ARTHUR COX

PENSIONS AND EMPLOYEE BENEFITS

Summer Update 2020

August 2020

SECOND SHAREHOLDERS' RIGHTS DIRECTIVE ("SRD II")

SRD II has been transposed into Irish law by the *European Union (Shareholders' Rights) Regulations 2020* (the "**Regulations**"). The Regulations aim to increase transparency and shareholder engagement in corporate governance.

The Regulations apply to "*relevant institutional investors*" which includes a pension scheme where the scheme is (i) an occupational pension scheme regulated in Ireland and (ii) invests directly, or through an asset manager, in shares traded on an EU regulated market. If a pension scheme meets these criteria it must publicly disclose an engagement policy, its investment strategy and any arrangements that it holds with asset managers. Public disclosure means publishing the information to make the matter available "*free of charge on the website of the relevant institutional investor*".

The Pensions Authority has not yet provided guidance on the practical aspects of the implementation of the Regulations and in particular the requirement to publically disclose on a website, as in most cases pension schemes will not have their own website. Further detail on each of the disclosure requirements is set out below:

- **Shareholder engagement policy**

  The engagement policy must contain, amongst other things, details on how shareholder engagement is integrated into the scheme's investment strategy, how conflicts of interest are managed in relation to engagement and how dialogue is conducted with EU investee companies. This obligation is on a "*comply or explain*" basis such that if no shareholder engagement policy is published then the pension scheme must explain why it has failed to do so.

- **Investment strategy**

  The Regulations also require an investment strategy to be publicly disclosed including information on the scheme's equity investment strategy, in particular how the main elements of the strategy are consistent with the profile and duration of its liabilities and contribute to the medium to long-term performance of its assets. For pension scheme trustees this obligation is similar (but not identical) to pre-existing requirements under the Pensions Act 1990 to prepare a Statement of Investment Policy Principles ("**SIPP**").

- **Arrangements with asset managers**

  Where an asset manager invests on behalf of a pension scheme that is a relevant institutional investor then that pension scheme must publicly disclose the main features of this agreement. This includes details on how the arrangement incentivises the asset manager to align its investment strategy and decisions with the profile and duration of the liabilities of the institutional investor. In addition, the scheme must disclose how it monitors portfolio turnover costs incurred by the manager and the length of the arrangement between the asset manager and the institutional investor.

Relevant pension schemes must consider the most appropriate method of making these disclosures. The European Insurance and Occupational Pensions Authority ("**EIOPA**") has previously suggested that an engagement policy could be incorporated into a SIPP, however, schemes may instead prefer to make these disclosures available on their websites.

While awaiting Pensions Authority guidance on public disclosure, we would recommend that SIPPs are reviewed and updated to meet the requirements of the Regulations.

PENSIONS AUTHORITY STATISTICS AND UPDATE

On 2 June 2020 the Pensions Authority published statistics for defined benefit ("**DB**") schemes based on analysis of Annual Actuarial Data Returns ("**ADDRs**") that it received to 31 March this year. The Pensions Authority reported minimal change from the statistics it had published the previous year and noted its continued concern about the level of investment risk associated with DB schemes. It

stated that this risk is not shared equally amongst scheme members but is concentrated primarily on members who have not yet retired. The ADDRs revealed that, of 567 continuing DB schemes, 86% were reported as meeting the statutory minimum funding standard. Only 76% of schemes were reported to hold sufficient additional resources to satisfy the funding standard reserve.

The Pensions Authority also warned that once IORP II has been transposed into Irish law, it will subject all schemes to a periodic supervisory review. It will assess the risks faced by individual pension schemes and the capacity of scheme trustees to manage those risks. It advised that it will not be satisfactory for trustees to explain their current approach to risk management. Instead, trustees must demonstrate that they have "*undertaken an objective and informed process, including consideration of alternatives and an assessment of the effect of potential risks on different classes of members*".

While the information gleaned from the ADDRs is not surprising in being similar to that of last year, the comments by the Pensions Authority in relation to IORP II are to be noted as we await further guidance from the Authority once IORP II has been transposed into Irish law.

PENSIONS REGULATOR'S ADDRESS TO THE SOCIETY OF ACTUARIES IN IRELAND

On 12 June 2020 the Pensions Regulator, Brendan Kennedy, gave an update on the Pensions Authority's current activities and future plans in an address to the Society of Actuaries in Ireland. He started by indicating that the transposition of IORP II is high priority work for the Department of Employment Affairs and Social Protection Department but that there was not yet an expected completion date. Notwithstanding this, he gave a clear outline of the approach he foresees for the Pensions Authority on future oversight in the context of IORP II.

Current activity

Mr. Kennedy highlighted that throughout the Covid-19 period the Pensions Authority has been working on three main initiatives:

- engaging with selected schemes to gain an understanding of how prepared they are for IORP II;
- working with the Pensions Committee of the Society of Actuaries regarding issues specific to defined benefit schemes – these include risk assessment, transfer value bases, Covid-19 issues and practising certificates; and
- preparation for the implementation of IORP II including how they will supervise and oversee trustee's own risk assessments. Mr. Kennedy indicated that once the transposition of the directive is complete, the Pensions Authority aims to publish as much of this material as practical.

Future oversight of DB

Mr. Kennedy emphasised that the Pensions Authority sees its role in supervising DB schemes as ensuring that these scheme are able to pay the benefits set out in their scheme rules and that it must look not only at present solvency but whether these schemes will be in a position to pay promised benefits in the future. He stated that trustees should be just as focussed on risks to the member benefits as the Pensions Authority will be and that the Pension Authority expects trustees "*to assess objectively the scheme's situation, to proactively identify weaknesses and shortcomings, and address them*".

While it believes that there is nothing contained in IORP II that a well-run scheme should not already be doing, Mr. Kennedy said that the Pensions Authority will assign each scheme it assesses to one of three categories depending on how likely they are to pay benefits owed. Category 1 will contain the scheme most likely to pay their benefits, Category 3 the least likely, and Category 2 will be assigned where it is judged that there is a "significant risk" to member benefits.

Solvency and the funding standard

Addressing DB schemes in particular, the Regulator stated that at present the only measure the Pensions Authority has to assess a scheme is the funding standard. However, he said this metric is a poor predictor of the ability of schemes to pay benefits as a defined benefit scheme is too complex and dynamic an entity for its financial health to be measured by a single number, and for the supervisory response to be limited to that single number.

Mr. Kennedy said that in the future the Pensions Authority will seek to utilise three wider measures: solvency; risk; and sustainability. Instead of looking at a single definitive calculation for each of these metrics, the conclusion about the adequacy of the scheme will be a matter of objective judgement, not rationalisation. He added that the funding standard will continue to apply after transposition of IORP II but that additional measures will be introduced by the Pensions Authority to assess the scheme's financial health which will likely lead to more issues being identified that will need addressing.

TAX RELIEF FOR CONTRIBUTIONS FOR EMPLOYEES OF ANOTHER EMPLOYER

The Revenue Commissioners have made changes to, among others, Chapter 16 (Group Schemes) of the Pensions Manual. Chapter 16 now sets out that, in accordance with section 17 of the Finance Act 2019, tax relief is allowed not only where an employer pays contributions for its own employees but also in respect of contributions for employees of another employer. This applies where the contributions are made under the terms of a legally binding agreement between the two employers in the following circumstances: in a group of companies, under a scheme of reconstruction or amalgamation, under a merger, under a division; or under a joint venture. Prior to this, such an arrangement was permitted by Revenue solely on a concessionary basis.

PROGRAMME FOR GOVERNMENT

On 16 June 2020 Fianna Fáil, Fine Gael and the Green Party (who have subsequently formed the new Government) published "A Programme for Government" containing a number of reforms that will impact the pensions sector. The document highlights the plan to establish a Commission on Pensions to examine sustainability of State pensions and the Social Insurance Fund including, exploring issues such as qualifying age, contribution rates, total contributions and eligibility requirements. The planned increase in the State pension age to 67 has been deferred pending the conclusion of a report by the Commission due to be completed by June 2021 and on which the new Government says it will act on within six months.

Additionally it has been decided that 65 year olds who are required to or chose to retire early can receive an "*early retirement allowance or pension*" at the same rate as jobseekers' benefit without a requirement to sign on, partake in any activation measures or be available for and genuinely seeking work. The new Government also aims to bring in a system to enable people to defer receipt of their state contributory pension on an annual basis, to include actuarial increases in payment as soon as practicable.

On auto-enrolment, the new Government has committed to gradually introducing the pension auto-enrolment system. Workers and employers will make matching contributions and the State will top up these contributions. The contribution from workers will be phased in over a decade but they will also have the option to opt-out of auto-enrolment.

CASE LAW UPDATE - SEAN HALLINAN V NATIONAL MUSEUM OF IRELAND

A WRC adjudicator has determined that an offer of a one-year fixed-term contract to an employee who had reached retirement age did not constitute age discrimination. The one-year contract was designed to bridge the gap between the National Museum of Ireland's compulsory retirement age and the age at which Hallinan, their employee, became entitled to a State pension. An interim arrangement had been implemented while the Government sought to extend the mandatory retirement age to 70 whereby existing staff could stay in employment until they reached 66 and could avail of their pension.

However, the fixed-term contract that the complainant was offered by the museum put him on point one of the salary scale. The complainant subsequently rejected this contract as it would have resulted in a pay reduction of €250 per week to remain in his role supervising people who were younger and less experienced than him. He believed this to be age discrimination and alleged that the setting of a compulsory retirement age and offering of a fixed-term contract were not objectively justified in this case.

The respondent argued that it was clearly expressed in the complainant's contract that there was a mandatory retirement age at 65. The National Museum submitted that it has a policy of enforcing its contractual retirement clauses and that they were objectively justifiable to achieve certainty of administration across the public sector.

The adjudicator found in favour of the respondent. She believed that the complainant was aware of his contractual retirement and that no age discrimination had been established in relation to the compulsory retirement policy. Regarding the offer of a fixed-term contract it was noted that the purpose of offering fixed-term contracts was to afford a group of employees who were required to retire at 65, the opportunity to continue working until they qualified for the State pension at 66. She found that 33% of employees nationally availed of such contracts and that the complainant was free to decline it but that no *prima facie* age discrimination had been established.

While this is not a binding legal precedent it is helpful that there is a WRC case which supports mandatory retirement ages and which moves away from the general proposition that a mandatory retirement age is *prima facie* age discrimination. It remains the case that retirement age disputes turn significantly on the fact pattern albeit that the Pensions Act and EU law permit a mandatory normal pension age in pension scheme rules without a requirement for justification (in contrast to a normal retirement age in an employment contract which must be objectively justified to avoid the risk of being adjudged unlawful discrimination).

CASE LAW UPDATE - RUSSELL ADAMS V OPTIONS SIPP UK LLP (FORMERLY CAREY PENSIONS UK LLP)

This UK case concerned the potential liability of an execution-only Self-Invested Personal Pension ("Personal Pension") provider to an investor who sustained substantial losses from their investment in the Personal Pension. The investor's claim was dismissed by the court and the judgment has provided greater clarity on the duties owed by a Personal Pension provider to investors.

The member, a Mr Adams, had been convinced by a financial adviser to move his pension savings into an investment in storage pods (a higher risk investment than his existing one) through a Personal Pension vehicle provided by Carey Pensions. It transpired that the financial adviser was an unregulated 'introducer' and that the investment was unsuitable for a pension and subsequently lost a significant proportion of its value. Mr Adams alleged that Carey Pensions had not acted in his best interests by accepting his investment without conducting due diligence and by accepting work from an unregulated introducer.

The High Court found, amongst other things, that the contract between the parties was unambiguous and made clear that Carey was acting on an execution only basis, was not giving financial advice to Adams and that he was responsible for his own investments. The judge further found that there was no legal requirement for the UK Personal Pension provider to refuse high risk investments.

It had been feared by UK Personal Pension providers that a decision in favour of Mr Adams would make the duties and responsibilities owed by Personal Pension providers even more onerous. Instead, the judgment made the investor solely responsible for his own losses where the Personal Pension provider was operating in an execution-only role and had contractually disclaimed any liability for adverse investments.

While not directly applicable to Irish pension schemes, the case is helpful where members have "Do it myself" investment options for AVCs and DC schemes to support the proposition that they are responsible for the choices they make.

KEY CONTACTS

Philip Smith
Head of Pensions and Employee Benefits
+353 1 920 1204
philip.smith@arthurcox.com

Sarah McCague
Of Counsel
+353 1 920 1051
sarah.mccague@arthurcox.com

Michael Shovlin
Associate
+353 1 920 1046
michael.shovlin@arthurcox.com

Daniel Watters
Associate
+353 1 920 1323
daniel.watters@arthurcox.com

Katie Lawless
Associate
+353 1 920 1476
katie.lawless@arthurcox.com