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European Commission Issues Long Awaited Revised Pension Directive - More Cross Border Pensions, New Uniform Participant Benefit Statements, More Governance, More Infrastructure Investment, No New Solvency Rules (For Now)

In 2003, the European Commission (EC) issued a Directive on Institutions for Occupational Retirement Provision or IORPs - for which term US pension lawyers should think of employee pension benefit plans - which laid down some initial European Union (EU) rules for pensions in the areas of (1) prudential rules to protect the pension members and beneficiaries including ensuring they would have sufficient information on the rules of their pension, the institution's financial situation and their rights, (2) investment rules concerning investing on a long-term basis with diversification of assets taking advantage of the benefits offered by the single market and the euro, and (3) rules permitting cross-border management of occupational pension schemes. Over the ensuing years, EU member countries have slowly been taking up these rules, and some cross-border EU pensions, mainly defined contribution, have begun to appear, but they are still relatively uncommon.

In March, 2014, the EC has issued an updated Directive, referred to as "IORP II". IORP II is notable both for what it does and what it does not do. The Directive states its main purposes as:

- (1) removing remaining prudential barriers for cross-border IORPs, notably by requiring that the rules on investment and disclosure of information to members and beneficiaries are those of the home Member State, as well as by clarifying procedures for cross-border activities and clearly defining the scope of action of home and host Member State;
- (2) ensuring good governance and risk management;
- (3) providing clear and relevant information to members and beneficiaries; and
- (4) ensuring that supervisors have the necessary tools to effectively supervise IORPs.

Cross-Border Pensions

One of the most interesting positive aspects of the new Directive is its emphasis on encouraging cross-border pensions. For some time, the EC has been seeking to eliminate tax discrimination against cross-border pensions (for some history on that, see here: <http://www.groom.com/resources-397.html> and here: <http://www.groom.com/resources-757.html>). The EC undoubtedly hopes that these rules will be implemented by EU member states and that the nascent cross-border pension market will grow. Presumably, due to continuing solvency and pension funding issues, which, as discussed below, were not addressed in the Directive, whatever push in this area occurs seems most likely to occur with

defined contribution plans, which are generally becoming more common in Europe as in the US.

Pension Governance and Risk Management

The expanded governance provisions of IORP II may also be of interest to multinational corporations, many of whom are already grappling with issues of global pension governance. Again, this new emphasis would be of a piece with the efforts of the OECD, which issued their “Guidelines for Pension Fund Governance” in 2009 (more information on those governance guidelines can be found here: <http://www.groom.com/resources-457.html>). One particular piece of the new governance rules that has garnered attention are new rules regarding risk management. One new article states that IORPs must have in place an effective risk-management system to identify, monitor, manage and report on a continuous basis all risks, including those related to outsourced or subsequently re-outsourced activities, to which the IORP or their interdependencies could be exposed. Another new article provides that EU member states shall require, as part of their risk-management system, IORPs to carry out their own risk assessment and to produce a risk evaluation for pensions in order to document that assessment. This risk evaluation is to be performed regularly and without delay following any significant change in the risk profile of the IORP, and cover:

- (1) the effectiveness of the risk-management system;
- (2) the overall funding needs of the institution;
- (3) the ability to comply with the requirements regarding technical provisions (calculation of pension liabilities and risk buffer) laid down in the IORP;
- (4) a qualitative assessment of the margin for adverse deviation as part of the calculation of the technical provisions in accordance with national law;
- (5) a description of pension benefits or capital accumulation;
- (6) a qualitative assessment of the sponsor support accessible to the institution;
- (7) a qualitative assessment of the operational risks for all schemes of the institution; and
- (8) a qualitative assessment of new or emerging risks relating to climate change, use of resources and the environment. This last element is seen as a strong achievement on the part of those seeking to have the EC emphasize environmental concerns.

In addition to the added cost and complexity introduced, some concern has been expressed whether additional rules, particularly regarding solvency and funding, may be introduced when the European Insurance and Occupational Pensions Authority (EIOPA) draws up technical standards for implementing IORP II in the coming months. However, Article 30 of the Directive states that those technical standards would not seek to impose “additional funding requirements beyond those foreseen in this Directive”.

The revised Directive also discusses in more detail non-listed undertakings including infrastructure projects, unlisted companies seeking growth, real estate or other assets that could be suitable for long term investment purposes, and while emphasizing that they are suitable for very long-term investors with low liquidity risks, provides that they should not be restricted except on prudential grounds.

EU-Wide Uniform Pension Benefit Statements

Another important element introduced in IORP II is EU-wide uniform pension benefit statements. Generally, the statements, though standardized, are to be specific to the individual member and provided at least every 12 months. The key components of these pension benefit statements are listed in detail in Articles in the IORP II and include:

- (1) personal details of the member;

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- (2) identification of the institution;
- (3) guarantees;
- (4) balance, contributions and costs;
- (5) pension projections;
- (6) investment profile;
- (7) past performance; and
- (8) supplementary information.

Consistent with the new risk evaluation, the information standards also require that the IORP inform prospective members about how environmental, climate, social and corporate governance issues are considered in the investment approach.

What is Missing - DB Plan Solvency Standards

One of the most notable things about IORP II is what is not in it. Though it was considered, the Directive does not address the introduction of new solvency rules (which are not relevant for defined contribution plans, of course), which threatened to increase funding standards under what is known as a “holistic balance sheet” approach. The concern is that this would potentially lead to EU-wide pension funding requirements along the lines of Solvency II (an EU Directive issued in 2009 but not yet in effect that codifies and harmonizes EU insurance regulation), which has been criticized as inappropriately putting pension funding standards on an equal playing field with insurance company reserve requirements. The Directive states that a quantitative impact study conducted by EIOPA in 2013 indicated that more complete data on solvency aspects are necessary before a decision can be taken on those aspects.

What Happens Next

EU Directives are not self-executing. They put down certain end results that then must be achieved in each member state, which has to adapt their own laws to meet the enumerated goals and have some discretion in how to do so. Most immediately, the EC is expected to instruct the European Insurance and Occupational Pensions Authority (EIOPA) to draw up the required technical standards to implement IORP II. As noted above, there is some concern as to whether that process may introduce further rules. Particularly interesting to watch will be whether the market for cross-border defined contribution plans expands as a result of changes arising due to the new Directive, and also whether there is movement towards standard pension benefit statements in the EU. Further, the EC has scheduled to review IORP II again in four years to “assess in particular the application of the rules regarding the calculation of the technical provisions, the funding of technical provisions, regulatory own funds, solvency margins, investment rules and any other aspect relating to the financial solvency situation of the institution”. So, though solvency standards escaped this iteration of the IORP, they seem likely to be revisited.