyone to whom these functions have been outsourced need to be “fit and proper”. This requires appropriate knowledge, experience and qualifications.

Importantly for UK trustee boards, the requirements for trustees can be met “collectively”. Only auditors and actuaries are required to have professional qualifications.

Pension funds will also be required to have a remuneration policy for key personnel, including service providers to whom key functions are outsourced, designed to support sound, prudent and effective management and to avoid encouraging inappropriate risk-taking.

Risk management and “own risk assessments”

More focus is given to risk management. Schemes are to have a “risk management system” covering amongst other matters asset-liability management, underwriting and reserving, operational risks, ESG and risk-mitigation techniques.

Schemes will be required to carry out a triennial “own risk assessment” to be sent to the national regulator. This is to cover all risks included in the risk management system together with others such as conflicts, indexation and a “qualitative assessment” of covenant support and other guarantees.

The risk management system will in effect cover solvency and funding risk but without the imposition of explicit capital requirements.

ESG

Environmental, social and governance factors are now to be included in investment decisions albeit only as part of prudence considerations. They are also included in the "own risk assessment".

Information to members

There are detailed requirements for information to members and prospective members and provision of a pension benefit statement. These have been somewhat watered down from earlier drafts which went as far as specifying minimum font size.

Regulator powers and cooperation with EIOPA

IORP II contains new provisions for Member States to report to EIOPA on prudential legislation and requires national regulators to co-operate with EIOPA to ensure consistent application of the directive. This will effectively require consistent application of risk management oversight, including asset-liability risk, i.e. solvency risk.

All decisions on administrative sanctions issued by national regulators need to be made public subject to limited confidentiality protections.

Review

IORP II is to be reviewed after six years to consider, amongst other matters, its adequacy from a prudential and governance point of view and its impact on the stability of IORPs. The threat of further solvency and capital requirements remains.

For now, it is still too early to tell what the impact on UK pension schemes will be.

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