"IORP II has introduced an entirely new layer of regulation for occupational pension schemes. But does increased regulation always mean better pension schemes for members or does it simply erode pension savings through the increased cost of compliance?"

Introduction

Following the implementation of the EU Directive on the activities and supervision of institutions for occupational retirement provision[1] ("**IORP II**"), by way of the European Union (Occupational Pension Schemes Regulations 2021[2], pension schemes in Ireland have faced increased governance standards and administrative obligations intended to better protect pension scheme members. However, the cost associated with this increased level of governance calls into question the effectiveness of the protection offered, in circumstances where it creates the potential for a reduction in the monetary value of pensions received on retirement. Consequently, the benefit of increased governance and transparency for pension scheme members is open to debate.

The implementation of IORP II has occurred against a background of existing high administrative charges, which had already been criticised on a number of occasions.[3] In this regard, a government report published in 2019[4] identified 160,000 occupational pension schemes, accounting for 50% of all pension schemes in the EU, but with Ireland representing only 1% of the EU population. In spite of this high level of availability, the number of employees in Ireland with pension scheme cover was comparatively low: the same report identified that only 35% of the private sector workforce participated in a pension scheme.[5] The significance of these figures is drawn out by research on pension costs in Ireland, which found that larger pension schemes incur lower pension costs due to economies of scale and the 'buying power' of schemes with larger contributions.[6] It follows, therefore, that the significantly high number of pension schemes in Ireland, coupled with low levels of pension coverage among Irish employees, already held the potential to create a problematic fee structure distributed amongst a low number of pension scheme members.

In addition to these cost issues, the Pensions Authority (the "**Authority**") identified a number of key drivers for reforming the pension system in Ireland, which included '*low public confidence in pension outcomes and difficulty understanding pensions*'.[7] The Authority concluded that this lack of confidence in the system was likely to play a role in low levels of pension coverage and adequacy among Irish employees. Included in the factors suggested to be contributing to this lack of confidence, the Authority considered poorly worded and structured communications, the complexity of pensions and the number of pension savings vehicles played a role.[8] Consequently, the aims of IORP II are not without merit, and, if properly adhered to, have the potential to increase public confidence and participation in pension schemes. Indeed, were this to occur, it is possible that higher membership numbers in occupational pension schemes would reduce the overall administrative cost to those schemes.

This paper will therefore consider the provisions of IORP II, having regard to the administrative burdens created and the needs of the Irish pensions market. In doing so, regard will also be had to the trend seen in the Irish market since the implementation of IORP II for employers to transfer pension

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1 Directive (EU) 2016/2341 (the "**Directive**").

2 S.I. 128/2021.

3 See, for example, the Consultation document issued by the Pensions Authority on the reform and simplification of funded private pensions (18 July 2016), available at <https://www.pensionsauthority.ie/en/news_press/news_press_archive/the_pensions_authority_publishes_proposals_for_pension_reform.html> (accessed on 8 June 2023).

4 A Roadmap for Pensions Reform 2018-2023, published on 2 July2019.

5 *Ibid* at page 14.

[6] Department of Social Protection, *Report on Pension Charges in Ireland 2012*.

[7] Note 5, at page 7.

[8] Note 5 at 8.

schemes and assets into master trust arrangements.[9] Finally, the overall implications of IORP II will be considered against the cost of its implementation, to determine whether it produces benefits for members, or erodes pension savings without adequate cause.

IORP II: Increasing Governance, Transparency, Risk Management and Communication

IORP II is intended to be a minimum harmonisation Directive, and to set a common standard across EU member states that ensures the soundness of occupational pension schemes and better protects pension scheme members. In order to achieve these aims the IORP II Directive, and the implementing Regulations:

(a) prescribe governance requirements for occupational pension schemes, including the need for written policies on risk management, internal audit, outsourced activities and remuneration, reviewed at regular intervals, alongside an effective internal control system[10];

(b) specify 'fit and proper' requirements for those conducting key functions in relation to an occupational pension scheme, including a need for adequate qualifications, knowledge and experience, and a requirement that the individual or firm in question is of good repute and integrity[11];

(c) specify the information that must be made available to members, including prospective members, and beneficiaries of occupational pension schemes, both at the outset of their membership, on an annual basis, and upon retirement[12]; and

(d) increase the supervisory powers of the Authority, to be utilised with a forward-looking and risk-based approach[13].

Furthermore, reference is made throughout both the IORP II Directive and Regulations to the need for information and policies to be communicated to pension scheme members in a clear, succinct and digestible manner.

The merits of the IORP II scheme of governance and communication are immediately apparent, and address the concerns identified by the Authority with regard public confidence in occupational pension schemes. Increasing the standards of governance by reference to specific qualifications and experience, and necessitating written policies, should operate to improve the overall administration and reputation of pension schemes in Ireland. However, as with any legislative reform, there is a risk that implementation is seen as a tick-box exercise and not embraced beyond discharging minimum statutory obligations. It is critical, therefore, that the Authority has been given additional supervisory powers to assist with this reform. This increased level of oversight creates the potential for the social and governance aims of IORP II to be properly realised and effectively reviewed on an ongoing basis.

However, the implementation of IORP II ought to be considered in the specific context of the Irish market. Given the appreciable number of occupational pension schemes, creating an IORP II compliant market would require vast amounts of resources. The strain placed upon these resources was perhaps seen in the decision of the Authority not to require full IORP II compliance by the intended deadline of 1 January 2023, insofar as certain requirements were met by the trustees of occupational pension

9 See, for example, Irish Times, *Irish Life hits 1,000 company milestone in master trust pension structure* (24 May 2023) available at <https://www.irishtimes.com/business/2023/05/24/irish-life-hits-1000-company-milestone-in-master-trust-pension-structure/> (accessed on 8 June 2023).

10 Article 21 of the Directive.

11 Article 22 of the Directive

12 Title IV of the Directive

13 Title V of the Directive.

schemes.[14] In accordance with this decision, trustees would not be required to meet the full requirements of IORP II if a formal commitment was made before 1 January 2023 to wind-up the scheme and transfer the assets of that scheme to a master trust, an option that appears to have been availed of by a number of occupational pension schemes.[15]

Master trusts, in this context, refer to a pension scheme for multiple employers that allow employers to decide what benefits the pension scheme will provide for their employees.[16] These arrangements are considered to achieve better outcomes for members due to the economy of scale, and investment expertise.[17] The transfer of assets to a master trust also aligns with a key goal of the government in its pension reform programme between 2018 and 2023, to reduce the number of occupational pension schemes operating in Ireland.[18] In its report, it was noted that reducing this number would "*help improve the overall standard of governance*" and "*reduce pension costs and risk*". Indeed, this intention was recently reiterated by the Minister for Social Protection, Heather Humphreys, wherein she considered that master trusts, and larger defined contribution pension schemes, are likely to incur lower costs overall.[19]

The prominence of the master trust vehicle therefore appears to be a positive addition to the Irish pensions market and, in line with the requirements of IORP II, the standardised approach to these schemes operates to ensure good governance, clear communication and transparency for pension scheme members. However, in order to operate at a large scale, and to transfer a significant number of occupational pension schemes in advance of the current 1 December 2023 deadline, reliance may need to be placed on standard form documentation, which may not cater to the needs of those pension schemes with peculiar or scheme-specific requirements. Equally, a transfer to a master trust also has the potential to involve a significant reallocation of power from the trustees and the employer of an occupational pension scheme to the master trust provider and trustees, which may not be a suitable arrangement for all schemes. Consequently, while this type of arrangement will significantly reduce the number of occupational pension schemes on the Irish market, it will not be the preferred option for all employers and trustees.

The Cost of IORP II: Better Outcomes for Members?

For those schemes not intending to participate in a master trust arrangement, it becomes apparent that IORP II will result in greater administrative charges, potentially on an ongoing basis. In accordance with the new regulations, schemes will need to implement a number of policies and improve communications with scheme members, alongside other additional obligations. Compliance will not occur on one occasion; rather, the reforms are intended to be reviewed on a continuous basis. Consequently, this will create increased cost for the scheme, combined with an additional time commitment from trustees and their advisors. Consideration must therefore be given, firstly, to the transparency of costs incurred and, secondly, to the benefits of the additional obligations creating those costs for pension scheme members.

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[14] Pensions Authority, *Information for group pension schemes on 1 January 2023 compliance deadline* (3 November 2022) available at <https://www.pensionsauthority.ie/en/news_press/news_press_archive/information_for_group_pension_schemes_on_1_january_2023_compliance_deadline.html> (accessed on 8 June 2023).

[15] See note 9. See also PwC 'Significant action needed to comply with new pension regulations' (24 August 2022) available at <https://www.pwc.ie/media-centre/press-releases/2022/pwc-2022-pension-survey.html> (accessed on 8 June 2023).

[16] For further detail, see Pensions Authority 'Employer guide to defined contribution master trusts' available at <https://www.pensionsauthority.ie/en/news_press/news_press_archive/employer-guide-to-defined-contribution-master-trusts.pdf> (accessed on 8 June 2023).

[17] See, for example, PwC note 15.

[18] Note 4 at 23.

[19] Dáil Éireann debates, 22 September 2022, available at <https://www.oireachtas.ie/en/debates/debate/dail/2022-09-22/42/> (accessed on 8 June 2023).

Increasingly, calls are being made for greater transparency in the administration costs of pension schemes.[20] In response, the Pensions Council (the "**Council**") has produced a report on cost transparency for the Minister for Social Protection[21], and agreed that there would be merit in introducing a cost transparency initiative. However, the Council emphasised that any such initiative should be straightforward to implement to ensure that it does not further increase the administrative costs faced by pension scheme members.[22] The Council was also of the view that increasing transparency would increase members' understanding and confidence, and may have the additional positive impact of driving price competition.[23] It was noted, however, that cost transparency would not result in lower costs in all cases, and other regulatory measures may also be needed to reduce the high levels of administration costs.[24]

Without a cost transparency measure, the specific impact of IORP II compliance is not readily available. Equally, the actual cost impact on pension schemes will depend on the fee arrangements that individual pension schemes have in place with administrators and, internally, whether administrative costs are borne by the scheme or by the employer. It is therefore likely that the cost burden of IORP II compliance will vary as between different occupational pension schemes. Creating greater transparency in this regard would therefore increase the data available, and provide a greater understanding of the cost implications of increased regulations on the pension savings of members.

Equally, the benefits of the IORP II reforms ought to be given consideration in the overall assessment. In this regard, it is clear from public consultations conducted by the Authority that pension scheme members have experienced a lack of confidence in the existing pension system.[25] The increased governance measures imposed by IORP II, alongside increased supervision by the Authority, are intended to address this concern and evidently have the interests of members in mind. The emphasis that has been placed by IORP II on clear, transparent and easily digestible information is intended to keep members informed on their pension savings, and ensures that members are engaged in what is a complex system and process. IORP II compliant schemes should therefore provide a greater benefit to pension scheme members. Indeed, a study conducted by Standard Life found that Irish people have been engaging more closely with pensions since the start of 2022.[26] Although this finding is not specifically attributed to IORP II, increased levels of media reporting and communication of new measures is likely to have played a role.

In order to ensure that members continue to engage and receive enhanced information on pension scheme savings, it is crucial that the new regulatory measures are combined with the proposal for a cost transparency initiative. Arming members with this increased level of information will further enhance the autonomy of pension savers, and will provide an opportunity for individuals to determine for themselves whether they are satisfied with the costs associated with administration more generally.

Conclusion

IORP II has undoubtedly increased the regulatory burdens placed on occupational pension schemes. However, it is clear that the pension market pre-IORP II was not without fault and is increasingly become the focus of legislative reform. The measures implemented by IORP II are intended to enhance

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[20] For example, a Private Members' Bill, Pensions (Amendment) (Transparency in Charges) Bill 2021, is currently at the Second Stage in the Dáil.

[21] The Pensions Council, *Report on Cost Transparency*, July 2022 available at <https://www.pensionscouncil.ie/en/council-opinions/2022/report-on-cost-transparency/report-on-cost-transparency.pdf> (accessed on 8 June 2023).

[22] Ibid.

[23] Ibid at page 7.

[24] Ibid at page 15.

[25] See note 3.

[26] Standard Life, *Standard Life Retirement Pulse Reveals Less Than a Third of Irish Adults Feel Financially Prepared for Retirement*, 29 June 2022 available at <https://www.standardlife.ie/dam/Global-blueprint/Geo-IE/Standardlife_IE/IE-PDFs/Standard-Life-Retirement-Pulse-Research_June.pdf> (accessed on 9 June 2023).

the confidence and engagement of pension scheme members, and to reduce the overall number of pension schemes operating in the Irish market. In this respect, it is clear that the prominence of the master trust vehicle following the implementation of IORP II is significant, both in terms of the increased levels of governance promised by these vehicles, and the benefits they yield in terms of a scale economy. This market reform should be welcomed as a positive impact of IORP II.

Equally, care needs to be taken to ensure that pension schemes opting not to avail of master trust products are not penalised by way of increased administrative costs in the ongoing implementation of IORP II. The proposals of the Council for enhanced transparency in the operating costs of pension schemes is a welcomed suggestion, and the government has indicated that it is considering this recommendation.[27] Although cost transparency will not, of itself, reduce overall administration costs, it does have the potential to encourage price competition between pension administrators and would enhance the overall understanding of members and employees.

Ultimately, it is clear that the pension landscape in Ireland is evolving, and IORP II has been a significant driver of this change. Although its implementation will raise the overall cost of administration, the exact figure is not yet known. Given its impact in reducing the overall number of schemes operating in the Irish market, it is also possible that IORP II will result in administrative savings for a large number of occupational pension schemes. As a consequence, it would not be fair to say that the pension savings of members have been eroded by its implementation. Equally, the enhanced autonomy and engagement of pension scheme members, and employees in the labour market more generally, is a significant goal, and measures intending to achieve this should not be understated. Further studies will need to be conducted to understand the effectiveness of IORP II in achieving these aims, but it is clear that the initial outlook is positive.

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27 See note 20.