WILLIAM FRY // Pensions

Winter Pensions Briefing

December 2023

Welcome to our Pensions Winter Briefing 2023!

In our latest Briefing, we bring you an update on a wide variety of legal developments affecting the pensions sector. A brief overview of what we cover follows below.

A. **'New Flexible State Pension Age – Impact on Employers'**
We review the State pension reforms that are set to introduce flexible drawdown options for the State pension from January 2024 and how this may impact employers in enforcing mandatory retirement ages.

B. **'The Recipe for Own Risk Assessment: Legal Risk as a Key Ingredient'**
We discuss how legal risks can form a key part of the own-risk assessment exercise facing trustees. We focus on some 'real-world' legal risks trustees can face in practice.

C. **'Regulatory Update – In Brief'**
We provide some 'bitesize' updates surveying:

- pension reforms in the Finance (No.2) Bill;
- changes to the rules on forced transfers of deferred members' benefits; and
- the current status of auto-enrolment proposals.

D. **'Navigating the New Era: AI and the Pensions Industry'**
We give an insight into the infusion of AI into the pensions industry, highlighting the impending AI Act, and delving into strategies to navigate compliance with AI in an evolving landscape.

A. New Flexible State Pension Age – Impact on Employers

In September 2022 the Cabinet announced *'landmark'* reforms of the State pension system in Ireland (**Reform Package**). One such proposal was the introduction from January 2024 of a 'new flexible pension age model', i.e. an option to continue working to age 70 in return for a higher State pension. Draft legislation has now been published to introduce this flexibility.

NEW FLEXIBLE DRAWDOWN OPTIONS

The Social Welfare (Miscellaneous Provisions) Bill 2023 (**Bill**) was published on 22 November 2023. Under the terms of the Bill:

- a person reaching age 66 will have the option to take payment of the State pension (contributory) at age 66 in the usual way (assuming they have made the requisite PRSI contributions); or
- defer taking payment of the State pension (contributory) until any age between 67 and 70 (in return for an actuarially increased rate of pension).

INCENTIVE TO WORK LONGER?

The advantages for an individual availing of the new flexibility to drawdown the State pension (contributory) are that:

- they will receive an actuarially increased pension; and
- any further PRSI contributions made while they remain in employment will count towards their rate of payment.

The explanatory notes to the General Scheme which pre-dated the Bill went so far as to propose that these reforms will offer an incentive to older people to remain in employment beyond age 66. In reality we are more likely to see a change in employee behaviour (i.e. opting to defer drawdown of the State pension (contributory)) in circumstances where an employer does not contribute to a pension scheme or PRSA on behalf of its employees or where employees have declined to take up such benefits.

ADDED CHALLENGE TO ENFORCING MANDATORY RETIREMENT AGES?

Employees who are not provided with pension benefits by their employer (or those who have not availed of available benefits) may well decide to remain in employment for longer because they will not have other financial supports available come retirement. This change to the State pension (contributory) may create an additional challenge for employers in the context of enforcing mandatory retirement ages (**MRAs**) as more employees may seek to work for longer. While the Employment Equality Acts 1998 to 2021 (**1998 Act**) provide for a general prohibition against age-related discrimination, the 1998 Act permits employers to implement a MRA. However, any such MRA will be considered discriminatory unless it can be objectively and reasonably justified by a legitimate aim and the means of achieving that aim are appropriate and necessary. That said, it is becoming increasingly difficult for an employer to successfully defend a MRA. Age-related discrimination complaints are on the rise. According to the 2022 Workplace Relations Commission's Annual Report, of the nine protected grounds for discrimination, age-related discrimination complaints showed the highest increase – 176% – when compared with 2021 figures.

Finally, the Reform Package proposes that the Department of Enterprise, Trade and Employment would introduce measures that *"allow, but do not compel"* an employee to stay in employment until the State pension age. This measure is not included in the Bill. We await the details of any such measures to consider how they may impact employers with MRAs below the State pension age.

DEFINED BENEFIT SCHEME DOCUMENTATION

The Bill may also have an impact on the interpretation of defined benefit (**DB**) scheme rules that operate on an *"integrated"* basis (i.e. where an individual's DB scheme pension makes an allowance for the fact that the individual will also receive a State pension). DB scheme documentation will have been drafted on the basis that there is one maximum rate of State pension (contributory) and that payment of State pension (contributory) may not be deferred. The Bill introduces 5 separate rates of State pension (contributory), being the '*age referenced*' rates at each age from 66 to 70. As such, trustees and sponsoring employers of DB schemes will need to evaluate with their advisers if the technical changes to social welfare legislation envisaged in the Bill will impact the operation of the 'integration' provisions within the rules of any such scheme.

CONCLUSION

The State pension reforms may create an additional challenge for some employers in the context of enforcing MRAs. However, a challenge for all employers will be the related PRSI increases. In an accompanying press release to the publication of the Bill the Minister for Social Protection announced incremental increases in all classes of PRSI. This was stated to support the cost of the retention of the State pension at age 66.

We anticipate the Bill will progress quickly with the State pension flexibility reform expected to take effect in January. Employers are best advised to consider how the State pension reforms will impact their business. For more information, please contact Ian Devlin, Nuala Clayton or your usual William Fry contact.

This article is based on the version of the Social Welfare (Miscellaneous Provisions) Bill 2023 as initiated on 22 November 2023.

B. The Recipe for Own Risk Assessment (ORA): Legal Risk as a Key Ingredient

INTRODUCTION

Much of the discussion and debate on the ORA exercise to date has focused on various aspects of funding, investment and administrative risks. However, legal risk is a core part of any ORA exercise. In this article, we examine some of the key "real-world" legal risks which we have seen trustees having to deal with in practice.

<table>
<tr><th>Source of Legal Risk</th><th>Comments</th></tr>
<tr><td>TRUST DEED AND RULES</td><td>The ORA provides a good opportunity for trustees to review their powers under their trust deed in key areas such as contributions, amendment and wind-up. The risk of the sponsor terminating its contribution liability, and possibly by immediate notice, is a risk to which many defined benefit scheme trustees are exposed. Trustees should understand whether this is a risk they face and how they can mitigate it.

The ORA also provides an opportunity to assess whether the existing trust deed and rules needs modernisation to reflect current legislative requirements and best practice. For instance:

• Does it contain any provisions which may now be unlawful or discriminate on grounds of gender, age, fixed-term or part-time worker status?

• Have trustees considered whether their scheme rules need to be updated arising from changes to the State pension age or recent changes to tax legislation, such as those related to approved retirement funds?

• Does it make provision for member-directed investment to avail of Pensions Act "safe-harbour" provisions?

• Should the scheme documentation be consolidated so that all amendments and benefit changes are appropriately housed within an up-to-date trust deed and rules, thus reducing the risk of benefit terms being misinterpreted?

These are just some of the reasons why a review of a scheme's trust deed and rules can be a useful part of the ORA exercise.</td></tr>
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Source of Legal Risk	Comments
SERVICE PROVIDER CONTRACTS	A key aspect of any well-governed scheme is to ensure that appropriate contracts are in place with all service providers. For that reason, the ORA exercise provides an opportunity to check that contracts are in place with all scheme service providers and to review those contracts against the minimum requirements for such contracts specified in the Pensions Authority's Code of Practice (**Code**). It is also important to understand the level of legal risk that trustees may be exposed to depending on the terms of those contracts. For instance, in many cases, limitation of liability and indemnity provisions are weighted in favour of service providers, particularly where those contracts have not been reviewed by the trustees' legal advisers. This can have significant implications should issues arise such as a data breach. The ORA provides trustees with an opportunity to assess what level of legal risk they are exposed to under such contracts and what steps can be taken to mitigate those risks.
GOVERNANCE	Due to IORP II, there is an increased focus on trustees putting in place an effective system of governance. Most well-governed schemes will have put in place the necessary suite of IORP II policies. The next phase in the governance journey is to ensure that the procedures and activities specified in those policies are implemented in practice. Building those activities into trustees' annual business plans can assist with that task. Another key aspect of good governance is ensuring that trustee meetings are properly conducted and documented in line with best practice and the requirements of the Code. For instance, are minutes being kept to accurately document decisions taken and any advice considered in reaching those decisions? If those decisions become the subject of legal challenges at a later point, then having well-documented minutes can greatly aid trustees' defence of such claims.
COMPLIANCE	IORP II has greatly increased the compliance obligations trustees now face. The range of those obligations means that it is becoming increasingly important for trustees to create a compliance checklist which identifies the key legal obligations with which they must now comply. Any thorough ORA exercise will involve trustees liaising with their advisers to put in place such a checklist and then have it reviewed to identify any gaps in compliance. This can inform an action plan which the trustees can put in place to address any compliance gaps they may have identified.

Source of Legal Risk	Comments
MEMBER COMMUNICATIONS	Situations can often arise in practice where member booklets may not accurately reflect benefit entitlements under the rules of a pension scheme. This has the potential to lead to member complaints or claims. For that reason, the ORA exercise provides a useful opportunity to assess whether member booklets need to be updated to reflect benefit changes which are not captured in the current edition.

CONCLUSION

The Pensions Authority has stated that the overall purpose of the ORA *"is to ensure members' benefits are well protected and that the scheme delivers good member outcomes"*. If the risks referred to in this article are not considered and properly addressed as part of an ORA then the potential for adverse member outcomes begins to come into play. For those reasons, trustees should ensure that an assessment of legal risks forms part of their ORA process.

If you would like advice on ORAs or any of the issues referred to above, please contact Ian Devlin, Ciara McLoughlin or your usual William Fry contact.

C. Regulatory Update - In Brief

1. FINANCE BILL (NO.2) 2023

In 2021 and 2022, the Finance Acts introduced specific legislative changes based on certain recommendations contained in the Report of the Interdepartmental Pensions Reform & Taxation Group (the **IPRTG Report**). The Finance (No.2) Bill 2023 continues to progress the implementation of the IPRTG Report recommendations with two proposals:

- the removal of the upper age limit (age 75) for taking benefits from a PRSA (to re-position PRSAs as a 'whole-of-life' product); and
- the prospective abolition of retirement annuity contracts (RACs) (so that Revenue will not approve any new applications made after 1 January 2024).

This table summarises progress to date in implementing some of the key recommendations of the IPRTG Report and some key recommendations which remain outstanding:

PROPOSAL	STATUS	COMMENT
1. Abolition of AMRF	✔	Implemented in Finance Act 2021
2. Removal of the 15 year rule (transfer to PRSA)	✔	Implemented in Finance Act 2021
3. ARF option on death-in-service	✔	Implemented in Finance Act 2021
4. PRSA tax reform (PRSAs should not be subject to BIK for employer contributions)	✔	Implemented in Finance Act 2022
5. PEPP tax treatment to mirror PRSA	✔	Implemented in Finance Act 2022
6. PRSA as whole-of-life product	⏳	Proposed in Finance (No.2) Bill 2023
7. Prospective abolition of RACs	⏳	Proposed in Finance (No.2) Bill 2023
8. In-Scheme drawdown (legislative amendments to be considered to enable flexible in-scheme drawdown)	✖	For consideration by the Department of Social Protection and the Pensions Authority
9. The upper age limit of 'normal retirement age' should be increased to age 75	✖	Outstanding
10. Prospective abolition of ARFs	✖	Outstanding

COMMENT:

One of the reform proposals in the IPRTG Report is discontinuation of the 'ARF option' on a prospective basis. It is to be replaced by a combination of in-scheme drawdown and a re-designed PRSA, which will operate as a whole-of-life product. Although the changes proposed to the PRSA product in the Finance (No.2) Bill 2023 are connected to that recommendation, the abolition of ARFs is unlikely to happen in the short-term and while proposals to facilitate in-scheme drawdown remain outstanding.

2. THE OCCUPATIONAL PENSION SCHEMES (PRESERVATION OF BENEFITS) (AMENDMENT) REGULATIONS 2023 (S.I. NO. 499 OF 2023) (THE AMENDING REGULATIONS)

The Amending Regulations make changes to the preservation regime to broaden the circumstances in which trustees can effect the transfer out of deferred members' benefits without their consent, while a scheme is continuing. The two key changes are:

- The Amending Regulations have increased the threshold where trustees may effect such forced transfers from €10,000 to €20,000.
- Trustees must notify members in advance of making any such transfer and the Amending Regulations now provide that the notification can be "given, sent or served" electronically as well as by hard copy.

COMMENT:

By increasing the threshold for forced transfers to €20,000, the Amending Regulations give trustees broader scope to deal with some of the administrative challenges posed by deferred members with small residual benefits within schemes. However, trustees should seek legal advice in considering whether to exercise such powers to ensure any proposed transfers are validly effected.

3. AUTO-ENROLMENT UPDATE

As detailed in our auto-enrolment (**AE**) briefings, in October 2023, February 2023, and November 2022, the Irish government is pushing ahead with its proposed implementation of AE. The latest implementation target date is the second half of 2024. However, the Bill to implement AE is awaited. We were expecting publication of the Bill before year end. However, Taoiseach Leo Varadkar speaking in the Dáil on 22 November implicitly acknowledged a delay with this process, by stating that the government "*will bring legislation on auto-enrolment through the House next year* [emphasis added]".

COMMENT:

Without a draft Bill to implement AE the target date of late 2024 is looking increasingly challenging. However, employers should still start to consider what AE will mean for their business and plan accordingly. There are complex legal, payroll and financial aspects to that planning exercise. Therefore, the sooner that work starts the better prepared employers will be for AE once it arrives.

For further information, please contact Ian Devlin, Ciara McLoughlin, Jane Barrett or your usual William Fry contact.

D. Navigating the New Era: AI and the Pensions Industry

INTRODUCTION: THE DAWN OF AI IN PENSIONS

The pensions industry, which is already undergoing rapid change after the transposition of IORP II and the introduction of master trusts, is at the threshold of a revolution driven by Artificial Intelligence (AI). This infusion of AI into pension schemes, especially in trustee administration and investment products, is a paradigm shift with significant legal implications. As the Pensions Authority is focusing more on risk management, we set out below some key suggestions on how to mitigate AI risk and highlight future reform in the AI area.

UNDERSTANDING AI IN PENSIONS: BEYOND TECHNOLOGY

AI's role in pensions is diverse. From automating administrative tasks to revolutionising investment strategies, AI is becoming indispensable. Trustees and employers must understand the nature of the entities they engage with. Are these entities merely technology providers, or do they qualify as fiduciaries or investment advisers? This distinction governs the scope of legal responsibilities and liabilities.

THE AI ACT: PREPARING FOR A LEGISLATIVE MILESTONE

The impending AI Act, a ground-breaking piece of legislation in the European Union, will redefine the legal framework surrounding AI. For the pensions industry, this means understanding and adhering to these new regulations. The Act categorises AI systems based on their risk level, imposing stringent requirements on "high-risk" AI systems, which could include those used in pensions for predictive analytics or investment decision-making.

AI AND BROADER EU REGULATIONS IMPACTING PENSIONS

Beyond the AI Act, AI's integration into pensions will interact with other EU regulations, such as:

- MiFID II (Markets in Financial Instruments Directive II): AI-driven investment advice or algorithms must comply with MiFID II's requirements for transparency, suitability, and record-keeping.
- GDPR (General Data Protection Regulation): The use of personal data in AI systems for pension schemes must align with GDPR's principles, particularly in terms of consent, data subject rights, and data minimisation.
- IORP II Directive: AI tools used in pension fund management and scheme administration must adhere to IORP II's governance and risk management requirements, ensuring prudence and member protection.

These regulations require careful consideration in the deployment of AI in pensions, underscoring the need for compliance and ethical considerations.

COMPLIANCE STRATEGIES: STEPS FOR TRUSTEES AND EMPLOYERS

As the pensions industry integrates AI, trustees and employers must adopt a nuanced and proactive approach to ensure compliance. Here are detailed strategies for navigating this evolving landscape:

1. COMPREHENSIVE REVIEW OF SERVICE AGREEMENTS:

- **Legal Provisions:** Agreements with AI service providers should have clear legal provisions detailing AI applications, data usage, and performance metrics.
- **Liability and Indemnity:** Establish clear parameters for AI-related errors or breaches, including indemnity clauses for potential regulatory penalties or data mishandling.
- **Regulatory Compliance Clauses:** Include explicit clauses ensuring adherence to the AI Act, GDPR, MiFID II, and other relevant regulations, covering transparency, data handling, and risk management.

2. **DEEP UNDERSTANDING OF AI CLASSIFICATIONS AND RISKS:**

    - **Risk Assessment of AI Tools:** Conduct thorough risk assessments to categorise AI systems as per the AI Act, evaluating potential biases, inaccuracies, and ethical concerns.

    - **Continuous Monitoring:** Implement ongoing monitoring to ensure AI tools comply with evolving regulations and ethical standards.

3. **ROBUST RISK MANAGEMENT AND DUE DILIGENCE:**

    - **Develop AI-Specific Risk Frameworks:** Create frameworks tailored to AI, focusing on data integrity, algorithmic transparency, and outcome predictability.

    - **Due Diligence in AI Selection:** Perform extensive due diligence before adopting AI solutions, evaluating the provider's track record, system robustness, and compliance history.

4. **TARGETED TRAINING AND AWARENESS PROGRAMMES:**

    - **AI Literacy:** Develop training programmes to enhance AI literacy among trustees and management, focusing on AI capabilities, limitations, and legal aspects.

    - **Scenario Planning:** Conduct workshops and scenario planning exercises for potential AI-driven challenges or regulatory changes.

5. **STRINGENT DATA GOVERNANCE PROTOCOLS:**

    - **Data Audit and Mapping:** Regularly audit and map data flows within AI systems to ensure compliance with data protection laws.

    - **Consent Management:** Establish robust consent management practices for data used in AI systems, ensuring transparency and user control.

6. **PROACTIVE ENGAGEMENT WITH REGULATORS AND LEGAL COUNSEL:**

    - **Regular Consultations:** Engage regularly with legal experts specialising in AI and pensions law for updates on legislative changes and best practices.

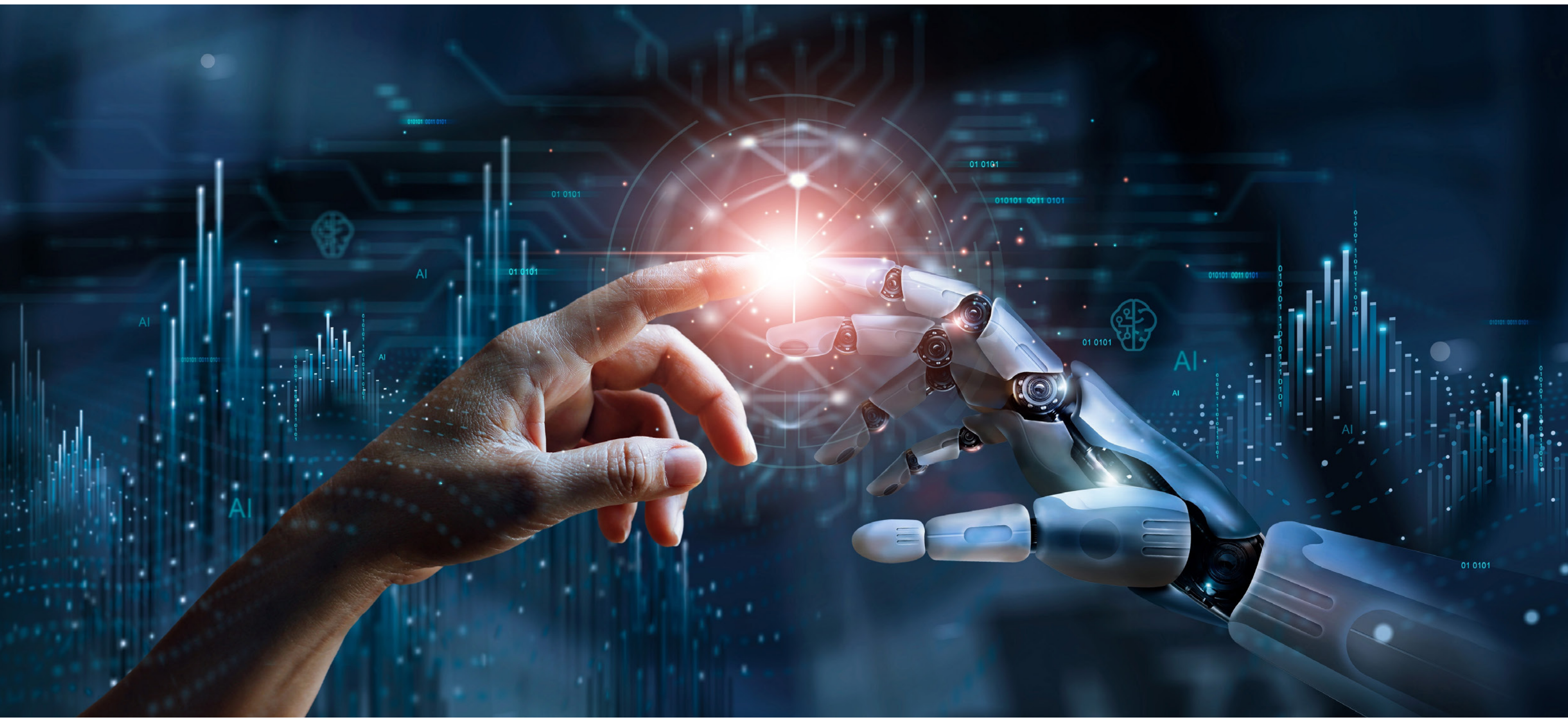
- **Regulatory Dialogue:** Maintain a dialogue with regulatory bodies for insights into upcoming regulations and to advocate for practical compliance solutions.

Adopting these strategies requires a commitment to understanding the intricacies of AI and its regulatory environment. By doing so, trustees and employers can comply with existing regulations and anticipate future changes, ensuring that their pension schemes remain resilient and forward-thinking in the age of AI.

EMBRACING THE FUTURE WITH PRUDENCE

As AI becomes embedded in the pensions industry, trustees and employers must navigate this terrain with enthusiasm and caution. Understanding the legal implications and preparing for legislation will enable them to harness AI's power while safeguarding member interests. This approach ensures compliance and positions pension schemes at the forefront of digital innovation.

For more information this topic please contact Ian Devlin, Ciara McLoughlin, Barry Scannell or your usual William Fry contact.



CONTACT US

For further information, please contact Ian Devlin, Ciara McLoughlin, Jane Barrett or your usual William Fry contact.

Ian Devlin
HEAD OF PENSIONS GROUP
+353 1 639 5064
ian.devlin@williamfry.com

Ciara McLoughlin
CONSULTANT
+353 1 489 6611
ciara.mcloughlin@williamfry.com

Jane Barrett
ASSOCIATE
+353 1 489 6684
jane.barrett@williamfry.com