REGULATION

Pension funds across Europe are having to deal with a tsunami of new requirements; Jack Gray **asks whether there is too much new regulation and how the pensions industry can cope with the increased burden**

Stepping up to the challenge

WRITTEN BY **JACK GRAY**

The green transition, improved governance, digitisation, climate disclosures; the list of policy areas requiring new regulation for pension funds goes on and on. Pension funds and other institutions are having to contend with swathes of new requirements, putting additional burden on their time, finances and resources, all while the economic and geopolitical landscape fluctuates violently. While all these policy areas have commendable aims and require attention, some argue that the speed and approach governing bodies are taking is too much for pension funds to handle. Not only are pension organisations having to deal with regulations specific to them, they are also increasingly coming into scope of broader financial requirements that are less tailored to the unique nature of pension funds. This has sparked concerns from professionals across the industry and raised questions as to whether there is too much regulation being proposed and brought into force in a short space of time.

How much is too much?

"The numerous regulations imposed over the past decade have substantially increased administrative burdens and compliance costs for pension funds," argues PensionsEurope CEO, Matti Leppälä. "This diverts resources away from investment activities.

"The pace of introducing new regulations is also very important. Too frequent changes create uncertainty and make long-term planning difficult for pension funds. In many new requirements, the implementation periods have been too short, and this is not a problem for just pension funds but also a challenge for supervisors."

The coming months and years will be pivotal for the operation and prosperity for pension funds across Europe, which are not only having to deal with new or updated EU-wide regulation, such as Sustainable Finance Disclosure Regulation (SFDR) and the Digital Operational Resilience Act (DORA), but also scheme- and country-specific policies, including the IORP II Directive, the Future Pensions Act in the Netherlands, and auto-enrolment in Ireland.

"There has indeed been a large increase in new regulation that pension funds across the EU must abide by, both coming into force and being proposed," notes Insurance & Pension Denmark deputy director, Torben Weiss Garne.

"We refer to this development as a tsunami of new regulation the industry has to adopt in the coming months and years. We are not only talking capital and reporting requirements, but especially new regulation concerning sustainability and digitalisation. Danish pension funds will meet the task ahead, but it will require a lot of work and come at a cost."

Looking at IORP II as one example, Leppälä highlights that the directive has 67 articles, compared to 27 in IORP I: "The implementation of IORP II entailed a significant financial burden for IORPs and, even though there are various reasons, the greatest threat to the survival of small IORPs is the cost burden. In some member states, the number of IORPs has already dropped by 25 per cent since the introduction of IORP II."

However, while PME Pensioenfonds senior strategic responsible investing, Daan Spaargaren, concedes the industry is having to deal with a lot of requirements and legislation, he argues that this is a signal that the pension industry is behind on what it needs to do, especially in world of sustainable investment.

"It is a corrective measure to make sure we bring our investments in line with what society asks," he continues. "Because, in the end, national governments and the EU are putting the legislation on our plate.

"If you look at SFDR, for example, it is aimed at making our investments more transparent and to be more transparent on how we invest sustainably. In that sense, this piece of legislation is primarily important for pension funds because we have a direct responsibility towards our ultimate beneficiaries, the participants, and the pensioners of the fund."

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Horizontal regulation

One of the key concerns about the level of new regulation is the amount that is focused on the wider financial sector, rather than pension fund-specific requirements. Pension fund trustees and managers are having to get to grips with policy areas they may not be familiar with, adding to the workload and resource burden that was already becoming an issue, as Leppälä explains: "In addition to increased regulation resulting from IORP II the number of European legislations that applies to pension funds keeps growing.

"On DORA, there are many ongoing consultations on the legislation that is crucial for the implementation of this legislation and what the actual impact on pension funds will be.

"These legislative processes are complicated and challenging for pension funds to assess what the impact on them will be and how should the specificities of pension funds be considered. Pension funds are in many aspects very different than other financial market entities and if it is deemed necessary to include them in these types of horizontal legislations proportionality is crucial for them."

"There has been significant growth in regulations," notes Aon head of pension risk management Ireland, Alcarine Power. "Some of it is very much needed and is good, but keeping it tailored to pension funds and outlining how they can differ from other financial institutions is important. It's not always obvious how it has been tailored."

Her colleague, Aon partner, international wealth solutions, Thierry Verkest, adds that a consequence of the lack of tailoring is trustees and pension managers struggling to understand the upcoming regulations they must comply with. “It has become a real struggle,” he explains.“Since the financial crisis, we have seen a huge increase in regulation where pension funds have been assimilated to all kinds of financial institutions and we tend to forget that pension funds have a different nature to other financial institutions.”

Verkest argues that while the regulation is necessary, it needs to be adapted to pension funds, their complexity and size, and that there is a role, especially for the national authorities, to transpose the law in a way that takes the nature of pension funds in each market into account.

“There is such a diversity across Europe that needs to be recognised in the regulations, even up to local legislation and tax regimes they are working in,” Power adds. “There needs to be considerable thought on a country-by country basis how that actually works within the framework of everything else.”

However, while Spaargaren agrees that the industry will always want regulation to be as specific as possible to best accommodate the requirements, he argues the pensions sector is simultaneously asking for a level playing field.

“This means that all the actors in the wider financial industry should adhere to the same standards,” he continues. “In that sense, I am not against broader regulation, because we have to adhere to the same standards as other investors.

“I don’t believe that it should be more tailored. It also makes it harder for the supervisory bodies to compare progress and disclosures.”

Stepping up to the challenge

While many pension professionals will argue there is too much regulation, and the broader requirements need more tailoring and proportionality, this does not change the fact that pension institutions must abide by the new rules.

Using external support and expertise seems key in meeting new requirements, especially for smaller schemes that often do not have the same level of internal resources as larger schemes to handle the increased burden, as Power explains: “Advisers are a necessity; this is not something trustees can be expected to be able to navigate without clarity from those who specialise in looking at these things.

“There are vehicles out there that will ease that, for example master trusts and collective schemes, where they can move some of that risk on to people that are dedicated professionals in this area.”

Verkest adds that it all starts with understanding the regulations, noting that once pension funds understand what needs to be done, they can assess their capabilities for meeting the requirements.

“They also need to think about whether it is all cost efficient,” he continues.

“A board member recently told me, about risk in IORP II, that they were already outsourcing so much work for the pension fund. So, what is holding them up in delegating governance as well?”

Weiss Garne acknowledges that many of the new rules are being introduced to improve outcomes, but warns that adopting the new regulations comes at a financial cost.

“Ultimately, this increase in cost is likely to influence the consumer in terms of higher administration costs,” he says.

“The only way forward to make better regulation is by slowing down the processes to be sure that it is value for money. The word deregulation seems at the same time to be totally lacking in the vocabulary.”

Spaargaren says that although he believes the industry should not complain about regulation, as it is there for a good reason, it can debate its quality.

“The influence of interest groups is huge, and political compromises have an impact on the quality of regulation,” he concludes.