

## IORP II

### Considerations for Trustees

#### Introduction

The objective of this note is to give trustees an understanding of the breadth of their responsibilities arising from the provisions of the IORP II Directive<sup>1</sup>. It should therefore be helpful to trustees in preparing for what the potential impact might be and what actions they should consider now.

As the legislation transposing the IORP II Directive has not as yet been introduced, this note is provided for information purposes only. While the Pensions Authority has made every effort to ensure that the information contained within this note is correct and accurate, full details cannot be provided until the legislation is finalised. The relevant legislation to transpose the Directive is due to be introduced by Government later in 2018.

#### Background

The IORP II Directive must be transposed into Irish law, and the laws of all EU Member States, by 13 January 2019.

The Directive provides for EU wide pension scheme standards including:

- An effective system of governance, covering areas such as;
  - fit and proper standards for trustees;
  - the appointment of Key Function Holders (KFHs) for risk management, actuarial and internal audit;
  - written policies on risk management, internal audit, and, where relevant, actuarial and outsourced activities, and
  - standards relating to internal controls, administrative and accounting procedures, contingency plans and remuneration.
- Communications with, and information to be provided to active members prospective members, deferred members, those nearing retirement and pensioners.

The Directive also covers the general principles of prudential supervision with an emphasis on a forward looking and risk-based approach, with greater interventionist powers available to the regulator, including a reach to outsourced service providers.

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<sup>1</sup> EU Directive on the activities and supervision of institutions for occupational retirement provision (Directive 2016/2341), known as the IORP II Directive.



## **Governance**

Governance can be defined as the approach which trustees adopt in order to meet their scheme's obligations and objectives. This encompasses objective setting, processes and procedures, decision making and the documentation of these activities.

While many of the scheme's activities, such as administration and investment management, may be outsourced, the trustees remain responsible for those activities and their governance systems must ensure proper oversight.

The Authority will oversee the extent and quality of a scheme's governance. Particular areas of focus will include:

- the composition of the trustee board including the procedures and processes it adopts in fulfilling its role and objectives;
- the policies in place relating to the range of scheme activities, including internal controls, and the management of risks; and
- the practical application of the agreed policies, procedures and operating principles.

The Authority expects that all significant activities should have documented policies and procedures, the rationale for the various decisions should be recorded and all material should be retained and available for inspection and audit by the Authority.

## **Role of the trustee board**

The trustee board is responsible for the effective, prudent and ethical oversight of the management of the scheme. Within its governance responsibility, amongst other things, is a requirement to set and oversee:

- an overall transparent operational structure for the scheme;
- an appropriate investment and funding structure;
- an adequate and effective internal control framework, that includes well-functioning risk management, compliance and internal audit functions as well as an appropriate financial reporting and accounting framework;
- a remuneration framework that is aligned with the objectives and risk strategies of the scheme;
- effective communication and reporting processes for members and beneficiaries.

The trustee board should consider the production of a Board Manual, which would fully document its roles and responsibilities, its policies and procedures, and a schedule of review dates – a record should be kept of each such review.

The trustees should have:

- the necessary knowledge, skills, experience, expertise, competencies, fitness, probity and integrity to carry out their duties;
- a full understanding of their individual and collective responsibilities;
- a full understanding of the nature of the scheme's activities and management; and
- an understanding of the scheme's financial position, risks and technical provisions.

### **Composition of the trustee board**

The trustee board should be of sufficient size and expertise to oversee adequately the operations of the scheme. While a sponsoring employer may be responsible for the appointment of trustees, the trustee board should satisfy itself that the trustees, including any potential new trustee prior to his or her appointment, collectively meet the fit and proper standards and should document how it has satisfied itself in this regard (see next section).

Trustee boards should consider reviewing their membership at least once every three years. This review, which should be documented, should take into consideration:

- the ability of individual trustees to devote the necessary time and attention to the role;
- possible conflicts of interest of its members, and whether they can be managed;
- the balance of experience and expertise.

### **Fit and proper requirements**

The Directive requires that trustees and KFHs meet fit and proper criteria.

“Fitness” means that the trustees as a group, and each person appointed as a KFH, has the necessary qualifications, skills and experience to perform the duties of that position.

The Authority expects trustees to have conducted and documented its own due diligence, including obtaining evidence of professional qualifications, CPD and previous experience, before a person is appointed as a trustee or KFH.

“Proper” means that each trustee and KFH must be honest, diligent and independent-minded.

Much of an assessment of a person's character, in terms of them meeting the “Proper” requirement, can only be undertaken in the case of exceptions, i.e. it

is only when evidence is available to suggest that a person might not comply with the standard required, that a scheme must investigate thoroughly.

The Authority expects trustees to have conducted and documented their own due diligence in satisfying themselves that a prospective trustee or KFH is a proper person for such a role.

A person appointed as a trustee or KFH must manage his or her personal affairs in a sound and prudent manner and must act ethically and with integrity. This includes disclosing any potential conflicts of interest.

### **Ongoing fit and proper compliance**

Being fit and proper is a continuing obligation and the Authority expects trustees to require persons to notify the trustee board of any material changes or issues relevant to their compliance. The Authority expects that trustee boards require their members and KFHs to confirm annually that there have been no material developments in relation to their compliance with the fit and proper standards.

Where a trustee board has concerns regarding the fit and proper standards of a member or KFH, the Authority expects them to investigate such concerns and take action as appropriate without delay.

Schemes are expected to document and record all due diligence undertaken, together with any documentation provided by the person, including any responses provided by the person in relation to the fit and proper standards. The Authority may require sight of any such records or due diligence.

Trustees should have regard to their obligations under Data Protection law in holding the information referred to, including ensuring that the information is held securely, as with all data.

### **Meetings**

The trustee board should meet as often as is necessary to fulfil its responsibilities effectively and prudently. In any event, it should meet at least four times per calendar year and at least once in every six-month period.

A detailed agenda of items for consideration at each meeting, together with minutes of the previous board meeting, should be circulated in advance of the meeting to allow all trustees adequate time to consider the material. Sufficient and clear supporting information and papers should also be circulated in advance. All such material must be available to the Authority on request.

The trustee board should consider whether it might be appropriate to publish an annual calendar of meeting dates together with a list of key events or actions that need to be considered, particularly from a compliance or regulatory perspective, over the scheme year.

Detailed minutes of all board meetings should be prepared, with:

- the attendance or nonattendance of members of the board noted;
- all decisions, discussions and points for further actions documented, and
- dissensions or negative votes documented in terms acceptable to the dissenting person or negative voter.

The minutes of meetings should provide sufficient detail to evidence appropriate trustee attention, the substance of discussions and their outcome and should be agreed at the subsequent meeting.

The trustee board should establish a documented conflicts of interest policy for its members and, where conflicts of interest arise, the board should ensure that they are managed appropriately, in accordance with the agreed policy, and noted in the minutes. If ongoing conflicts of interest arise that are deemed material in terms of their impact on the business of the board, consideration should be given to changing the membership of the board.

### **Committees of the trustee board**

The trustee board may consider establishing committees to review and consider specific issues that require significant oversight on a once-off or ongoing basis.

The trustee board may delegate responsibility to sub-committees or to the scheme management to act on its behalf in respect of certain matters but where it does so, it should have mechanisms in place for documenting the delegation and monitoring the exercise of delegated functions. The board remains responsible for all decisions and actions taken on its behalf.

### **Governance and scheme management**

Trustees must have policies and procedures in place for all significant activities and must be able to demonstrate compliance with those systems and policies.

The procedures must be sufficiently sophisticated to ensure that there is effective oversight of the activities of the scheme taking into consideration the nature, scale and complexity of the business being conducted. The governance approach and culture will be an important element of the Authority's supervision of the scheme, and trustees should be able to demonstrate that they always prioritise the protection of member's rights and interests.

### **Policies**

The Authority will pay particular attention to the quality and application of comprehensive written policies in the following areas:

- scheme administration
- risk management

- internal control framework
- outsourcing activities (where relevant)
- remuneration
- actuarial and funding matters (for defined benefit schemes).

All policies and procedures should be reviewed and updated at least every three years, or more frequently in the event of significant change.

Documentary evidence of such review and update should be retained, and will be examined by the Authority.

### ***Scheme administration***

Trustee board should have in place an administration policy which documents the administration activities, their delegation and monitoring.

At a minimum, the policy should address the following matters:

- each of the main administration activities the approach to determining how they should be carried out,
- the procedures for appointing administrators, where relevant,
- the information to be provided by the administrator to the trustees, and
- the procedures for assessing and reviewing the performance of the administration.

There should be documented evidence of adherence to the administration policy.

### ***Risk management***

The risk management policy should set out the methods adopted to identify the most significant risks to which the scheme is exposed and how the risk appetite of the scheme will be agreed for both individual and scheme risks.

The processes governing the periodic Own-Risk Assessment should also be documented.

The risk management policy should be reviewed at least every three years following a comprehensive Own Risk Assessment.

Comprehensive risk management should include the development of contingency plans in areas where the scheme is likely to be especially vulnerable.

### ***Internal control***

The scheme's internal control procedures should at a minimum provide for documented evidence of the following:

- Procedures providing for segregation of financial activities to reduce the likelihood of deliberate fraud. This would include the segregation of principal duties such as:
  - custody of assets
  - authorisation and approval of transactions
  - reconciling or reporting of transactions
  - data security.
- financial record keeping procedures;
- physical control over financial records;
- clear lines of authority and reporting;
- independent checks, including periodic reviews of all financial reports and filings;
- a robust and independent internal audit process.

### ***Outsourced activities:***

The trustees should be able to demonstrate that they;

- have developed a policy for the extent to which scheme activities should be carried out in-house or outsourced to third parties;
- have developed an appropriate specification for the activities to be outsourced and the obligations of the service provider
- have gone through an appropriate process for the selection of the service provider;
- are monitoring the activities of the service provider on an ongoing basis to ensure its proper functioning;
- have a written agreement in force which is legally enforceable and defines the rights and obligations of the scheme and service provider;
- notify the outsourced activity to the Authority in a timely manner, or in advance where the activities relate to key functions or the management of the scheme; and

- has enabled the Authority to request information directly from the service provider.

### **Remuneration**

The trustee board must have a documented remuneration policy governing the remuneration of trustees, KFHS, critical service providers and any other people or organisations of significant importance to the scheme. The policy must be designed to ensure that the scheme's remuneration practices do not create conflicts of interest and do not promote excessive risk taking.

### **Key functions**

The trustee board must ensure that there is a risk management function, an internal audit function, and for defined benefit schemes, an actuarial function.

The trustee board must ensure that the holders of each of these key functions (a Key Function Holder or KFH) have the resources and authority to enable them to undertake their duties effectively in an objective, fair and independent manner. In addition, the trustee board must ensure that they receive timely, accurate and sufficiently detailed information from KFHS and to document its key information requirements from each KFH for consideration at each meeting of the trustee board.

Full details of appointees to each of these roles, including a copy of the CV and the rationale for the appointment, should be documented and, where such roles are outsourced, the Authority should be advised in advance of any agreement in respect of such outsourcing entering into force.

### **Supervision**

The Authority will be adopting a forward looking and risk based approach to supervision, which focuses on the risks of non-compliance and poor member outcomes. A key trigger for this approach will be an assessment of the overall governance culture within the scheme.

### **Next Steps**

As and when the legislation giving effect to the IORP II Directive is published, the Authority intends to issue further communications and guidance to assist trustees in understanding their obligations.