IORP II: Is the Juice Worth the Squeeze?

> ***'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?'***

The above statement presents an either/or situation on the effect that increased regulation has for members of occupational pension schemes. Answering the question, however, cannot be done in such binary terms as both options are half-truths. Increased regulation does not always mean better pension schemes; yet it can lead to better pension schemes where there is a need for regulation and that regulation is of high quality, adaptable and properly implemented and enforced. Similarly, while increased regulation can erode pension savings through the increased cost of compliance that is not simply the case and will depend on a myriad of factors including the size of the pension scheme, employers' resources and the way in which employers meet these requirements.

The issue vexing industry stakeholders is whether occupational pension scheme benefits brought about by the IORP II directive are actually worth the time, effort and resources spent on complying with the new regulations. In other words, *whether the juice is worth the squeeze*? Unfortunately, this question is posed somewhat prematurely as group pension schemes in Ireland only had to comply with the requirements of IORP II by 1st January 2023 which means not enough time has surpassed for studies and impact assessment statements to be carried out.[1]

Nevertheless, there is still scope for speculation and debate from what we have seen so far on whether the juice will be worth the squeeze, and this paper posits that the benefits to be gained by pension scheme members are anticipated to outweigh the costs of implementation in the long-term where employers avail of outsourcing and economies of scale. Part I of this paper explores the need for increased regulation in Ireland, the objectives of the IORP II directive and its potential to enhance pension schemes for members, meanwhile

[1] The European Insurance and Occupational Pensions Authority consultation paper on technical advice for the review of the IORP II Directive is scheduled for publication in October 2023 meaning that data available on the actual impact of the directive is somewhat limited. In their draft paper at page 16 the EIOPA note that many countries are *"still in the process of preparing secondary legislation and supervisory guidance….it is too early to provide a long-term assessment of the effectiveness of the IORP II Directive"*.

acknowledging some regulatory shortcomings. Part II analyses the cost burden imposed by IORP II, its potential impact on different schemes, and various approaches that trustees and employers can take to manage these costs.

PART I: Does increased regulation always mean better pension schemes for members?

The effectiveness of IORP II hinges on whether it appropriately addresses a need for same, and it's proper and seamless implementation.

a) *The Need for Increased Regulation*

In response to the national pensions reform consultation process that was launched in 2016, the Pensions Authority provided the Minister for Employment Affairs and Social Protection with proposals for reform which were prompted by a number of concerns.[2] First, the public displayed a lack of trust in pension scheme outcomes and perceived them as overly complex.[3] The economy and financial markets were severely affected by the Great Recession of 2007-2009, and Ireland's banking crisis in 2008. During this period, pension funds suffered losses which decreased pension values and weakened public faith in the stability and security of occupational pension schemes.[4] Relatedly, the Pensions Authority identified a need for a robust regulatory structure which imposes stringent obligations on pension providers, and enables the Authority to intervene and address non-compliance.[5] In addition, Ireland was identified as an outlier in the European pensions landscape as it was home to 50% of all occupational pension plans in Europe.[6] Reducing the number of pension plans in Ireland may accommodate decreased fees through economies of scale, drive consolidation and bring the

[2] Government of Ireland, *A Roadmap for Pensions Reform 2018 - 2023* (02 July 2019) 21.
[3] ibid.
[4] In Ireland, there were several high-profile pension scheme failures where businesses, including Waterford Crystal, Independent News and Media, Vita Cortex and Irish Airlines Superannuation Scheme, went bankrupt or had financial issues that led to deficits in pension schemes and benefit reductions. The public's confidence has been undermined by these high-profile failures, especially among those who were personally impacted.
For more information see, <https://www.irishtimes.com/business/transport-and-tourism/dublin-airport-and-aer-lingus-pensioners-lose-court-challenge-over-cuts-to-scheme-1.4288492>, <https://www.ipe.com/irish-publishing-group-to-pay-70m-to-settle-pension-dispute/10020006.article>, and <https://nationalpensionhelpline.ie/pensions/case-study-mistakes-of-the-waterford-crystal-pension-scheme-and-how-to-avoid-them/#:~:text=Winning%20back%20their%20weirs%2C%20the,of%20nearly%20%E2%82%AC110%20million> accessed 01 June 2023.
[5] Government of Ireland (n2) ibid.
[6] ibid.

country in line with international standards.[7] The Citizens' Assembly on the future of pension provision in Ireland arrived at the same conclusion, and urged that the government take action to rationalise private pension plans and increase fee transparency.[8]

A clear need for further regulation existed in Ireland, and the government demonstrated an official commitment to creating a reliable, trustworthy and transparent environment for private pension provision in the 'Roadmap for Pensions Reform 2018-2023'.[9] Meanwhile, the EU had the same goal of implementing an effective system of governance across Europe heralding the introduction of IORP II on 12 January 2017 after three years of negotiations and debate.[10]

b) *Overview of IORP II*

The Institutions for Occupational Retirement Provision II (IORP II) directive builds upon the previous IORP directive to enhance governance of occupational pension funds, improve communications and transparency for pension members and streamline the processes for carrying out cross-border transfers and activities.[11] In achieving such ends, IORP II imposes onerous new obligations on pension scheme providers. Of significant importance are the following: -

1. Minimum experience and qualification requirements for trustee boards;
2. Appointing key function holders for internal audit, actuarial, and risk management;
3. Devising written policies for internal audit, risk management, remuneration, and where applicable, actuarial and outsourced responsibilities;
4. Introducing internal control standards, administrative and accounting protocols, and contingency strategies; and
5. All current members, prospective members, deferred members, people on the cusp on retirement, and pensioners to be provided with communications and information.

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[7] 'The IORP II journey—where does the market stand now?' (09 June 2022, PWC) < https://www.pwc.ie/services/human-resources/insights/iorp-2-journey.html> accessed 01 June 2023.
[8] The Citizens' Assembly, *Second Report and Recommendation of the Citizens' Assembly: How we best respond to the challenges and opportunities of an ageing population* (December 2017) 5.
[9] Government of Ireland (n2) ibid.
[10] 'IORP II is Now in Force', (*LK Shields,* 14 February 2017) <https://www.lkshields.ie/newsinsights/publication/iorp-ii-is-now-in-force> accessed 01 June 2023.
[11] Directive (EU) 2016/2341 of the European Parliament and of the council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (recast).

Stakeholders throughout the industry are in agreement that the obligations and standards imposed by IORP II will create a member-centric pension market. James Campbell, Head of Legal Consulting with Mercer, claims that *"introducing mandatory minimum standards across the board has to be a positive development for pension scheme members and there are many positive elements in strengthening governance, risk management and communications requirements. Clearly this is better for members*."[12] Minister for Social Protection, Heather Humphries, remarked that the IORP II directive complements the Irish government's agenda to positively reform the occupational pension sector.[13]

The challenge, however, is meeting the requirements as they are particularly burdensome and costly. Pensions regulator, Brendan Kennedy, notes that IORP II has a clear objective to improve the outcomes for members of pension schemes, but there is a significant amount of work required by employers and trustees to meet the standards and obligations contained in the directive.[14] Similarly, Shane O'Farrell, Director of Products at Irish Life, acknowledges that delivering new industry standards is viewed by many as a pulsing headache, *"[b]ut in the greater scheme of things, if it actually delivers what it was designed to achieve, it could be beneficial for both pension plans and their members in the longer term, assuming a smooth transition journey."*[15]

Although more regulation does not necessarily mean better, if IORP II is implemented appropriately it is predicted that the new layer of regulation will lead to better pension schemes for members by enabling them to actively participate in financially planning and securing their future and increase their prospects of receiving pension-saving rewards.

c) *Shortcomings*

Although the new layer of regulation certainly has laudable aims and is expected to improve pension schemes for members overall, it is not without its faults and there are already certain elements which could be strengthened.

[12] Barry McCall 'IORP II: A bigger deal than it sounds for standalone pensions' *The Irish Times* (Dublin, 29 October 21).
[13] 'IORP II transposed into Irish law, compliance cost a concern' (*IAPF*, 29 April 21) <https://www.iapf.ie/News/News/?id=210> accessed 07 June 2023.
[14] ibid.
[15] (n13) ibid.

I. Cross-border

One of the core goals of the IORP II directive was to encourage cross-border activities involving IORPs. Cross-border activities are important as they facilitate the free movement of workers within the EU by enabling the transfer of pension rights and benefits to schemes outside of their jurisdiction.[16] In addition, IORPs can expand and diversify their investment portfolios by investing in financial assets and other opportunities in different EU countries.

The IORP II directive acknowledged that differences in national social and labour law stifles cross-border activities, and therefore sought only to achieve minimum harmonisation by not precluding Member States from introducing legislation which protects scheme members.[17] A strategy which Finbarr Murphy BL rightly criticises as being "limited in ambition".[18] To date the directive's laissez-faire approach has proved unsuccessful as the regulations enacted on a national level have done little to facilitate the cross-border transfer of pension benefits.[19] The European Insurance and Occupational Pensions Authority has advised the European Commission that the new directive has its shortcomings, *"[t]here is clear evidence that the original purpose of the IORP II Directive, in terms of developing an internal market for cross-border IORPS, has failed*," and further recommends considering *"frameworks beyond the IORP II Directive that may offer more potential to grow the internal market"*.[20]

The experience with cross-border transfers thus far demonstrates that new regulations do not always achieve their intended aim, particularly in circumstances where harmonious regulations are not implemented across all member states national legal systems in furtherance of a pan-European goal.

II. Proportionality

A major cause of consternation[21] throughout the industry is the lack of proportionality present in Ireland's transposition of the IORP II directive[22] in relation to single member schemes.

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[16] Pensions Europe, *PensionsEurope Overview: Cross-border Pension Funds* (February 2019) 5.
[17] Consideration (3) of the Preamble.
[18] Finbarr Murphy, 'Pensions Policy and the Implementation of IORP II in Ireland' Commercial Law Practitioner 2023, 30(1), 3-16.
[19] SI No. 631 of 2021- The Occupational Pension Schemes (Cross-Border) (Amendment) Regulations 2021 entered into force on 25 November 2021.
[20] European Insurance and Occupational Pensions Authority, *Consultation paper on technical advice for the review of the IORP II Directive* (03 March 2023) 100.
[21] The Pensions Authority, *IORP II Preparation Survey 2020: Findings Report'* (February 2021) 7. See also, Stephen Gillick, 'Pensions Update 2022' (*Mason Hayes and Curran*, 10 March 2022) <https://www.youtube.com/watch?v=JXoLXdwhrQk> accessed 03 June 2023.

Proportional implementation acknowledges that a one-size-fits-all strategy is not suitable to all member states and allows countries to tailor a directive to accommodate their nation's unique circumstances, current laws and societal factors. Member states had the option of excluding schemes with less than 100 members from the onerous obligations of the IORP II directive, however, Ireland decided against the derogation.[23] Furthermore, even though the Pensions Authority originally stated that the size, nature, and complexity of a scheme would be taken into account when achieving the new requirements, the regulator has since veered away from proportional regulation and decided to treat one-member schemes in the same way as all other schemes.[24] It came as a shock to the industry that one-member pension arrangements are subject to the exact same standards as much larger, well-resourced schemes, considering that one-member arrangements are already heavily governed by the central bank and do not fall under the umbrella of IORP I.[25]

One member schemes will be unable to remain viable with the cost and administrative burdens imposed by IORP II and will be forced to either wind-up or consolidate by means of master trust or scheme merger.[26] Although a small number of large occupational schemes is considered international best practice, it has yet to be proven that consolidation will actually benefit the unique Irish pensions industry[27] where micro-enterprises account for 92.6% of businesses in the Irish market.[28] Those setting up a business may not start saving for retirement until much later in life and require a more bespoke scheme tailored to their needs.[29] Or perhaps given the culture of autonomous ownership in Ireland, scheme members may prefer to retain a high degree of control over their pension which is generally one's second largest asset after the family home. Nevertheless, mass-consolidation is exactly what the government has endeavoured (and are on track) to achieve, as compliance costs are

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[22] The IORP II directive was transposed into Irish law on 22 April 2021 via-á-vis the European Union (Occupational Pension Schemes) Regulations, 2021.

[23] Rachel McGovern, 'Small business owners being locked out of pension plans' *The Irish Times* (Dublin, 11 July 2022).

[24] The Pensions Authority, *European Union (Occupational Pension Schemes) Regulations 2021: Information for trustees* (10 June 2019) 4. Note, the transitional periods are extended for one member schemes.

[25] Rachael McGovern (n19).

[26] PWC 'Bringing order to a fragmented pensions landscape' *The Irish Times* (Dublin, 24 May 2021).

[27]Barry Prendiville, 'The changing pensions landscape' (*Accountancy Ireland*, 06 Oct 2022) <https://www.charteredaccountants.ie/Accountancy-Ireland/Home/AI-Articles/the-changing-pensions-landscape> accessed 06 June 23.

[28] Central Statistics Office, 'Business in Ireland in 2020: Small and Medium Enterprises (SMEs)' (*CSO*, 02 November 22) <https://www.cso.ie/en/releasesandpublications/ep/pbii/businessinireland2020/smallandmediumenterprises/> accessed 06 June 2023.

[29] McGovern (n23).

prompting the consolidation goal set out in the 'Roadmap for Pensions Reform 2018 - 2023' where the government commits to *"[t]aking steps to reduce the large number of pension schemes in operation - future pension provision by smaller employers will increasingly be by means of membership of large multiemployer structures or through pension contracts"*.[30]

The way in which regulations are implemented, whether proportionally or not, will have vastly different effects on pension scheme outcomes. In this case, Ireland's IORP II regulations are spearheading consolidation to the greatest extent, despite having the option of proportional implementation. Employers are likely to have less freedom to choose investment options, contribution models or benefit clauses, compared to single member arrangements. While this regulation certainly achieves the government's aim and will result in more secure pension schemes, it remains to be seen whether pension savers in Ireland will value the increased pension protection and security over their liberty and flexibility to customise their pension scheme.

PART II: Does increased regulation simply erode pension savings through the increased cost of compliance?

Although the content of the IORP II directive has been praised for creating a more robust pensions landscape in Ireland, Paul Dunne, Head of Distribute of State Street notes *"[t]he potentially onerous cost of meeting the requirements of the legislation has meant something of a backlash to IORP II"*.[31] It is too early to say whether the regulations are significantly reducing pension benefits for members but there certainly will be additional compliance costs which ought to be controlled.

a) Cost of Compliance

The burning question among industry stakeholders is what compliance is going to cost. A single figure cannot be provided as cost of compliance will vary depending on the size, type and nature of the scheme.[32] Elma Fox, Independent Trustees trustee manager and director,

[30] The Government of Ireland (n2) 25.
[31] McCall (n12).
[32] Natalie Tuck, 'Irish Association of Pension Fund's Spring Conference Wednesday (*IAPF*, 23 March 2022) <https://www.europeanpensions.net/ep/Irish-experts-detail-full-extent-of-IORP-II-compliance-costs.php> accessed 06 June 23.

remarks that cost of compliance falls within a "really wide range".[33] Some of the anticipated costs of implementation include: -

- Appointing key function holders;
- Internal Audit;
- Risk Management;
- Producing written policies; and
- Time commitment from trustees and sponsors to meet the requirements.

Figures vary depending on the size and scale of a scheme. Some predict that the mere appointment of key function holders will increase the operation costs of a typical scheme by €20,000 to €50,000.[34] Whereas others project the total figure for implementation to sit at around €30,000 to €100,000.[35] Furthermore, these costs are not once off as employers will have to ensure their scheme remains compliant due to the directive's review provisions. At the Irish Association of Pension Fund's Spring Conference, Ross Mitchel, PWC Ireland director, advised schemes trustees that ongoing costs might range from €30,000 upwards.[36] And the buck does not stop there as David Begg, Chairperson of the Pensions Authority predicts that occupational schemes fees will rise in the future to offset the additional regulatory resources required by the watchdog.[37]

From what we have seen thus far we cannot put an exact figure on the cost of compliance; however, we can predict with certainty that this is a very high cost and providers of occupational pension schemes will have to ascertain the optimum way to control these costs.

b) Meeting the Costs

Trustees and employers have three main options to consider when meeting the costs of compliance.[38]

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[33] ibid.
[34] Tina Oversby 'IORP II in Ireland: Are master trusts the solution?' (*Go Pensions*, 24 May 2022) < https://go-group.co.uk/iorp-ii-in-ireland-are-master-trusts-the-solution/> accessed 08 June 2023.
[35] Tuck (n32).
[36] ibid.
'More intrusive' oversight by pensions watchdog' (*The Law Society Gazette*, 04 October 2022) <https://www.lawsociety.ie/gazette/top-stories/2022/october/more-intrusive-oversight-by-pensions-watchdog> accessed 06 June 23.
[38] Caroline Rowan 'Pensions and IORP II: What Employers and Trustees Need to Know' (*Mason, Hayes and Curran*, 27 May 2021) <https://www.youtube.com/watch?v=t4G1ofFFlRQ> accessed 06 June 2023.

1. **Remain the same** - Large pension schemes may be in a position to stay in their own trust model and to step up to the demands of IORP II.[39]

2. **Wind up** – It is anticipated that smaller schemes will wind up, either voluntarily or under the direction of the Pension Authority, due to an inability to get compliant.[40]

3. **Consolidate –** Two types of consolidation are likely to occur. Firstly, there is a predicted increase in scheme mergers where an employer has multiple schemes as a result of previous merger and acquisition activity. Secondly, with regards defined contribution pensions, there is a shift towards master trusts. A master trust is a multi-employer vehicle which oversees multiple pensions schemes offering high quality shared governance.[41]

The main takeaway we have seen since the introduction of IORP II is the growing interest in master trusts in Ireland.[42] Master trusts enable employers to outsource scheme governance and avail of professional trusteeship, economies of scale and access in-house expertise for investments and compliance.[43] Munro O'Dwyer, PwC pensions partner, claims that master trusts are an effective way to manage the costs burden imposed by IORP II, " *[i]t is difficult to see why companies would willingly take on an additional financial burden that will come with the new rules when they can in fact save money on the current cost of managing schemes*".[44] Significantly, he notes that the savings can range from one-third to one-half of what is currently spent on managing schemes meaning that master trusts have the potential to completely offset the costs of compliance. In the same vein, Brendan Kennedy, Chief Executive of the Pensions Authority, remarks that a small number of larger and more efficient schemes will result in better bang for one's buck.[45]

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[39] Joe Dermody, 'Master Trust is top option with new pension rules, says expert' *Irish Examiner* (Dublin, 08 Sept 2022).
[40] The Pensions Authority, *Engagement and Audit Findings Report 2022* (December 2022) 6.
[41] 'Emergency law needed for pension-pot anomaly' (*The Law Society Gazette*, 06 March 2023) <https://www.lawsociety.ie/gazette/top-stories/2023/march/emergency-legislation-needed-to-address-pension-pot-anomaly> accessed 06 June 2023.
[42] Address by the Minister for Finance Michael McGrath to the Irish Association of Pension Funds Annual Dinner on 23 February 2023. Available at: <https://www.gov.ie/en/speech/dd17c-address-by-the-minister-for- finance-michael-mcgrath-td-to-the-irish-association-of-pension-funds-annual-dinner/#iorp-ii>.
[43] Barry McCall 'Is the end nigh for your pension scheme?' *The Irish Times* (Dublin, 28 October 2022).
[44] Dominic Coyle, 'Employers can save up to half company pension scheme costs, claims expert' *The Irish Times* (Dublin, 24 August 2022).
[45] Edel Corrigan, 'Pension planning: mastering the costs of compliance' *The Irish Times* (Dublin, 29 October 2021).

We should, however, be cautious about placing the master trust on a pedestal. Master trusts appear to be advertised as the holy grail for reducing the cost and administrative burden brought about by IORP II, but they are a relatively new development in the Irish pensions market and their success has yet to be measured.[46] In addition, there are a number of outstanding issues in relation to master trusts. First, master trusts are proposing differential pricing for "deferred members" meaning that previous-employees may face higher charges than present-employees. Glenn Gaughran, head of business development at ITC, argues that this situation is wholly inequitable, particularly where the insurance sector are regulating against dual pricing.[47] Secondly, transferring either into or out of a master trust can be both complex and costly. A particular example of this is that master trusts exclude pension adjustment orders. Where a transfer of a pension benefit is made to a master trust, the pension adjustment order cannot accompany it as it is scheme specific. Therefore, individuals will have to endure further costly family law proceedings to remedy this matter. While many stakeholders have flagged this issue, it has yet to be resolved.[48] Furthermore, there is potential for an over-concentrated master trust market. In Ireland there are currently only 9 master trust providers operating in the market.[49] Employers and employees may have fewer scheme options and less competition as only a small number of master trust providers control the market which may lead to fewer innovations, higher expenses, or worse terms and conditions for pension plans.

Meeting the costs of compliance via a master trust will prevent the erosion of pension savings and may even reduce the current rates of fees paid by pension members. However, even though master trusts have the potential to drastically improve pension outcomes for members, they still have outstanding issues which need to be addressed to avoid adverse consequences for scheme members.

Conclusion

While increased regulation does not always guarantee better pension schemes, it can lead to significant improvements if implemented appropriately. Similarly, while compliance costs

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[46] Pensions Authority, *Master Trust Compliance Report 2022* (August 2022) 3.
[47] Dominic Coyle 'Pension reform could leave some workers facing higher charges' *The Irish Times* (Dublin, 20 June 2022).
'Pension Adjustment Orders and IORP II' (*The Law Society of Ireland*, 03 March 2023) <https://www.lawsociety.ie/news/news/Stories/pension-adjustment-orders-and-iorp-ii> accessed 06 June 2023.
[49] Dermody (n39) ibid.

can erode pension savings strategies such as master trusts offer potential solutions to offset costs. Ultimately, the true impact of increased regulation and its cost of compliance on pension schemes will become clearer over time as outstanding issues are ironed out, and studies and assessments are conducted.

For now, the IORP II directive is a headache and a costly and administrative burden for employers and trustees, however, it appears to be on track to achieve better outcomes for pension members in the long-term by improving the governance and transparency of pension schemes, bolstering protection for members, and restoring faith in the market. If certain elements of the regulations are refined and carefully implemented the juice will be well worth the squeeze!

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