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// PENSIONS

Pensions Winter Briefing

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1. THE FINAL FURLONG FOR IORP II COMPLIANCE

BACKGROUND

The Pensions Authority (**Authority**) gave trustees of group pension schemes until 1 January 2023 to achieve full IORP II compliance. That date is fast approaching, and it is now "crunch time" for pension trustees to address any remaining compliance requirements or for sponsoring employers to decide on an alternative means for pension provision.

IMPACT OF IORP II COMPLIANCE BURDEN

For many smaller pension schemes, the costs of IORP II compliance will be too much for their sponsoring employers to bear. This is forcing many employers to consider alternative means of pension provision, with master trusts proving to be an increasingly popular alternative.

This trend is reflected in a recent IORP II-related survey published by the Authority. The survey confirmed that almost half of the defined contribution (**DC**) trustee respondents indicated that the scheme may be wound up as part of a move to a master trust. In contrast, most defined benefit (**DB**) scheme trustees surveyed intend to continue their scheme.

EMPLOYER DECISION TIME

Given how close we are to the 1 January 2023 compliance deadline, employers who have not considered how IORP II affects their current model of pension provision of DC schemes, should do so without delay. This usually comes down to a decision on whether the increased IORP II related compliance costs render the current model no longer viable.

If that is the case, a plan to move to an alternative pension arrangement needs to be put in place, bearing in mind that the implementation of that plan will take several months to execute. However, some employers have decided to adopt a "wait & see" approach. This is usually on the basis they will ultimately move to master trust, but will bear increased IORP II compliance costs in the interim. This allows them time to plan an orderly move to a master trust after choosing the right provider in a less time-pressurised fashion.

If action is not taken and IORP II requirements are not fully addressed this creates legal exposure for employers and pension trustees. Non-compliance with IORP II requirements, in many instances, amounts to a criminal offence liable to prosecution by the Authority, leading to fines and a risk of negative publicity.

Helpfully, the Authority recently announced that:

- once a formal commitment has been made to wind-up the scheme before 1 January 2023 and transfer to a master trust or to PRSAs; and
- provided the transfer is completed by 31 December 2023;

trustees of those schemes will not be required to meet the new IORP II requirements.

IORP II COMPLIANCE

For schemes that will continue in the post-IORP II environment, the clock is now ticking ahead of the January 2023 deadline. We have published commentary on IORP II previously here and here. The trustees of such schemes should be taking the following actions:

- finalise policies and procedures required by IORP II / the Authority's Code of Practice (**Code**);
- appoint key function holders (**KFHs**) and notify the Authority of those appointments;
- review contracts in place with service providers for compliance with the Code's requirements; and
- complete trustee qualification courses or appoint a professional trustee.

The need to address these compliance requirements is critical, as trustees will be required to prepare an annual compliance statement (**ACS**) for 2022, by 31 January 2023. The ACS requires trustees to confirm if certain core IORP II policies are in place and that KFHs have been appointed. As part of its regulatory activity, the Authority may request trustees to provide it with their 2022 ACS, which could bring trustee non-compliance onto the Authority's radar and consequent prosecution risk for trustees.

CONCLUSION

IORP II has sent shockwaves through the Irish pensions landscape and will result in a greatly consolidated Irish DC market. The Authority is strongly encouraging employers with small standalone pension schemes, for which it may not be cost-efficient to meet the new obligations, to use the remaining weeks of 2022 to take concrete steps to implement alternative pension arrangements.

2. MASTERS OF THE UNIVERSE? MASTER TRUSTS, THE FINE PRINT

As already discussed, IORP II has prompted many employers sponsoring standalone pension schemes to move to a master trust (**MT**). We have previously commented on the standards the Pensions Authority (**Authority**) now impose on MTs and the guidance the Authority offer employers considering moving to a MT. In essence, that guidance focuses on five issues:

1. if MT trustees satisfied the required "fit and proper" standards;
2. if the MT meets capitalisation expectations;
3. if conflicts of interest policies are in place;
4. understanding the charging structure and its competitiveness; and
5. that default investment options are appropriate and clearly communicated to members.

In this article, we comment on some of the key legal issues employers should consider in assessing whether the move to a MT is appropriate for their business.

MT – THE FINE PRINT

Implementing a successful move to a MT for future pension provision involves significant management time and resources. Before embarking on that exercise, employers should understand the nature of what they are signing up to and consider if the risks outweigh the benefits.

1. COMPLEX TO SWITCH MT PROVIDER

Employers should understand that switching a MT provider is different from changing a service provider to an existing scheme. That freedom to "hire and fire" service providers is effectively lost once the switch to a MT is made.

Instead, an employer's right to cease participation in a MT may be subject to a notice period of several months. Also, the ability to transfer the members' assets to a new MT provider may be subject to the consent of the MT trustee or provider. The asset transfer exercise will be complex and could involve the encashment of members' assets and out-of-market risk exposure for members. Managing these risks and planning a successful transition to a new MT provider will involve a significant investment of management time and resources.

These issues act as a strong disincentive to switch a MT provider once the move to MT has been made. Employers need to understand that this is one of the inherently different features

of a MT compared to a standalone company pension scheme and decide whether they are comfortable with that effective reduction in the freedom to switch providers.

2. LACK OF LEGAL RING-FENCING

Different employer sections within a MT are not legally segregated from each other. The MT documentation will usually enable the MT provider or trustee to administer employer sections separately and segregate corresponding assets and liabilities. However, this is merely administrative ring-fencing; legally, those assets and liabilities are not ring-fenced and form part of a single trust's overall assets and liabilities. Again, employers need to decide if they are comfortable with that structure from a risk perspective.

3. INDEMNITY TO TRUSTEES

Employers should consider if they are required to provide indemnities to MT providers and the MT trustee that are more onerous than any indemnities they may provide to the current trustees of their existing pension scheme. In many cases, MT documentation contains extensive and widely framed employer indemnities in favour of the MT provider and trustee, potentially increasing the level of legal risk for employers compared to standalone schemes.

4. FREEDOM TO CHANGE CHARGING STRUCTURE

Although the Authority advises employers to consider the MT charging structure, a related issue is whether that charging structure contractually binds the provider for a defined period. Most MT providers reserve the right to increase fees on notice, without any prior consultation, albeit a minimum of six months' notice is required under the Authority's Code of Practice for MT providers. This freedom to increase charges is significant given the challenges described earlier with switching a MT provider.

CONCLUSION

The terms offered by each MT provider vary in terms of the level of legal risks imposed on employers. Given the potentially long-term nature of any arrangement with a MT provider, employers should ensure they get advice and carefully consider those legal risks before moving to a MT.

3. BETTER 'ARF'? OFFERING SURVIVING DEPENDANTS MORE FLEXIBILITY

The Finance Act 2021 (the **Act**) has changed how an approved pension scheme may be designed to provide benefits to a member's surviving dependant(s) where that member dies before retirement. Until the end of 2021, an approved scheme could be designed to provide:

- a lump sum benefit on death before retirement of a member (not exceeding four times the employee's final remuneration and a refund of member contributions), (the **Lump Sum Limit**); and/or
- benefits by way of a pension for the member's surviving spouse, civil partner or dependant(s) (**Dependants**).

The Act introduced the additional option of transferring benefits to an Approved Retirement Fund (**ARF**) for surviving Dependants on death before retirement. In broad terms, an ARF is a post-retirement investment product that allows a person to invest pension savings tax-efficiently and draw down money as the need arises.

ARF ALTERNATIVE FOR DEPENDANTS

The Act permits pension trustees to offer the ARF option to surviving Dependants on a member's death before retirement as an alternative to a Dependant's pension. Where lump sum benefits on death in service exceed the Lump Sum Limit, this ARF option will also be relevant. The Act enables the transfer of those excess amounts to an ARF as an alternative to applying them towards a pension for the surviving Dependant.

However, as this ARF option is a new feature of tax legislation, existing scheme rules will need to be updated to allow schemes make this option available to surviving Dependants.

Whether a Dependant would prefer a pension or to avail of the ARF option instead will depend on their circumstances. For example, a young surviving spouse may prefer an ARF and the ability to draw down that capital as the need arises. In contrast, an elderly surviving spouse may prefer the certainty of a regular income stream via a pension.

CONCLUSION

There are potential advantages, from a member's perspective, of having an ARF option available to surviving Dependants where a member dies before retirement. Therefore, trustees should consider engaging with the sponsoring employer to amend their scheme rules so that the ARF option can be offered to surviving Dependants in future cases. Any such amendment should build in appropriate protections for trustees, given the risks associated with monies invested in an ARF.

4. REGULATORY UPDATE - IN BRIEF

1. ONE MEMBER ARRANGEMENTS (**OMAS**)

The deadline for OMAs set up on or after 22 April 2021 to achieve full IORP II compliance expired on 1 July this year. In advance of that deadline, the Pensions Authority (the **Authority**) advised insurance companies that the use of standardised trustee services and policies and key function holder appointments replicated across a large portfolio of OMAs would be unlikely to meet the compliance threshold. The Authority also advised insurers that non-compliance by new OMAs would not be tolerated after 1 July and that enforcement action and prosecutions may be taken in response to non-compliance.

Life offices have since largely withdrawn their single member executive pension plan offerings from the market and some are now in the process of migrating their OMAs portfolios to Master Trusts (**MTs**). Others are expected to launch new MT offerings aimed specifically at the executive pension plan market imminently. Current trends suggest that we are likely to see the bulk of existing OMAs migrate to MTs, but it is a journey that is going to take a long time to complete.

2. PAN-EUROPEAN PERSONAL PENSION PRODUCT (**PEPP**)

In our briefing on PEPPs from August 2021 (which can be accessed here), we explored the core features of the PEPP.

The regulatory landscape for PEPPs in Ireland became clearer with the introduction of the European Union (Pan-European Personal Pension Product) Regulations 2022 (**PEPP Regulations**) in September this year. They designate the Central Bank as the competent authority responsible for supervising PEPP providers and distributors in the State and provide it with various regulatory and enforcement powers relating to PEPPs.

The publication of the Finance Bill 2022 (the **Finance Bill**) in October this year helped to provide more clarity regarding the tax treatment of PEPPs. In broad terms, the tax treatment of PEPPs will align with the tax treatment which currently applies to PRSAs.

Now that the regulatory and tax framework as they apply to PEPPs in Ireland has become clear, it is over to providers to decide whether there is likely to be a demand for PEPPs and, if so, whether Ireland is the appropriate place from which to launch their PEPP offerings at the Irish and European markets.

3. PRSA TAX REFORMS

One of the longstanding weaknesses with PRSAs as compared to OMAs was the much more limited opportunities for tax efficient retirement savings with PRSAs for high earners. This was due to employer contributions being treated for tax relief purposes as if they have been made by the employee.

The Finance Bill proposes to address this issue by:

- exempting an employer's contribution to an employee's PRSA (or PEPP for that matter) from income tax as a benefit-in-kind; and
- no longer deeming an employer's contribution to a PRSA to be an employee contribution for the purposes of individual tax relief limits.

These proposals follow recommendations made by the Inter-departmental Pensions Reform and Taxation Groups. If passed into law, they will be welcomed as a step in the right direction in seeking to harmonise some aspects of the complex tax regime which applies to the pensions sector. They will also enhance the attractiveness of PRSAs as a pensions savings vehicle for high earners.

4. AUTO-ENROLMENT BILL

In early October, we had the announcement that the General Scheme of the Automatic Enrolment (**AE**) Retirement Savings System Bill had received Government approval.

With the final design of the AE system having been confirmed in March, the announcement has provided a timeline for implementation, with a provisional implementation date set for 2024. We discussed the implications of this announcement in our recent article (which can be accessed here).

CONCLUSION

The future shape of the Irish pensions market for individual retirement savers is beginning to become clear. The OMA is expected to gradually disappear and likely to be replaced by MTs aimed at the executive pension plan market. PRSAs should become more attractive to high earners if the Finance Bill reforms become law, albeit some of the investment restrictions which apply to PRSAs mean that they are unlikely to step into the space currently occupied by OMAs. Meanwhile, it remains to be seen if PEPPs will have any role to play in this sector of the Irish pension market and, as we approach the end of 2022, a provisional implementation date of 2024 for the AE system seems ambitious.

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