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BENEFITS BRIEF

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Author: David W. Powell

If you have questions, please contact your regular Groom attorney or one of the attorneys listed below:

Louis T. Mazawey
lmazawey@groom.com
(202) 861-6608

David W. Powell
dpowell@groom.com
(202) 861-6600

Kevin L. Walsh
kwalsh@groom.com
(202) 861-6645

IORP II - European Pension Regulation Revised, Further Encourages Cross-Border Pensions, Pushes Social Investing

In July, 2016, the European Commission issued the final text of a revised Institutions for Occupational Retirement Provision (IORP), known as "IORP II". The prior version issued in 2014 generated some controversy, leading to the involvement of a number of parties in substantially revising the 2014 proposal and delaying its implementation. For more information on the 2014 version, please see our Groom Alert at: http://www.groom.com/resources-880.html.

For those interested in cross-border pension arrangements, the revised IORP II is worth review. It will not result in any immediate changes - it is to be voted on by the European Parliament on October 25, 2016, which is expected to be pro forma, and then must be implemented by individual European Union (EU) countries in local legislation which is not likely for a year or more. However, it is notable for its effort to nudge cross-border pensions a little further down the road by clarifying their manner of regulation, as well as some other items which have been included, such as social investing (environmental, social and governance, or "ESG"), or specifically not included, such as EU-level funding rules.

Absence of Defined Benefit Funding Standards

One of the more notable things about IORP II is what it did not do, and that is that the new Directive has dropped the effort, for now, to adopt cross-border defined benefit plan funding requirements such as the possible application of the Solvency II or Holistic Balance Sheet funding models. The Directive indicates that this is because EU-level regulation in that area could potentially decrease the willingness of employers to provide occupational pensions. At this point, funding rules will be left to the individual states, at least until the Directive is due to be revisited six years after it is effective.

As with the prior version of the IORP, the new Directive generally requires that cross-border plans be fully funded at all times, but acknowledges the possibility that cross-border IORPs may be underfunded, providing that, in that event, the authorities in the home state are to promptly intervene and the IORP is to immediately draw up appropriate measures and implement them without delay to protect the participants and beneficiaries.

Encouragement of Cross-Border Pensions

The European Commission is known to have an interest in encouraging cross-border pensions, which was one of the key reasons for the promulgation of the original IORP in 2003. Due to the political controversies over defined benefit funding, IORP II, like the original IORP, can be read to be more workable with defined contribution plans, which seem to be becoming more prevalent in the EU, just as they have for some time in the US.

In this regard, IORP II has added some revisions in the area of cross-border pensions, including clarifications to the roles of home and host country regulators, information requirements and transfers between IORPs. In addition, in the case of a disagreement between member country regulators, the European Insurance and Occupation Pensions Authority ("EIOPA") is given the role of nonbinding mediator.

More on ESGs

One of the additions to this revision of IORP II is a push for pension funds to be required to consider environmental, social and governance factors ("ESGs"). This has become something of a theme in global pension policy circles. For example, similar language was added to the recent updated OECD Core Principles of Private Pension Regulation adopted in June, 2016, and OECD presentations recently questioned the application of modern portfolio theory to pension investing, which has been seen by some as an impediment to ESGs. See our recent Groom Alert on this here: http://www.groom.com/resources-1066.html

The Impact of Brexit

Finally, one question that has been raised is whether the exit of the UK may have an impact on the Directive, either as a political matter (the head of the Directorate that was responsible for the Directive, British EU Commissioner Jonathan Hill, having resigned following the Brexit vote), or whether the UK may still enact any changes to conform to the Directive. While a direct impact on the Directive is not apparent, whether there may be an indirect impact from Brexit remains to be seen.

In summary, the revised IORP II represents a negotiated outcome and another step to encourage cross-border pensions. It will be interesting to see how it is implemented in the coming years.