POINT OF VIEW HARWELL

IORP II

European guidelines for Retirement Pension Institutions

The new IORP II Directive (Institutions for Occupational Retirement Provision) entered into force on 13 January 2017, but has only been applied since 13 January 2019, in order to allow time for Member States to transpose the new rules into their respective national legislations.

This law replacing the IORP I Directive enforced since 2003, amended the law of October 2006 related to the control of retirement pension institutions (RPIs). The IORP I Directive set out the main principles RPIs had to adhere to but without specifying any regulatory obligations to implement them; which has led to heterogeneous national regulatory frameworks.

The IORP II Directive does not impose any quantitative capital requirement, considered unrealistic from a practical point of view, but it does aim to harmonize the risk assessment, members' publications, and investment principles in social and responsible activities at European level.

Scope, Guiding Principle, and Objectives

This Directive targets all RPIs in the European Union that already got an approval by January 13, 2019 i.e. the effective date of the enforcement of the regulation. As far as the UK is concerned, the extent with which it will fall under the scope of the IORP II Directive is still unclear considering the uncertainty on both the nature and the timeframe of the Brexit.

The guiding principle of proportionality is key in this new Directive. The breadth and depth of the Financial Services and Markets Authority's (FSMA) expectations may vary according to the nature, size, and complexity of the RPIs' activities. To assess these elements and their associated risks, the FSMA examines the situation of each RPI separately.

The IORP II Directive pursues a four-fold objective:

- Strengthen the governance of funds: ensuring the soundness of occupational pensions

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and better protecting plan members and beneficiaries;

- Improve the communication with both members and beneficiaries;

- Remove barriers to the provision of cross-border services. In this respect, the EIOPA (European Insurance and Occupational Pensions Authority) acknowledges that the stated capital requirements would be insufficient. Hence, it argues for a risk assessment and transparency framework based on a harmonized set of valuation rules such as the establishment of a market-consistent balance sheet taking into account security and benefit adjustment mechanisms.

- Encourage long-term, socially responsible investments as well as investments in job-creating economic activities thanks to the modernization of investment rules.

Governance

RPIs have until December 31 2020 to formally adapt their policy.

RPIs are required to implement:
- written rules, revised once a year, in relation with risk management, internal audit, internal control systems, including administrative and accounting procedures.
- a «sound» compensation policy applying to RPIs and the service providers operating for them.

The effectiveness of the governance system is a key success factor to enable an appropriate risk management and protection for affiliates and beneficiaries. Moreover, such a system should be adapted to the size, nature, scale and complexity of the RPIs activities.

Key Functions

The RPIs must have four key effective functions at all times : Risk Management, Actuarial, Compliance and Internal Audit Functions.

For each key function, RPIs must both appoint an independent person as Head of Function and set up an alert mechanism. IORPs may allow a single person or organizational unit to carry out more than one key function, except for the internal audit function referred to in Article 26, which shall be independent from the other key functions

Only the risk management function is new compared to IORP I.

In the new framework, two milestones have been defined. First, by December 31, 2019, RPIs must have set up the Risk Management Function and must have appointed its Head of Function. Second, by December 31, 2020, RPIs must have appointed new Heads of Function for all key functions facing an outdated leadership renewal date.

Risk Assessment

RPIs are required to design and implement a «Risk Assessment Plan» on a regular basis – at least every 3 years – or immediately after any change in their risk profile.

For this purpose and as part of their risk management policy, RPIs must have developed an ORA (Own Risk Assessment) implementation policy by December 31, 2020. The first ORA report will have to be submitted to the FSMA by January 13, 2022. The FSMA advises to have matching with the ORA exercise.

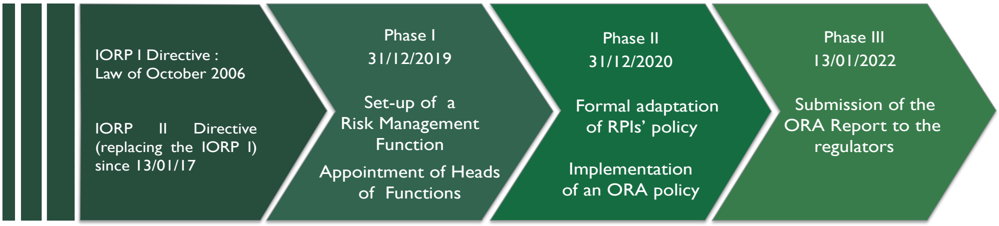
This risk assessment should be comprehensive and cover data such as RPIs' financial needs; description of pension benefits for defined benefit schemes « DB » and defined contribution schemes « DC », and a qualitative assessment of the sponsoring company support, operational risks, and new risks related to climate change, resources and environmental use, etc.

Member States must implement methods in order to identify potential problems, and supervisory authorities must be able to take remediation measures.

Appointment of a custodian

DC schemes (Article 83) must appoint a single

IORP II Directive
Provisional Implementation Roadmap



custodian to ensure the depositary aspect. This rule applies systematically for DC schemes. For PD schemes (Article 39), the appointment of a custodian is at the discretion of each Member State.

This custodian may be located in a country other than the one where the fund is established.

Communication with Beneficiaries

RPIs are required to provide a pension benefit statement (PBS) to their members once a year. It is a concise and annual document which is harmonized across the EU. It describes costs, contributions, guarantees (if any), the level of capitalization, the planned contributions, the investment options, etc.

For DB schemes (Article 39), the pension entitlements must include projections of the best estimates of the (monthly) earning target at retirement age,

For DC schemes (Article 83), a synthetic indicator of the risk/return profile should be provided,

RPIs are required to circulate information on the scheme to future members, «pre-retirement» information to members at least two years before retirement (annuities, phased retirement, with the advantages and the disadvantages of the various options) as well as information on benefits and payment options to members already retired.

Finally, pension funds must notify their members in advance if benefits have changed.

Cross-Border Plans

One of the main objectives of the IORP II Directive is to remove legal barriers that could hinder the cross-border management of Pension plans by RPI (transfer of pension funds' portfolios from one approved RPI to one recipient RPI).

The ultimate ambition is to create a genuine internal market in this area.

In order to further facilitate the mobility of workers between Member States, the Directive aims to ensure the right governance, the provision of information to affiliates, transparency and security of pension plans. This Directive introduces a separate procedure for any cross-border transfer, whether it leads or not to cross-border activity.

The Host countries will not be able to impose restrictions, specific investment rules or disclosure requirements.

Responsible Investment

A very active dialogue has been established between the concerned parties, which has led to numerous amendments of the Directive.

The pension funds must take into account environmental, social and governance criteria for their investment decisions, and must publish a document setting out the principles of their investment policy once every three years. The European Commission has stated that these standardized data have to be consistent with those applicable to other investment / retirement products such as mutual funds, retail and Packaged Retail Investment and Insurance-based Products (PRIIP), and personal savings products.

Conclusion

This Directive aims to encourage the Member States to set up appropriate, safe and sustainable occupational pension schemes and to facilitate cross-border activity.

RPIs should be able to work with companies established in any other Member State and they should manage occupational pension schemes with affiliates based in more than one Member State. This could enable these RPIs to achieve significant economies of scale, improve the competitiveness of the sector within the EU and facilitate labor mobility.

With this Directive, pension funds will establish controls and produce additional information for regulators and investors. Banks already have expertise because they provide custodian and fund administration services under the current AIFMD and UCITS V Guidelines.

Harwell Management can support you to assess the impact of the new IORP II guiding principles on your RPI in terms of organization, processes and systems. Harwell Management can also help you to formalize and/or implement an IORP II Compliance Roadmap to ensure full compliance of your organization by the regulatory deadline.

OUR EXPERTS

Alain BUENO
Head of CIB & Investor Services practice
alain.bueno@harwell-management.com

Gwenn LE PAVIC
Executive Director UK
gwenn.lepavic@harwell-management.com

Maïna K.M'POYO
Manager
maina.k.mpoyo@harwell-management.com

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