# The IORP II Directive: Implications for Pension Funds

## Abstract

An ageing population coupled with higher life expectancy and a smaller workforce is straining Europe's pension systems and making it difficult for pension funds to honor promises made to beneficiaries. The IORP directive published in 2003 sought to improve the supervision of occupational pension funds and mandated prudence to ensure the best interest of beneficiaries. Since 2003, significant macroeconomic developments including the failure of some pension funds in Europe have underscored the need for stronger governance.[1] The European Commission has published the revised IORP II directive to strengthen governance and transparency, ensure disclosure of relevant information to members, and facilitate increased cross-border activity. This paper discusses the implications of IORP II for financial institutions operating pension funds, highlights the operational impact, and proposes an approach for compliance.

## Main Goals of IORP II

The European Commission (EC) released the revised version of the Institutions for Occupational Retirement Provision Directive (IORP II) in December 2016. The new directive came into effect on January 12, 2017, and member states have to incorporate it into national law by January 13, 2019.

Given that pension funds across Europe manage assets valued at GBP 2.5 trillion (USD 3.5 trillion) for 75 million beneficiaries,[1] IORP II mandates strong governance, sound risk assessment, and improved transparency to better protect the interests of members. IORP II envisages a minimum harmonization approach aimed at improving governance and transparency, enforcing information sharing with members and regulators, and ensuring smooth cross-border transfers. Figure 1 depicts the changes introduced by the IORP II directive to improve regulation of pension schemes.

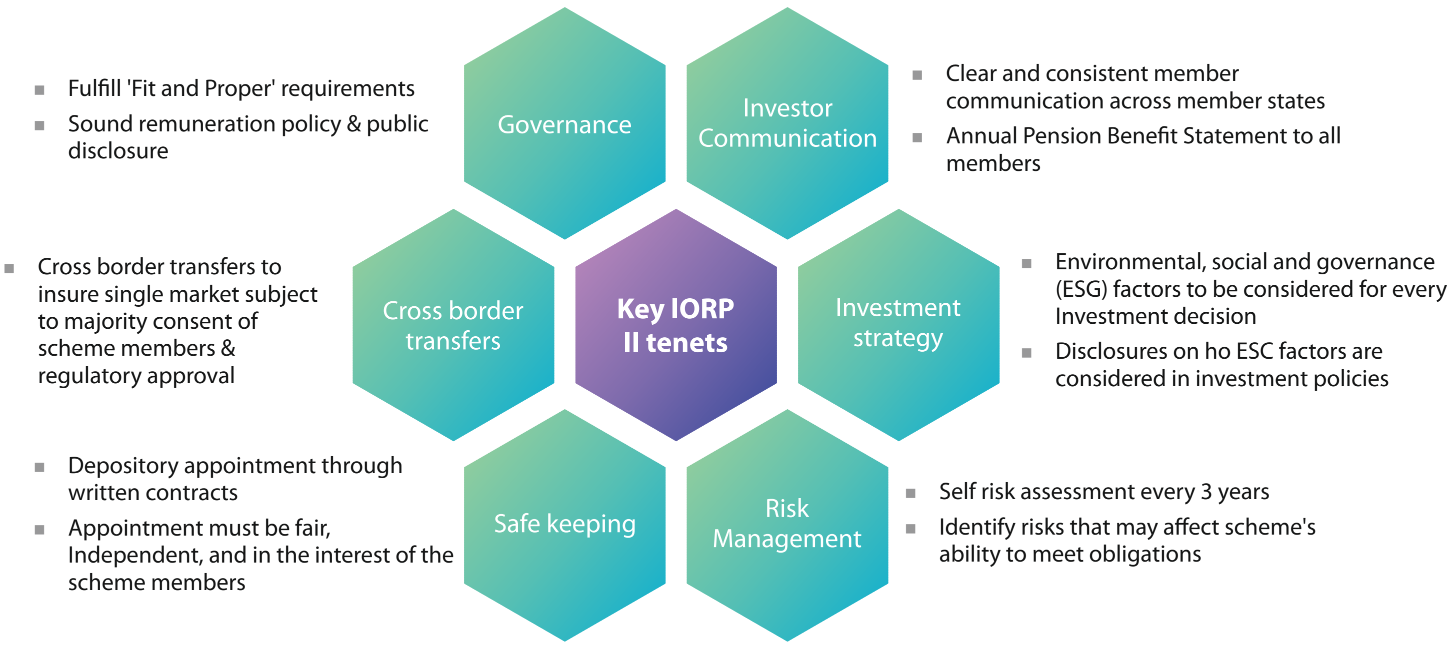


**Figure 1: Key Tenets of IORP II**

## IORP II Impact on Pension Funds in Europe

Given the gravity and nature of the impact the IORP II directive will have on pension firms, pension providers across the EU have been keenly following the rule-making process. Now that the directive has come into force, firms are formalizing their compliance programs as per the stipulated implementation time frame.

Based on how individual countries incorporate the regulation into their national legislation, IORP II will mandate changes to the IT systems and processes that support banks' risk management, governance, and information sharing functions. We present a high-level approach to design an IT transformation program; however, individual firms will need to tailor implementation strategies depending on their business footprint and the geographies they operate in.

**Impact assessment:** Perform initial assessment to evaluate the high-level impact of the directive on existing business models, risk management, and governance functions. This will include assessing the impact on clients, accounts, investment decisions, and pension providers.

**Gap analysis:** Leverage technology solutions to identify gaps in processes, policies, and underlying technology platforms of impacted business areas based on a comparative evaluation of the current state and the future target state. For instance, IORP II mandates comprehensive risk evaluation of internal policies every three years; the existing IT applications supporting this may need to be enhanced to comply with this provision.

**Business model:** Review the operational structure of pension schemes to determine how IORP II requirements will affect them and formalize the new business model and strategy based on the impact.  Incorporate changes to comply with the rules on remuneration policy, environmental, social, and governance (ESG) provisions and the related disclosure clauses.

**Implementation strategy:** Define a clear execution roadmap with appropriate deadlines to complete the enhancement cycle in order to achieve compliance within the stipulated timelines. Establish a robust communication strategy to ensure a seamless rollout.

**Technology partner:** Since compliance with IORP II will require changes to underlying IT systems and processes, pension firms must consider collaborating with a technology partner to implement the required changes in the existing portal or build a new portal. For instance, according to IORP II, the portal must reflect the exact amount of payout at the time of retirement; if there is a deviation in the amount, the portal must reflect it. Operationalizing such changes will require a large-scale reconfiguration of underlying systems and processes. Timely and hassle-free compliance will depend on collaborating with the right vendor, and firms must make this decision post an elaborate, well-rounded market analysis and evaluation.

## Technology Enhancements

Technology will play a critical role in managing the increased compliance obligations envisioned by IORP II. Let's look at a few technology enhancements that firms can implement to ensure compliance.

**Platform enhancements:** For most banks, the existing technology platforms will need to undergo significant upgrades to comply with the enhanced governance, risk management, and member communication requirements. The research function will need to adopt new software tools to identify investment plans that comply with the environmental, social, and governance (ESG) provisions. In addition, new capabilities will need to be built to meet the 'own risk assessment' criteria. Firms will need to ensure tech support for new depositories that will have to be set up under IORP II to mitigate the impact of default on the entire clearing and settlement infrastructure.

The reporting and distribution mechanisms that currently support the generation of pension statements will need modifications to comply with the new format and enable sharing with all the members as opposed to only active members under the existing regime. Similarly, compliance with other provisions like remuneration policy, disclosure obligations, and seamless cross-border transfers will necessitate IT infrastructure enhancements. Firms must also consider building the capabilities required to offer the European Commission's Pan European Pension Product (PEPP), a voluntary pan European pension scheme that offers members a new option to save for retirement,[2] and enable their cross-border distribution. Offering PEPP could be the differentiator that attracts consumers, especially given the increased cross-border mobility of European workers.

A comprehensive quality assurance check spanning functional testing of front- and back-office systems and end-to-end testing of IORP provider applications must compulsorily form a part of the transformation program to ensure smooth operations. Testing must also be undertaken to make sure that the new app meets all the disclosure obligations and adheres to all the new stipulations.

Other digital initiatives that pension funds can implement to achieve compliance with the investor communication and education provisions of the IORP II directive include:

**Mobile phone notifications:** Pension funds must develop the capability to send notifications and alerts on mobile phones to scheme members. Members should be able to see their real-time pension holdings. This will enable them to easily meet the new information sharing obligations mandated by IORP II.

**Gamification:** Gamified tools can be adopted to augment traditional modes of member communication as well as to train and educate pension providers on the new regulation; clear understanding will drive compliance. Similarly, gamified tools can be used to inform and educate members on pension related matters and raise the overall literacy level on personal financial management to help them plan for retirement.

**Robo-advisory:** Leveraging robo-advisory and deploying bots to consolidate all pension schemes in a single portal and continuously updating fund details on the portal will make it easier for members to track their pension benefits. A bot-powered interactive digital platform can significantly simplify the process of communicating with a multitude of members and ease the burden of complying with the information sharing obligation imposed by IORP II besides delivering cost efficiencies. Bot-powered portals can also be used to facilitate cross-border transfers of pension scheme assets and liabilities.

## The Road Ahead

IORPs across member states are subject to different regulations and operate with varied business models. A one-size-fits-all approach to compliance may therefore not be feasible and individual firms must define their implementation roadmaps based on internal policies and business strategies. It is, however, undeniable that compliance with IORP II will be challenging given the enhanced governance requirements, especially the 'own risk assessment' component. A thorough assessment of existing IT infrastructure, identification of the necessary change programs, a clearly defined implementation roadmap, and efficient execution are key to compliance. Pension firms in Europe would do well to proactively initiate the key initial steps required for timely compliance even as they wait for clarity on how individual member states will incorporate IORP II provisions into national legislation.

## References

1] European Commission, Press Release: Revision of the Occupational Pension Funds Directive – Frequently asked questions (March 2014), accessed April 16, 2018, http://europa.eu/rapid/press-release_MEMO-14-239_en.htm

2] European Commission, Press Release: Pan European Pension Product – Frequently asked questions (June 2017), accessed April 16, 2018, http://europa.eu/rapid/press-release_MEMO-17-1798_en.htm

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