MACFARLANES

# THE IORP DIRECTIVE: WHERE ARE WE NOW?

## PENSIONS

**We highlighted in an earlier briefing that changes to European legislation were being considered. We had hoped that the process would go back to the original business liberalisation agenda many hoped that the original IORP Directive (Directive 2003/41/EC) would deliver (click here for more on this). This would have enabled employers to establish cross border pension schemes or streamline existing ones so that costs could be brought down and pension provision encouraged. Unfortunately the European Commission has chosen instead to propose a revision of the IORP Directive which seeks to impose on funded pension schemes a regulatory regime based on that applicable to insurance companies-Solvency II. The result is likely to have a material impact on the governance and funding of both defined benefit and defined contribution schemes, and an additional round of compliance costs as well. For funded schemes and their sponsors in particular the consequences could be very serious indeed. They could face higher funding costs, changes in their investment policy and less flexibility.**

European legislation tends to be a longwinded process. It is tempting to believe that nothing will happen at all, or that if it does, it's too far away to bother about. Tempting – but a mistake. The implications of the proposed revision to the IORP Directive remain as potentially serious as ever, with far reaching consequences for employers, schemes, members and investors. The lack of clarity which still exists about the proposals is particularly worrying.

At the turn of 2011/2012, there was a flurry of activity. EIOPA set out a short period for consultation on the proposals it was intending to make to the European Commission. The consultation timetable had originally been even shorter, until a chorus of protest led to an extension of the period during which comments could be submitted. Even so, many organisations spent the 2011 Christmas period putting the finishing touches to their detailed responses to EIOPA's consultation document. For Macfarlanes' response click **here**.

The overall thrust of the responses was critical of EIOPA's proposed approach. Concern was voiced about the consultation's central assumption – that Solvency II was an appropriate framework for the regulation of funded company schemes. Some questioned whether there was a need for regulation of this sort at all, given existing layers of statutory protection, and wondered whether change would deliver any real benefit. Respondents highlighted the major potential compliance cost of any change, and the fact that it was odd to regulate funded schemes (which backed company promises with real assets) more than unfunded ones (which did not). Most were clearly sceptical of the need for a 'level playing field' in the regulation of insurance companies and company pension schemes, arguing that they were different in nature, presented wholly different levels of systemic risk and did not compete for the same business. Concerns were also expressed about the implications of increased funding levels for employers and businesses at a time when Europe was struggling for investment and growth, as well as the impact on investment markets and equity capital. Much debate centred on EIOPA's proposals for a holistic balance sheet, which is a formula enabling different kinds of benefit adjustment and security mechanisms to be included in order that the value of IORP resources and obligations can be compared on a consistent basis. How would it work and what impact would it have on corporate activity?

Many respondents were also concerned about the speed at which the process was being driven. Given the potential impact of the changes, why was there such a need for speed? In particular, some of the stated policy objectives – the expansion of employer sponsored retirement provision for example – seemed at odds with the proposals. Both sides of industry agreed that the proposals were likely to deter employers from establishing and maintaining workplace schemes rather than encouraging them. It seemed odd to push forward with proposals when the need for them was hotly disputed and their effect – whether the immediate impact or the longer term economic impact – had not been tested by appropriate impact assessment and could not be weighed against any perceived benefits. The proposals were at once detailed but imprecise.

It seems clear that the European Commission was surprised by the extent of opposition to the proposals, particularly from the social partners – in the UK the CBI and the TUC – and their European equivalents. In evidence to a hostile session of the UK Work and Pensions Select Committee in April this year, Commission officials sought to play down the impact of Solvency II saying that nothing was yet decided, and raised the possibility of a lengthy transition period before any new system was fully introduced.

Since then, consultation on the technical specifications of a quantative impact study (QIS) has been conducted by EIOPA. Most comment was critical, with many actuarial firms concluding that the process was flawed, and accordingly the results of the QIS were also likely to be flawed. In the UK, the QIS itself is being conducted by the Pensions Regulator, although schemes which wish to run the data are being encouraged to do so. The results will be incorporated by the Regulator in its response, which is to be presented on an aggregate basis. The calculations are sufficiently complex (and costly) such that they will exclude all but the biggest schemes from participating.

The Commission is still saying that a draft Directive will be published in the summer of 2013. How realistic that is remains to be seen.

**CONTACT DETAILS**
If you would like further information or specific advice please contact:

**JANE MARSHALL**
DD: +44 (0)20 7849 2059
jane.marshall@macfarlanes.com

**CAMILLA BARRY**
DD: +44 (0)20 7849 2238
camilla.barry@macfarlanes.com

**NOVEMBER 2012**