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Pensions Winter Briefing

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PENSION DEVELOPMENTS – WHAT'S ON THE HORIZON IN 2021?

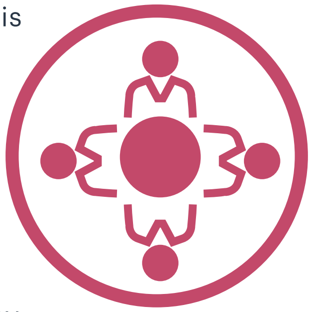
We look ahead at the developments we may see across the Irish pensions sector later this year.

1. Culture Change Coming? The Pensions Authority's Expectations of Trustees

We now understand that we will see legislation transposing IORP II in the first half of 2021, and possibly during Q1. In anticipation of this legislation, the Pensions Authority (**Authority**) made a number of announcements late last year highlighting what it expects of trustees once IORP II is implemented, how it will supervise trustees, and what can be done now by trustees to prepare for IORP II.

On 7 October 2020, the Authority published new information for trustees of defined benefit schemes and on 23 November 2020 the Pensions Regulator, Brendan Kennedy, spoke at the IAPF's Annual Governance Conference. In both instances the same message was conveyed; the culture of trustee boards will, from now on, be central to the Authority's oversight of pension schemes.

1. Culture Change Coming? The Pensions Authority's Expectations of Trustees (Continued)



The Authority, in line with what is required of it under IORP II, is moving to a risk-based and forward-looking approach to supervision. Trustees will therefore be expected to change the way they approach their work. This approach means that the Authority won't simply limit its supervision to assessing whether there have been any past breaches of technical aspects of the Pensions Act. Instead, supervision will be more overarching and will assess the management and governance of schemes by trustees to ascertain whether the culture itself is a risk to beneficiaries' interests.

Many trustee boards may be wondering what is meant by culture in this context. Brendan Kennedy has stated that he means it to be *"the set of attitudes, values, expectations, and practices that determine the activity of the trustees"*. Trustees are being encouraged to be proactive, to identify what decisions they need to make, to make those decisions and to monitor actions. They are also being reminded that trustee responsibility cannot be outsourced; trustees must regularly monitor the activities of their service providers. The Regulator believes this will require a fundamental change in the mindset of many trustees who view trusteeship as a mechanical box-ticking exercise.

There will be no official guidance from the Authority before the transposition of IORP II, so what can trustees do now to prepare for IORP II?

The Regulator has suggested that a good place for trustees to start is to carry out a self-assessment of their own boards to ensure that they have the right mix of experience and knowledge. He also encouraged trustees to assess their financial controls, ensure they have a conflicts policy, and that appropriate contractual arrangements supported by service level agreements and key performance indicators are in place with service providers.

There is understandable frustration within the pension industry regarding the delay with transposition of IORP II and how that delay impacts the ability of trustees to fully prepare for IORP II. However, the Authority has made it clear that IORP II will bring with it an increase in what is expected of trustees in terms of the governance and management of schemes and a shift in the Authority's own approach to supervision. The combination of both these factors is likely to result in significant changes to the operation of pension schemes in the post-IORP II landscape.

2. Master Trusts - Higher Standards Expected

The Authority recently published the findings from its 2020 engagement exercise with master trusts (**MT**). The Authority described its overall findings as *"disappointing"*. The report criticised existing MT offerings on issues such as governance practices, conflicts and the constraints placed on trustees when it comes to changing MT service providers and exercising investment powers.

The Authority has confirmed that it will continue its engagement with current and future MTs and that, following transposition of IORP II, it intends to publish guidance, aimed at employers, on the minimum standards they should seek from MTs before participating. The Authority cautioned that many of the MTs they have examined would currently not meet such standards without addressing the findings in the Authority's report. The Authority stated that it will *"strongly advise any employer against participating"* in MTs which *"inappropriately"* constrain trustees' powers.

To date, we have not seen a wide-scale shift towards MTs by employers who currently offer standalone pension schemes to their employees. The pressure to consider such a move is likely to increase once IORP II is transposed but the Authority's report has highlighted some of the issues that employers considering the switch to MTs should assess.

3. Pension Simplification and Reform Proposed

Late last year also saw the publication of the long-awaited report by the Interdepartmental Pensions Reform and Taxation Group on recommendations to reform and simplify the existing pensions regime in Ireland. Many of these reforms make sense as they seek to address some widely recognised anomalies and inconsistencies in the existing regime. Some of the key reforms recommended in the report include:

- abolishing buyout bonds and retirement annuity contracts prospectively so that PRSAs will operate as the sole contract-based personal pensions product;
- standardising drawdown ages under products so that the lower age limit at which savers can access retirement benefits is increased to age 55 following an appropriate lead-in time and increasing the upper limit of normal retirement to age 75;

3. Pension Simplification and Reform Proposed (Continued)

- modernising and updating the existing PRSA regime and aligning the transposition of the Pan-European Personal Pension Regulation with existing PRSA legislation; and
- replacing the ARF option with a combination of an in-scheme drawdown (on an optional basis) and a re-designed PRSA product which operates as a whole-life product.

The report confirmed that the next steps will involve agreeing an implementation plan to progress specific reforms and to then implement the less complex measures. The aim is to draft further engagement measures for some of the more complex actions with a view to then implementing them. The intention is to carry out these measures in tandem with the work being done on the auto-enrolment project and the transposition of IORP II.

The implementation of these reforms will be a significant task and will require input from a variety of stakeholders. Irish pension reform has tended to happen at a very gradual pace. The absence in the report of any timeframes for the implementation of these reforms means that it is uncertain whether we will see some of the less complex proposals implemented later this year.

4. Auto-enrolment Update

The current Programme for Government confirmed that the government will seek to *"gradually"* deliver auto-enrolment, taking account of the *"exceptional strain both employers and employees are now under"*. However, the Programme did not set a date for its intended introduction and it is widely acknowledged that the planned introduction of auto-enrolment in 2022 will be delayed.

Last month, the Minister for Social Protection confirmed that officials in her Department are developing design options for government to consider regarding the phased introduction of an auto-enrolment system. Therefore, we can expect work to continue on this project in the background during 2021 but when the phased implementation of auto-enrolment will actually commence remains an open question.

5. Sustainable Finance

Pension scheme trustees will face new disclosure obligations related to "*sustainability risks*" as a result of the EU's Sustainable Finance Disclosures Regulation (**SFDR**). "*Sustainability risks*" mean environmental, social and governance events or conditions that could cause a negative impact on the value of an investment. Pension schemes are "*financial market participants*" for the purposes of SFDR. The general principles under Level 1 of SFDR will apply from 10 March 2021. For pension schemes, this will include the requirement to provide information on the manner sustainability risks are integrated into investment decisions. How information is provided will be governed by IORP II. It is expected that the Authority will issue guidance on this topic at a later date.

6. Brexit & GDPR

One final issue that trustees and employers will need to focus on during the first half of 2021 is to assess how Brexit impacts on their GDPR obligations in a pensions context. Our colleagues in our Technology and Privacy Team have provided a brief overview of the continued transmission of personal data from organisations in the EEA to the UK under the Trade and Co-Operation Agreement and what might be coming up ahead. The seamless flow of personal data will be one of the key data protection concerns for any trustee or employer working with UK service providers or otherwise operating in the UK in the wake of Brexit. A link to the Technology and Privacy Team's recent article on the topic can be found here.

THE PENSIONS EXEMPTION? AML EXEMPTIONS FOR PENSION SCHEMES MOOTED IN DÁIL.

The Criminal Justice (Money Laundering and Terrorist Financing) (Amendment) Bill 2020 (the **2020 Bill**) has been passed by Dáil Éireann and is currently before the Seanad. The Bill will transpose the Fifth Anti-Money Laundering Directive (the **Directive**) into Irish Law.

Beneficial Ownership

The 2020 Bill brings the obligations under the European Union (Anti-Money Laundering: Beneficial Ownership of Trusts) Regulations 2019 (the **Trust Regulations**) back into focus. Our cross-departmental briefing on that topic is available here. The Trust Regulations require express trusts (including pension trusts) to maintain an internal beneficial ownership register (the **Internal Register**). What *"beneficial owner"* means when it comes to pension trusts has been the subject of much legal debate and guidance from the Department of Finance has been requested on this issue by several bodies in the pensions industry.

Verification Requirements

The verification obligations under the 2020 Bill require designated pensions to verify the beneficial ownership of customers who are subject to beneficial ownership disclosure requirements. This would require a designated person to ascertain the beneficial ownership information of a trustee customer subject to the Trust Regulations before entering that business relationship and to ensure the information was duly registered on the Internal Register for the trust.

The Central Register

One requirement of the Directive that is not directly dealt with by the 2020 Bill is the establishment of a public central beneficial ownership register in each Member State (the **Central Register**). The establishment of the Central Register is expected to be dealt with by ministerial regulations soon. The 2020 Bill introduces provisions on interpretation that will apply to such regulations (the **Interpretation Provisions**). The Interpretation Provisions introduce a definition of *"relevant trust"*. Broadly, this includes express trusts but specifically carves out what is termed an *"excluded arrangement"*. Pension schemes, as well as various other trusts, will be excluded arrangements.

The Minister for Finance, Pascal Donohoe (the **Minister**), speaking in the Dáil during the debates on the 2020 Bill signalled an intention for pension schemes to be excluded from the future requirements related to the Central Register.

The Minister acknowledged that because trusts are used in Ireland for purposes such as pensions, Irish individuals, by virtue of being a member of a pension scheme, could be discriminated against compared to citizens of other EU Members States by their personal information being placed on the Central Register. He noted that on advice of the Attorney General, a member state may exclude trusts that are excluded by other member states by reason of those states using a vehicle that is not a trust. He stated that *"occupational pension schemes ... have been excluded from the requirement to register"*.

Presumably, the Minister is pointing to an exemption for pension schemes from the requirements related to the Central Register, once in force. The Interpretation Provisions create a pathway for such an exemption by ministerial regulation.

What next?

That the 2020 Bill proposes to exclude pension schemes from what are considered *"relevant trusts"* and the Minister's comments indicate that pension schemes may be excluded from the obligations the 2020 Bill, and any related regulations, will impose on such trusts once in force. Also, comments from the Minister give trustees a welcome indication that pension schemes are also likely to be excluded from the requirement to file details of their beneficial owners with the Central Register, once established.

However, we will not have a clear picture of how the beneficial ownership requirements will apply to pension schemes until all relevant legislation is in place. We are tracking developments and will provide further updates as that legislative picture becomes clearer.

STATE PENSION AGE STAYS AT 66 FOR NOW

Last year's Programme for Government contained a commitment to postpone increasing the state pension age from 66 to 67. This increase was scheduled to take effect on 1 January 2021. However, legislation to defer that increase was passed just before Christmas 2020.

The legislation has not only deferred the planned increase of the state pension from 66 to 67 this year but it also repealed the legislative provisions designed to increase state pension age from 67 to 68 in 2028. As a result, the state pension age will now be anchored at age 66 unless the government passes legislation to change that position.

In the meantime, the government has confirmed the establishment of the Commission on Pensions. The Commission's terms of reference have been framed broadly. They cover an in-depth review of the existing state pension system, as well as issues related to the use of mandatory retirement ages in the private sector.

The Commission on Pensions is due to submit its recommendations to government by 30 June 2021 and government has committed to act on those recommendations within six months.

Impact on Trustees and Employers

Some pension schemes and employers have aligned the retirement age for their members and employees with the planned increase in state pension age that was due to take place this year. To the extent that those arrangements have not already been reconsidered by trustees and employers, that is something that will now need to be done as employees may be able to access the state pension a year earlier than anticipated.

For defined benefit schemes, this change also has the potential to result in an increase in liabilities where normal retirement age for members is linked to the date of eligibility for the state pension. Depending on how that has been documented in existing scheme documentation, employees may now have an ability to access benefits a year earlier than anticipated.

It is difficult for trustees and employers to make any changes to future-proof scheme rules, as we do not know: (a) what the Commission on Pensions will recommend; and (b) what government will decide based on any such recommendations. The sooner there is clarity on this issue the better for all stakeholders.

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