

“Trustees will be expected to change the way they approach their work”

A new approach to the supervision of DB pension schemes by the Pensions Authority



On Wednesday 8 October, the Pensions Authority provided additional detail for trustees of defined benefit (DB) schemes on likely changes to the way it supervises DB schemes and on the implications of the transposition of the IORP II Directive into Irish law. This announcement further builds on and develops the key points outlined in a presentation by the Authority’s chief executive, Brendan Kennedy, in June 2020.

Risk based and forward looking approach

The Authority’s release indicated that it is moving to a “risk-based and forward-looking” approach to supervision for DB schemes. In particular, they wish to move away from the Pensions Act Funding Standard as the only measure which the Pensions Authority can use to assess the adequacy of a scheme.

A risk-based approach involves considering the long term sustainability of the scheme under prudent assumptions and an analysis of possible scenarios and stresses that can impact on the benefits which a scheme member will receive.

The IORP II legislation will likely result in a requirement for trustees to formally document a range of policies and the area of risk management is one of specific focus for the Pensions Authority. In particular, IORP II legislation will require schemes to adopt strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report key risks to which the scheme is or could be exposed. The new approach to supervision by the Pensions Authority is therefore consistent with the expected requirements under IORP II.

Proactive Approach Expected

Despite an EU deadline of 13 January 2019 for the Irish state to transpose the requirements of IORP II into Irish law the required legislation has yet to be published. This is a frustrating situation for pension scheme trustees and the Pensions Authority is now advocating that Trustees should start engaging with and acting upon the IORP II Directive in advance of its transposition, on the basis that the Directive’s requirements “are already clear”.

The most recent announcement from the Pensions Authority makes it clear that it now expects trustees to prepare in advance and understand their changing responsibilities.

It also expects trustees to build knowledge and expertise in the following areas:

- potential risk identification,
- risk quantification and risk management, and
- risk interdependencies and scenario planning

Risk Management Function

The legislation transposing IORP II will also require trustees to appoint a risk management function holder. A key task of the risk manager will be the delivery of timely, accurate and sufficiently detailed information on a regular basis to enable trustees to identify, measure, monitor, manage and report key risks. The risk manager will also be responsible for ensuring completion of fully comprehensive own risk assessment at least once every three years.

The Pensions Authority recommended in the recent announcement that trustees should start identifying who might be their risk management function holder as part of the preparation for IORP II readiness.

Scheme Supervision

The Pensions Authority had previously advised that they would categorise schemes in accordance with their analysis of the likelihood of the scheme being in a position to pay all benefits when due. The most recent announcement develops this categorisation by identifying the Authority's priorities with respect to the supervision of each category as follows:

Category	Scheme Description	Action Required by Trustees
1	Schemes likely to meet obligations	Monitor to ensure categorisation is maintained
2	Schemes with significant risk, that require change to scheme practices	Secure necessary change to reduce/eliminate relevant risk(s)
3	Schemes which are unlikely to be able to meet their obligations	Reduce benefits or wind up

Schemes will be notified of which category they have been assigned to. The level of attention they will get from the Pensions Authority will depend on their categorisation.

LCP Comment

While much of the Authority's announcement builds on commentary which they have previously provided throughout 2020, this latest announcement sees somewhat of a change in nature. Trustees are now being asked to take a proactive approach in order to pre-empt the legal requirements that are likely to be placed on them following the Directive's transposition on the basis that the IORP II Directive's requirements "are already clear".



While we appreciate and understand the desire for the Pensions Authority to move the supervisory regime forward, it is challenging for trustees to seek to fundamentally change their approach in the absence of any precise legislation.

In truth, most well run schemes will have migrated to a forward-looking and risk-based approach to governance. LCP welcomes a move away from simple binary tests such as the Funding Standard or proportion of assets held in government bonds to a more holistic approach where risk is measured and managed in the context of the long term objective of the scheme.

LCP clients will be familiar with detailed analysis of required returns vs expectations as well as a range of risk metrics. Where a scheme is on lcpvisualise.com trustees have available online and in real time updated metrics of key funding and risk measures.

For some large schemes, LCP have already been appointed as a risk manager. As part of this role, having identified key risks and mitigation measures, LCP provide regular risk management reports to enable trustees measure, monitor and report movements in agreed risk metrics. The reports, together with real-time reporting on LCP Visualise, also help trustees identify opportunities to de-risk further as they arise.



LCP can also offer a bespoke risk information workshop to trustees where our governance, investment and actuarial teams work together with trustee boards to help identify, understand and benchmark key risks. Again, specifically developed risk management tools such as LCP Sonar can bring the key risks to light – helping trustees prioritise and manage those risks more effectively.

If you have any questions on the above please call Conor Daly, Partner at LCP on 01 6144393 or the LCP colleague who normally advises you.



Want to find out more?

Contact our experts
+353 (0)1 614 4393

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