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"Pensions regulation is moving under the umbrella of general financial regulation at E.U. level – what is the impact of this on the Irish pensions industry now and in the future? (focussing on ESG, trustee investment duties, SRD2, SFDR and IORP II etc.)"

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In this paper, I intend to address how EU regulation is impacting the current pensions landscape in Ireland and the impact it will have in the future. In order to do this, I will firstly attempt to briefly outline the Irish pensions landscape and to situate it in a European context. I will then move to consider how the EU system of financial regulation has developed over the last decade with a view to identifying the drivers of the development of the regulations. I will look at three different EU directives that have/will impact the Irish pensions landscape. Finally, I will suggest that Ireland will be forced to move to fewer pension schemes with a larger membership base and that this will be driven by the impact of EU regulation as transposed into Irish law.

The Irish Pensions Landscape In A European Context

Ireland is a major outlier when it comes to pensions in a European context. According to European Institute and Occupational Pensions Authority (EIOPA) figures in 2019 there were around 45 million active members of occupational pension schemes in Europe. Ireland, with

approximately 455,000 active members accounts for 1% of scheme members.[1] This would seem to make sense as we also account for 1% of the population of the European Union. However, we are home to approximately half of the occupational pension schemes in the EU.[2] This is not because Irish people are more inclined to invest in pensions than their European counterparts (although we might be given that Ireland accounts for 1.8% of the total assets invested in occupational pensions in the EU)[3], instead it seems to be a reflection of the fact that we have a highly fragmented pensions landscape.

Ireland has approximately 75,100 active occupational pension schemes (i.e. those to which contributions are currently being made), of which around 66,000 of them are single member schemes.[4] These schemes are only capable of having one member. There are 8,500 schemes which are capable of having more than one member – each of which currently has less than 100 members, while there are only 600 schemes which have more than 100 members in Ireland.

In comparison, most of our EU counterparts have much bigger schemes. This can be seen from a rudimentary analysis of the average scheme membership in Ireland vis-à-vis the rest of the European Union. In Ireland, we have approximately six members per scheme while the average scheme membership across the EU is around 5,300. Austria has 14 occupational pension schemes for approximately 780,000 scheme members, while the Netherlands has 299 occupational pension schemes[5] in total and 5.89 million scheme members.

Occupational Pension Scheme Statistics 2019[6]			
Country	*Number Of Schemes*	*Number Of Members*	*Average Members Per Scheme*
Austria	14	780,000	55,714

[1] EIOPA, *Statistical Time Series 2004 – 2019* <https://www.eiopa.europa.eu/tools-and-data/occupational-pensions-statistics_en#Statistics2004-2019> accessed 26 July 2021 – Figures Calculated By Author Based On Data (Figures exclude France, Estonia and Cyprus as no data are available)
[2] Government of Ireland, *'A Roadmap for Pensions Reform 2018 - 2023'* 14
[3] EIOPA, *Statistical Time Series 2004 – 2019* <https://www.eiopa.europa.eu/tools-and-data/occupational-pensions-statistics_en#Statistics2004-2019> accessed 26 July 2021 – Figures Calculated By Author Based On Data (Figures exclude France, Estonia and Cyprus as no data are available)
[4] Government of Ireland, *'Report of the Interdepartmental Pensions Reform and Taxation Group'* 16
[5] EIOPA, *Statistical Time Series 2004 – 2019* <https://www.eiopa.europa.eu/tools-and-data/occupational-pensions-statistics_en#Statistics2004-2019> accessed 26 July 2021
[6] EIOPA, *Statistical Time Series 2004 – 2019* <https://www.eiopa.europa.eu/tools-and-data/occupational-pensions-statistics_en#Statistics2004-2019> accessed 26 July 2021

Netherlands	299	5,898,000	19,726
Italy	322	5,089,000	15,804
Germany	2,674	5,879,000	2,199
Ireland	75,100	455,000	6

This means in essence that European regulation is required to deal with a hugely divergent array of national pension sectors. At this point it is worth considering how regulation of the pensions sector in Europe has developed over the last decade.

The European System Of Financial Supervision

One of the responses of the European Union to the financial downturn in the late 2000s was the establishment of the European System of Financial Supervision. The de Larosière expert group which was established in the wake of the crash highlighted key failings in the regulatory framework. More specifically however, it recommended that:

> *'In the first stage, EU should also develop a more harmonised set of financial regulations, supervisory powers and sanctioning regimes.*
>
> *- The European Institutions and the level 3 committees should initiate a determined effort to equip the EU with a far more consistent set of rules by the beginning of 2013. Key differences in national legislation stemming from exceptions, derogations, additions made at national level or ambiguities contained in current directives should be identified and removed, so a harmonized core set of standards is defined and applied throughout the EU.*
>
> *- The European Institutions should set in motion a process leading to far stronger and consistent supervisory and sanctioning regimes in the Member States.'*[7]

[7] Jacques de Larosière, *'Report of The High-Level Group On Financial Supervision In The EU'* 51

In essence, the report recommended the harmonisation of financial regulations across the EU. It further speaks to the notion of limiting the impact or effect of derogations – that is the ability of member states to opt out of specific parts of EU regulations. This is important in an Irish context as it was a derogation which allowed the Irish Government to limit the effect of the original IORP directive on our smaller pension schemes. It is this driving force – harmonisation – which will best illuminate the future impact of European regulation on the Irish pensions market.

The question that always arises in the context of harmonization is who is going to change? When two parties are equal in size, both sides generally reach a compromise which means that both sides move some way towards the other in an attempt to reach a shared end point. However, in this situation – Ireland is a small cog (the aforementioned 1% of EU population) in a much bigger wheel. The reality is that we are probably going to be required to adapt ourselves to rules which are designed with the broader EU pensions market in mind. This means that there is likely to be scant concern and consideration shown at an EU level for the smaller single member type schemes which are such a striking feature of the Irish landscape. At this point, it is worth looking at some examples of the differing EU regulations that have been put in place in recent years to see if there is a pattern that can be discerned in terms of the adaptations that might be necessary.

Shareholders Rights Directive II

The first European directive that I wish to look at is the Shareholders Rights Directive II which was transposed into Irish law by the European Union (Shareholders' Rights) Regulations 2020. These regulations apply to any occupational pension scheme which invests directly, or through an asset manager in shares traded on an EU regulated market. The regulations require a pension scheme to do three things. Firstly, they must have an investment strategy which is published on their website and explains:

> *'how the main elements of its equity investment strategy are consistent with the profile and duration of its liabilities, in particular its long-term liabilities, and such disclosure shall*

include how those elements contribute to the medium to long-term performance of its assets.'[8]

Secondly, the occupational pension scheme must develop and disclose an engagement policy which explains how the scheme monitors the companies it invests in, how it uses its voting rights and other rights attached to shares, how it cooperates with other shareholders and how it uses shareholder engagement in its investment strategy among other things. The pension scheme is however able to deal with this requirement on a comply or explain basis – i.e. it can publish a clear and reasoned explanation for why it is not publishing an engagement strategy as above instead of publishing the strategy.

Finally, where it is an asset manager who is investing on behalf of the pension scheme – the pension scheme must publish the following information (among other things) as regards its arrangement with the asset manager:

'(a) how that arrangement incentivises the asset manager to align its investment strategy and decisions with the profile and duration of the liabilities of the relevant institutional investor, in particular long-term liabilities;

(b) how that arrangement incentivises the asset manager to make investment decisions based on assessments about the medium to long-term financial and non-financial performance of the investee company, and engage with investee companies in order to improve their performance in the medium to long term;

(c) how the method and time horizon of the evaluation of the asset manager's performance and the remuneration for asset management services are in line with the profile and duration of the liabilities of the relevant institutional investor, in particular the long-term liabilities, and take absolute long-term performance into account.'[9]

[8] S1110I (1) Companies Act 2014
[9] S1110I (2) Companies Act 2014

In essence, all these requirements are designed for what are termed 'institutional investors' in the regulations. From even a basic reading of them it can be seen that the requirements are designed to provide increased transparency and information to investors not involved in the day to day management of their fund. Such reports, policies and documents all constitute significant fixed costs – which in the context of a large multi-member fund can be easily absorbed. However, for the small one member scheme – these requirements represent a significant cost. Without even considering the requirement to commission someone to draw up the relevant reports, you also have the cost and hassle of maintaining a website for the single member fund. These requirements are almost singularly unsuited to the notion of a single member fund in an Irish context, where it seems likely that the single member would be sitting down with a qualified financial adviser and determining where the funds are going. The single member may need a report on what he is investing in within his/her single member scheme – however it seems far less likely that they would need to read a report online on an shareholder engagement strategy – given that the size of their stake in Tesco plc is unlikely to merit a meeting with the board of Tesco plc (or indeed with other institutional investors).

IORP II

A second directive that is worth looking at in the context of the impact of EU regulations on the Irish pensions market is the IORP II directive. Transposed into Irish law by the European Union (Occupational Pension Schemes) Regulations 2021, the IORP II directive represents a sea-change in how the Irish pensions market will look in the future. Indeed Brendan Kennedy, the chief executive of The Pensions Authority has said that, 'Irish occupational pensions are about to undergo the most significant changes in at least a generation.'[10]

As mentioned above, Ireland exercised its rights under a derogation when they were implementing the original IORP directive. This allowed schemes with fewer than 100 members to opt out of the more onerous requirements that were imposed by the first directive. The government has chosen on this occasion not to allow for any derogation for schemes with less than 100 members. This means that the full impact of IORP II will be felt by all schemes.

[10] Barry McCall, 'Radical changes to pensions landscape on the horizon' The Irish Times (Dublin, 23 October 2020)

What is this impact? Firstly, each scheme must have two trustees who will be subject to the relevant fitness and probity arrangements. One of these will be required to have two years experience as a trustee. There must be an effective governance system – to include an organisational structure with a clear allocation of responsibilities. This system must also include consideration of environmental, social and governance (ESG) factors. There must be a written governance policy for risk management, internal audit, actuarial controls and outsourcing. An annual compliance statement must be provided. Each scheme must appoint key function holders who will have responsibility for handling each of the following functions – risk management, actuarial and internal audit. Each scheme must also conduct its own risk assessment every three years along with a review of the above mentioned policies. Finally, the ability for one person schemes to borrow for the purpose of investment has been removed and investments must be 'predominantly in regulated markets.'[11]

Again from looking at these measures – there is a clear trend. The regulations appear to be designed for much larger schemes. The same issues around the absorption of fixed costs as mentioned above appear again here – only this time there are far more moving parts and no 'comply or explain' type options to take. It seems very clear that there is a message to be taken from the way these regulations are being transposed into Irish law, namely that one member schemes are not in our future. Indeed, the Government has indicated this in the *'Roadmap for Pensions Reform 2018 - 2023'* when it states that they will:

> *'Tak[e] steps to reduce the large number of pension schemes in operation - future pension provision by smaller employers will increasingly be by means of membership of large multiemployer structures or through pension contracts.'*[12]

The Government is merely reflecting the reality that EU regulation is forcing us to move away from the small, single member schemes into what it sees as a much more professionalized

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[11] S59AB (2)(d) Pensions Act 1990 (as amended)
[12] Government of Ireland, *'A Roadmap for Pensions Reform 2018 - 2023'* 21

pensions sector. This is reflected by many in the industry. According to Munro O'Dwyer of PwC:

> *'The policy position is that smaller schemes incur disproportionately larger administrative costs as fixed costs are shared among fewer people…IORP II and its forerunner contain lots of principles on how to run best in class pension schemes. I don't think anyone disagrees with them. Very simply, we will end up with a much smaller number of much better regulated and run pension schemes.'*[13]

The costs of implementing the changes illustrated above represent a key driver away from the smaller pension schemes. It is a simple and effective nudge that will drive people away from their one member scheme as it will simply not be viable to continue to invest in that way.

SFDR Regulations

The EU has also introduced further regulations in the area of sustainable finance (SFDR). This means that schemes will be required to disclose information about how ESG events could cause an actual or potential negative impact on the value of an investment. Schemes will also be required to disclose how they consider any adverse impact of their investments on environmental, social and employee matters and respect for human rights. A 'comply or explain' approach may be taken to the matters relating to adverse impacts.

Conclusion

In considering the various regulations that have been promulgated at EU level and the response of the Irish Government – a clear pathway for the future of the Irish pensions landscape has emerged. All of the EU regulations around occupational pensions are designed for large schemes. Given Ireland's small size in an EU context and our significant outlier status – we will be forced to converge with the broader EU consensus. The fact that EU policy is moving in a harmonizing direction means that we will have limited scope to remain an outlier. The significant financial cost for smaller schemes to comply with new EU regulations will gradually

[13] PwC, 'Bringing order to a fragmented pensions landscape' The Irish Times (Dublin, 24 May 2020)

eliminate the smaller schemes and force Ireland’s pensions landscape to look more like the rest of the EU.