



## Pensions briefing

### IORPs II

November 2018

#### What is it?

It is Directive (EU) 2016/2341 on the activities and supervision of institutions of occupational retirement provision.

#### When will it come into force?

Ireland must transpose the provisions of the Directive into Irish law and bring them into force by 13 January 2019.

#### How is it being implemented in Ireland?

The exact process is unknown although the deadline is less than two months away.

It seems most likely that it will be implemented by regulations made under the relevant statutory authority to transpose EU Directives into Irish law by such means, rather than by statute.

These regulations are liable to be supplemented by Pensions Authority guidance. The Authority has indicated it will publish such guidance, to set out in practical and specific terms what the Authority expects trustees to do and the standards against which trustees will be assessed. Importantly, however, it is not clear if this guidance will have statutory force.

The Authority also recently published an information note which provides an indication of the how the Authority views the Directive's requirements and how it will expect trustees to demonstrate compliance.

#### Are there derogations?

Yes, the Directive provides authority for member states to dis-apply many of its requirements to schemes of less than 100 members. The UK has exempted schemes of less than 100 members from many of the Directive's requirements, but Ireland may not apply the same approach.

The Directive also includes a potential requirement for pension schemes to appoint a separate depository to hold scheme assets, which member states may choose not to apply. There could be significant cost implications if such a requirement was imposed on Irish pension schemes.

#### Some key potential impacts of the Directive

##### ESG considerations in investment decisions

Responsible investing, according to the UN principles of responsible investing, is an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable, long term returns. The Directive contains provisions which would both authorise trustees to consider the impact of their investment decisions on ESG factors in the wider sphere and require them to take ESG factors into account as part of their investment process. ESG must also be taken into account in risk assessments going forward and in a scheme's statement of investment policy principles.

The exact ambit of these requirements in Ireland will be better known when the transposing legislation is published.

### Effective governance and written policies

The Directive requires pension schemes to have an “effective system of governance which provides for sound and prudent management of their activities”.

Schemes will also have to document this by having written policies in relation to risk management, internal audit, actuarial and outsourcing activities.

These policies will be subject to review and amendment to reflect changed circumstances. Schemes will also need to have a remuneration policy governing the remuneration of trustees, key function holders and persons to whom activities are outsourced, and other key staff.

The Directive contains a number of requirements around these policies.

### Key functions

The Directive requires pension schemes to put in place the following key functions:

- A risk management function, which is aimed at regularly identifying, measuring, monitoring and reporting the risks to which the scheme could be exposed
- An internal audit function to evaluate the adequacy and effectiveness of the scheme’s internal control and governance systems, including in relation to outsourcing
- An actuarial function, for defined benefit schemes.

The risk management and actuarial functions may be carried out by the same person or organisational unit. However, the internal audit function must remain independent of the other functions.

The Directive also prohibits the same person or organisational unit carrying out a key function on behalf of both the scheme and its sponsoring employer. However, member states are allowed to derogate from this restriction. This could be important, as Irish trustees may need to look to their sponsoring employer to support them in carrying out key functions, in particular internal audit.

The Pensions Authority has indicated that it will expect the holders of key functions to be properly resourced and that trustee boards will be expected to receive regular and adequately detailed information from key function holders and to consider that information at their trustee meetings.

Trustees will also have to put specified documentary processes around the appointment of key function holders.

One of the key discretions in the Directive allows member states to either permit or require pension schemes to outsource their activities, including key function holder activities. How this discretion is exercised by Ireland is obviously a critical issue.

### Fit and proper requirements for trustees

Trustees will be required to collectively possess adequate “qualifications, knowledge and experience ... to enable them to ensure a sound and prudent management of the” pension scheme. The “qualifications” element of this may require at least one trustee to have a recognised trusteeship qualification.

The Pensions Authority’s recent information note indicates that going forward it will expect the composition of trustee boards to be reviewed at least every three years, taking into account issues such as capacity to devote the necessary time and attention to the role, potential conflicts of interest and the balance of expertise and experience on the trustee board. Individual trustees will also be expected to confirm annually their continuing compliance with the fit and proper requirements.

The Authority will also expect trustees to conduct and document their own due diligence on any new trustees to be appointed to the board to confirm that they are fit and proper.

### Trustee meetings

While the frequency and conduct of trustee meetings is not specifically addressed in the Directive, the Pensions Authority’s recent information note indicates that trustees will now be expected to meet at least four times a year and to keep very detailed minutes of all meetings, evidencing the substance of trustee discussions of particular issues as well as the outcome of those discussions. The Authority will also expect the rationale for all decisions to be recorded.

This raises difficult questions as to whether valid trustee decisions may be subject to second guessing with hindsight by either the Authority or by third parties such as beneficiaries.

The Pensions Authority also indicates that dissenting views on the trustee board need to be documented and recorded and that all meeting materials should be retained and available for inspection by the Authority.

These proposals are quite similar to some of the requirements which the Central Bank imposes on regulated financial services businesses, and it may be useful to apply learnings from that sector to the conduct and documentation of trustee meetings under the new regime.

### Own risk assessments

The Directive requires trustees to carry out and document a triannual risk assessment, which must include an assessment of a number of matters including:

- the effectiveness of the scheme’s risk management system
- how the scheme prevents conflicts of interest with its sponsoring employer, where the sponsor carries out key functions on behalf of the scheme
- the overall funding needs of the scheme and any necessary recovery plans
- operational risks
- the protective measures that the scheme has in place in relation to funding (eg. guarantees or other financial supports or covenants, and
- where ESG factors are considered in investment decisions, new and emerging risks including risks relating to climate change, social risks and risks relating to the depreciation of assets due to regulatory change.

### Disclosure of information to deferred members

The Directive sets out some minimum information requirements which must be given to prospective members, members and beneficiaries of pension schemes.

There are only a few requirements in the Directive which would not already be covered by existing Irish information disclosure requirements. However, one major development is that the annual pension benefits statement which must be given to pre-retirement members must be given to deferred members as well as active members.

The Directive allows for flexibility in the delivery mechanism for these annual benefit statements, providing that they can be made available by electronic means, once a paper copy is provided to a member on request.

A key issue for Irish pension schemes and one which trustees should engage on immediately is to ensure that they have current contact details for as many of their deferred members as possible. There are obvious difficulties with sending confidential financial information to a deferred member at an address which may no longer be current.

This interplay between the requirement to provide information and the requirement for data security will be a key issue with missing deferred members and one which hopefully the Pensions Authority will assist Trustees with. A mechanism whereby the required information is made available through a secure website portal may address these issues, but Pensions Authority guidance will be needed to see whether such a solution can be used.

### Supervision of schemes by the Pensions Authority

The Directive provides for a forward looking and risk based approach to the supervision of pension schemes. Effectively, the Pensions Authority will be moving from a rules based regulatory system (compliance with the Pensions Act) to a risk based approach, where issues such as culture and the quality and substance of the trustees’ performance of their duties will come to the fore.

This is a huge cultural change, and will involve a lot more evidencing of processes and procedures and the substance of decision making by scheme trustees.

The Pensions Authority’s guidance in this area will be important in clarifying the exact scope of what the Authority expects.

### Conclusion

The implementation of the Directive will involve very significant changes in how trustees are required to conduct their business going forward.

Many trustee boards have already started down the path which the new regime will lead to, while others are only beginning the journey.

While the Pensions Authority has indicated that it will give adequate time for trustees to comply with the new standards, 2019 is going to be a very challenging year for trustee boards.

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