REGULATION

The known unknown

How much of an influence will the long-disputed IORP II Directive really have on scheme governance?

WRITTEN BY MAREK HANDZEL, A FREELANCE JOURNALIST

In theory, the implementation of the Institutions for Occupational Retirement Provision (IORP) II Directive should be a lot smoother than its gestation.

Some three years in the making, the directive certainly tested the patience of many of Europe's pension funds and their service providers with its initially rigid and unrealistic dictates. But by the time it was ratified in late 2016, IORP II had morphed into a less authoritarian beast. Gone, for example, was one of the original contentious plans to impose a Solvency II-type 'holistic balance sheet' rule on scheme funding. Having listened to numerous concerns raised by the pensions sector, the EU Commission had left most parties with skin in the game satisfied that member states will be able to comfortably meet the 12 January 2019 implementation deadline.

The vast majority of pension funds affected by the directive are based in the UK and the Netherlands' well-regulated markets, with both countries accounting for 86.6 per cent of IORP assets, according to the European Parliament. It is hoped however, that the directive will lay solid foundations that immature pension markets can build on.

The good news for those fledging systems is that implementation doesn't necessarily mean that IORP has to be in practical effect from next year. What it really means, as the UK's Pensions, Lifetimes and Savings Association (PLSA) policy lead on engagement, the EU and regulation, James Walsh, explains, is that member states must satisfy the European Commission that they are putting the directive into effect, even if it takes some more months or years for its practical ramifications to come through.

The directive has four specific aims: improve transparency in member communications; enable widespread cross-border IORP activity; establish good governance and risk management; and ensure that member state supervisors have the means to supervise IORPs. It is the third of these objectives that has raised some renewed questions over how suitable IORP II is for a continent where the variance between pension schemes is even wider than the yield spread between a German and Tajikistani government bond.

Nothing new?

As the German Association for Occupational Pensions' secretary general, Klaus Stiefermann, explains, many national regulations have increased significantly since the global financial crisis of 2007/08 and these have included the governance of pension funds.

"In Germany, the minimum requirements for risk management in insurance undertakings were introduced in 2009 by the German supervisory authority BaFin and are still relevant for German IORPs," he says.

"Therefore, many of the IORP II governance requirements are not new for German IORPs."

The Netherlands — which announced that it was to insert the directive into its statute books in January this year — and the UK, are in similar positions.

THE EU COMMISSION HAD LEFT MOST PARTIES WITH SKIN IN THE GAME SATISFIED THAT MEMBER STATES WILL BE ABLE TO COMFORTABLY MEET THE 12 JANUARY 2019 IMPLEMENTATION DEADLINE

In Walsh's view, IORP II will only be a modest contributing factor in improving better overall governance of Europe's pension schemes.

"Looking at the UK, we don't expect it to make a major change to what schemes have to do by way of governance arrangements," he says. "That's largely because the UK already has a highly developed system of pension scheme governance with a highly developed regulatory system around it.

"I can see some countries where their pension systems are newer, and less developed, where the IORP II Directive might have a bigger impact, but in the UK, I don't think it will have that effect."

Danger

However, making an impact in countries where the second pillar is underdeveloped could be hampered by too strict an implementation, argues the Irish Association of Pension Funds' CEO Jerry Moriarty.

"The danger is that individual countries decide to go belt and braces with everything and you just make providing pensions much more difficult and you end up changing the fundamental nature of pensions," he warns.

"So you may end up with schemes being unable to continue unless they have professional trustees, for example, so they have to move into master trusts, which may not be better for people overall."

Added to that, says Moriarty, who is also vice chairperson of PensionsEurope and chair of the PensionsEurope DC Committee, IORP II will impose additional costs on smaller schemes, making it debatable as to whether the benefits will outweigh the costs.

No longer one-size-fits-all

Fortunately, a good degree of this cost risk can be mitigated by individual countries taking full advantage of the flexibility that the finalised IORP II Directive offers them.

No longer a one-size-fits-all option, as Stiefermann highlights, the directive is now aimed at a minimum level of harmonisation.

"It does not claim to offer any comprehensive and definitive solutions. Rather, it leaves member states room for tailor-made regulatory steps," he says. "Given the considerable diversity of occupational pensions within the EU, we think this is the right approach."

For Moriarty, this flexibility is both IORP II's strength and weakness: "You would prefer that people were focusing on governance because it's the right thing to do, rather than because they feel that they have to do it, or that they're being forced to do it."

Comparing a Dutch scheme with hundreds of billions of assets in many investment pots and a small Irish employer DC scheme with just one default option fund, Moriarty underlines how difficult it is to come with a common governance standard. And given the leeway that individual countries can exercise, they could end up utilising such minimal elements of IORP II that they have a negligible impact on pension management standards.

The European Association of Paritarian Institutions' (AEIP), permanent representative, Alexandra Kaydzhiyska, has similar concerns.

"There is a small issue here as social and labour laws as a concept remains undefined at European level and there are different terminologies and perceptions of what social and labour law is," she says. "There is no common interpretation at a European level that defines this as a term.

"The IORP II Directive refers to it, but doesn't provide a definition, so member states here are free to decide for themselves as to what it includes. So it's difficult to draw conclusions *[as to how the directive will]* further improve governance."

Individual responsibility

Even if every member state rubber-stamped IORP II in its entirety, however, it is debatable as to whether this would significantly improve governance, even within young pension markets. After all, most pension advisers would agree that good governance comes from within, both at an individual and at a national level.

Walsh argues that what really improves governance is the quality of people selected to do the governing. "It's true that IORP II does say something about the quality of people," he says, "but it's slightly broad brush."

***[THE IORP II DIRECTIVE]* DOES NOT CLAIM TO OFFER ANY COMPREHENSIVE AND DEFINITIVE SOLUTIONS. RATHER, IT LEAVES MEMBER STATES ROOM FOR TAILOR-MADE REGULATORY STEPS**

And from a country's perspective, more needs to be done than just incorporating IORP II into law. Stiefermann cites the work carried out in Germany to improve retirement provision to illustrate his belief that the directive is just a starting point.

"In 2017 the German legislator strengthened the role of social partners and significantly improved incentives in tax and social law," he says.

"Therefore, the actual key to better retirement provision for individual employees – both in quantitative terms such as coverage and benefit levels, and in qualitative terms – lies in the hands of the national legislator, employers and social partners."

Beyond IORP II

Ultimately, the known unknown of IORP II is whether or not it will deliver better pension benefit outcomes for Europe's workers. Kaydzhiyska believes that it is a step in the right direction, but requires member states to face up to the financial implications of increased life expectancy and for future pension legislation to adopt a more interconnected approach to pensions.

"Retirement provision will be up to individual countries to make a success of it. It's very different from one county to another," she says. "In some countries IORPs are a fundamental part of pension provision, in others they don't exist.

"We believe that in order to improve retirement provision for European workers there should be a holistic approach. It's not only the second pillar or the third pillar that can solve the challenges that we have.

"The way forward in all future pension policies is a balanced multi-pillar approach, while improving the schemes that are already in place." ■