

Pensions

Update

Keeping your vision in focus

Key legal updates

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Introduction

Welcome to our Pensions Update for Autumn/Winter 2020.

It has been a tumultuous year, and in our newsletter, we focus on some of the current issues arising for pension schemes. A number of these themes were also explored in our recent pensions webinar, and if you would like to listen to a playback of our webinar, please [click here](#).

If you would like to discuss any aspect of this newsletter in further detail, we would be delighted to speak with you.

Key contacts



Peter Fahy
Partner, Head of Pensions

+353 1 6644 206
PeterFahy
@eversheds-sutherland.ie



Lorcan Keenan
Partner, Pensions

+353 1 6644 219
LorcanKeenan
@eversheds-sutherland.ie



David McKeating
Associate, Pensions

+353 1 6644 369
DavidMcKeating
@eversheds-sutherland.ie

Second Shareholder Rights Directive ("SRD II")

The EU (Shareholders' Rights) Regulations 2020 (the "**Regulations**") are in force, which transpose SRD II into Irish law. SRD II amends the existing Shareholders' Rights Directive (2007/36/EC).

The Regulations aim to increase transparency and shareholder engagement in corporate governance.

The Regulations introduced three new chapters into Part 17 of the Companies Act 2014:

- Chapter 8A (Rights of Shareholders) provides for the identification of underlying shareholders and information flows between underlying shareholders and companies;
- Chapter 8B (Transparency of institutional investors, asset managers and proxy advisors) provides new transparency obligations for these sectors with the aim of increasing transparency and shareholder engagement; and
- Chapter 8C (Remuneration Policy, remuneration report and transparency and approval of related party transactions) which provides for shareholder approval of directors; remuneration and related party transactions.

This article considers the impact of Chapter 8B on Irish pension schemes and outlines the steps to be taken by pension scheme trustees.

"Relevant Institutional Investor"

The Regulations introduce certain public disclosure requirements for Irish institutional investors. The impact of the Regulations on a pension scheme will depend on whether it is a "*relevant institutional investor*". In order to be considered a "*relevant institutional investor*", the pension scheme must:

1. Be an occupational pension scheme established in Ireland and falling within the scope of the IORP II Directive, without any local law exemptions from that Directive; and
2. invest directly, or through an asset manager, in shares traded on an EU regulated market.

If the pension scheme falls within the meaning of "*relevant institutional investor*", it will be required to:

- i. develop and publically disclose an engagement policy; and
- ii. make certain disclosures in relation to investment strategy.

Public disclosure means publishing the information available "*free of charge on the website of the relevant institutional investor*".

Scope of Regulations

The Regulations are much less clear cut than the Directive in limiting the scope of the required disclosures to investments in shares traded on EU regulated markets. Therefore, trustees need to consider carefully the scope of their legal obligations under the Regulations.

Engagement Policy

Trustees of schemes that are caught by the Regulations are obliged to develop and disclose a shareholder engagement policy on their website. To the extent they do not do so, such trustees must provide a clear and reasoned explanation on their website as to why they have not done so.

The engagement policy must describe how the trustees integrate shareholder engagement into the pension scheme's investment strategy. It must also describe how they monitor the companies the scheme invests in on matters such as strategy, financial and non-financial performance, risk and ESG factors, how they exercise voting rights and how they engage with other shareholders and stakeholders, among other matters.

The pension scheme trustees must also report annually on their voting activity, excluding insignificant votes.

Asset managers are obliged to produce a similar engagement policy under the Regulations, and can potentially be looked to by trustees who are invested in their funds for assistance with these disclosure obligations.

Investment Strategy Disclosures

Trustees of schemes which are caught by the Regulations must also publically disclose how the scheme's equity investment strategy is consistent with the profile and duration of its liabilities, and contributes to the medium to long-term

performance of its assets. While this has echoes of existing obligations under the Investment Regulations, the need to articulate and publicly disclose these matters is a new element.

Asset Manager Disclosures

Where an asset manager invests on behalf of the pension scheme on a discretionary client by client basis or through a collective investment undertaking, then the trustees must publicly disclose the main features of this arrangement.

As this wording appears to limit the obligation to certain types of investment structure only, trustees need to first assess to which parts of their portfolio this obligation applies.

Where applicable, the required disclosures include:

- How the arrangement incentivises the asset manager to align with the profile and duration of the scheme liabilities
- How the manager is incentivised to make investment decisions based on the medium to long term performance of investee companies and to engage with investee companies to improve their performance
- How the evaluation method and time horizon for evaluation of the asset manager and the manager's remuneration align with the profile and duration of the scheme liabilities and take absolute long term performance into account; and
- How the trustees monitor the manager's portfolio turnover costs and how they monitor portfolio turnover.

The trustees can exclude some or all of the above elements, but must then disclose a clear and reasoned explanation for the non inclusion. There are obvious differences between how passive managers are evaluated and selected by comparison with active managers, for example.

Guidance

No guidance has been issued to date by either the Office of the Director of Corporate Enforcement or the Department of Business, Enterprise and Innovation on Chapter 8B of the Companies Act 2014.

The European Insurance and Occupational Pensions Authority has suggested that the SRD II engagement policy disclosures may be integrated into an IORP's statement of investment policy. However, this assumes that this statement is publicly disclosed.

Most usefully, the institutional investor aspect of SRD II has been implemented in a more directional fashion, and under the Pensions Act, in the UK. In the UK, the view has been taken that disclosure to members is not sufficient to constitute public disclosure. Many schemes in the UK have implemented disclosure via sponsoring employer websites.

How can we help?

We have developed a streamlined approach to enable pension trustees to cost efficiently:

- Assess which parts of their scheme's investment portfolio are caught by the Regulations;
- Implement a compliance strategy, with the assistance of underlying asset managers; and
- Integrate SRD II into the investment selection process going forward.



Pensions Authority update for DB Schemes

On 7 October 2020 the Pensions Authority published an information paper titled "Important information for trustees of defined benefit schemes". The paper provides some further information on the Authority's intended future approach to defined benefit regulation.

New approach to supervision

As the Authority has previously outlined, it is moving to a risk based and forward looking approach to supervision. Rather than simply looking at the funding standard position of a scheme, the Authority will view schemes through three lenses:

- solvency;
- sustainability; and
- risk.

Schemes will also be categorised by reference to the Authority's assessment of their ability to pay benefits. This categorisation will be shared with trustees.

Table 1, on the following page, sets out the three categories and the Authority's priorities for each.

The Authority is developing the criteria on which this categorisation will be based but it seems likely that solvency, sustainability and risk will play a key role. It seems that Schemes which currently meet the funding standard could nevertheless be placed in category 2, or even conceivably 3, based on their anticipated future risk and sustainability profile.

The paper notes that the majority of DB schemes have "significant challenges" and the Pensions Regulator, Brendan Kennedy, has previously indicated that very few schemes are likely to be assessed as category 1. The majority of schemes are therefore likely to be given an initial assessment of category 2/3 status.

Role of the trustee under the new supervisory regime

The paper also elaborates on what will be expected of trustees under this new regime. In one sentence, this could be summarised as taking a forward looking and continuous approach to

scheme and risk management. Trustees will be expected to:

- demonstrate they understand and are managing their scheme;
- regularly consider potential scenarios and stresses (with their advisers), and proactively assess and take steps to address any shortcomings and weaknesses;
- understand their IORP II obligations and what steps they need to take to ensure compliance; and
- prepare and examine a wider range of financial and actuarial data than presently, with a focus on the future (this is likely to include having a greater ongoing focus on sponsor covenant).

Most DB schemes will already have in place risk registers which they review and maintain on an ongoing basis. Our sense is the Authority may be signalling that, for most schemes, their existing processes will need to be enhanced significantly.

Current action items for trustees

Finally, the Authority recommends that trustees read the IORP II Directive which will enable them to identify what steps can be taken now to prepare for the Directive's transposition. Suggested actions include:

- assessing the knowledge and experience of the trustee board;
- reviewing existing service provider terms;
- considering who will act as risk management function holder; and
- developing knowledge and expertise on potential risk identification, risk quantification and risk management, and risk interdependencies and scenario planning.

What can we do for you?

We can:

- provide trustees with information and training on the provisions of IORP II and the implications for their schemes; and
- facilitate workshops on specific areas of focus, such as the scheme’s approach to risk management.

We can also assist trustees on the preparation of a tailored IORP II implementation plan. The first step of this process is to prepare a gap analysis report which identifies required actions and decision points, assesses existing policies and procedures, and includes recommendations on appropriate next steps. This report can then be reviewed and updated on an ongoing basis, and used as a tool to track and monitor IORP II implementation.

Table 1 (proposed categorisation of DB schemes):

	Category 1	Category 2	Category 3
Likelihood of meeting targets	Those that are likely to pay benefits as promised.	Those that are unlikely to be able to pay benefits unless there is change (see below).	Those that are unlikely to be able to pay benefits no matter what.
Pensions Authority priorities for relevant schemes	Monitor to ensure that they stay in category 1.	Secure necessary change which could be in governance, administration, funding or risk management.	Reduce benefits or wind-up.



COVID – Temporary changes to legislation

The move to remote working has made “business as usual” activities challenging for both trustees and sponsors. Temporary legislative changes have been introduced to assist with some of those challenges, some of which are particularly relevant in a pensions context.

Holding of Remote Meetings

Holding remote or virtual meetings has become the norm for most trustee boards in 2020.

Corporate trustees have benefitted from the provisions of the Companies Act 2014 which expressly allow company board meetings to be held remotely by tele or video conference.

However, similar legislative provisions did not apply to unincorporated trustee boards. Instead, their ability to conduct business remotely is dependent on the wording of their scheme rules and many older deeds do not contain provision for virtual meetings.

The Civil Law and Criminal Law (Miscellaneous) Provisions Act 2020 introduces a statutory basis for unincorporated bodies, such as a trustee board, to hold meetings remotely. Section 30 of the Act provides that, notwithstanding anything in the rules governing the body, the validity of a meeting will not be affected by virtue of the fact that it was held remotely. Importantly, the validity of any vote taken, decision made or other act done at such a meeting is similarly protected. All that is required is that each of the attendees be able to speak to and be heard by each of the other attendees.

This is clearly a useful enabling provision but its use is limited. In particular, it is effective only for a temporary period running for three months from 21 August 2020. While the Government is given the power to extend this period where it considers it necessary in the public interest, trustees should not view the Act as anything more than a stop gap.

Accordingly, trustees should review their trust deed to ensure it allows trustee meetings to be held remotely before the expiry of the temporary period on 21 November 2020.

Execution of Deeds

Several temporary measures have been introduced to the Companies Act 2014 to help mitigate some of the difficulties of remote working.

Of particular interest in a pensions context is the new section 43A which deals with the execution of documents. In the normal course, when a company executes a deed the company seal and wet ink signatures of the authorised witnesses to the affixing of the seal need to be on the same counterpart of the deed. Section 43A allows instruments that must be executed by a company under seal to be executed in any number of counterparts.

This power applies regardless of any contrary provision of the company’s constitution. Again, this is a temporary measure available to companies until 31 December 2020. However, the government has the ability to extend the measure beyond that date where it considers it to be in the public interest.

This temporary measure provides more flexibility and is useful for both employers and corporate trustees that might otherwise find it difficult to execute deeds in the current climate.

What can we do for you?

The challenges posed by the current pandemic have brought into sharp focus the importance of having a trust deed that is up to date and reflects modern best practice.

We can assist trustees in reviewing their trust deeds and advising on potential best practice changes, such as expressly permitting remote meetings.

We can also assist with queries on execution formalities in the context of remote working.

Negative Revaluation for 2020?

The Consumer Price Index is showing an overall decrease of 1.2% up to end September this year.

This indicates a strong possibility that the Minister will declare a negative revaluation percentage for 2020 in Spring 2021. If so, this would be only the second time, and the first since 2016, that a negative revaluation percentage was declared in respect of preserved benefits held by defined benefit schemes.

In light of this, employers and trustees should consider whether their scheme rules allow the passing through of a negative revaluation percentage in calculating the preserved benefit entitlements of deferred members of the scheme. This was an issue which was much debated when the Minister first declared a negative revaluation percentage in 2016 for the 2015 revaluation year.

The general view is that scheme rules should specifically allow for deferred benefits to be reduced as well as increased in line with the revaluation percentage in order for negative revaluation to be passed through to the calculation of deferred pensions for deferred members of the scheme. However, the specific circumstances and terms of an individual scheme need to be considered.

The issue is also potentially relevant in the context of contractual revaluation for employed members of schemes that have frozen to future accrual and broken the link to final salary.

How can we help?

We can assist you in assessing the current position under your rules, and in drafting any amendments necessary to prepare for the potential return of deflation and of negative revaluation in 2021.



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