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Pensions Conference 2015

24 – 26 June
Hilton, Glasgow

22 June 2015

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Developments in European Pensions

Chair:

Speaker: Charles Cowling

22 June 2015

Agenda

Background to EU institutions and legislative process

Introduction to EIOPA

IORP Directive - journey and likely new regulations

EIOPA work on Solvency and the Holistic Balance Sheet

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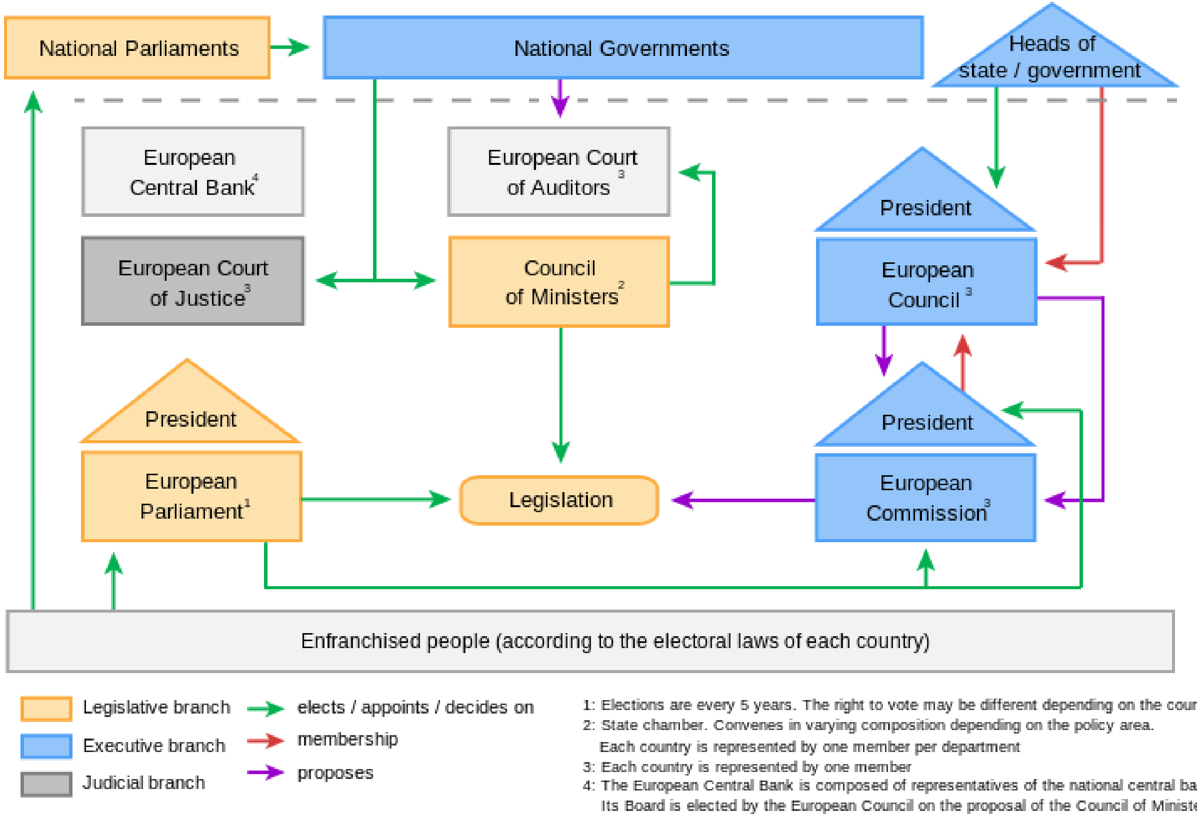
EU Institutions



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EU Presidents

President of the European Council

Donald Tusk *(former Prime Minister of Poland)*

President of the European Commission

Jean-Claude Juncker *(former Prime Minister of Luxembourg)*

President of the Council of the European Union

Latvia

President of the European Parliament

Martin Schulz *(German leader of the Progressive Alliance of Socialists and Democrats)*

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EU Commission

Independent Supranational Authority

- Paid executive of the EU
- Supported by 23,000 European civil servants, split into departments

28 Commissioners

- Required to act independently
- Providing cabinet style Government with each Commissioner running a department

Financial Stability, Financial Services and Capital Markets Union

- Department responsible for banking, finance and pensions
- Commissioner is Lord Jonathan Hill
- Appointed November 2014

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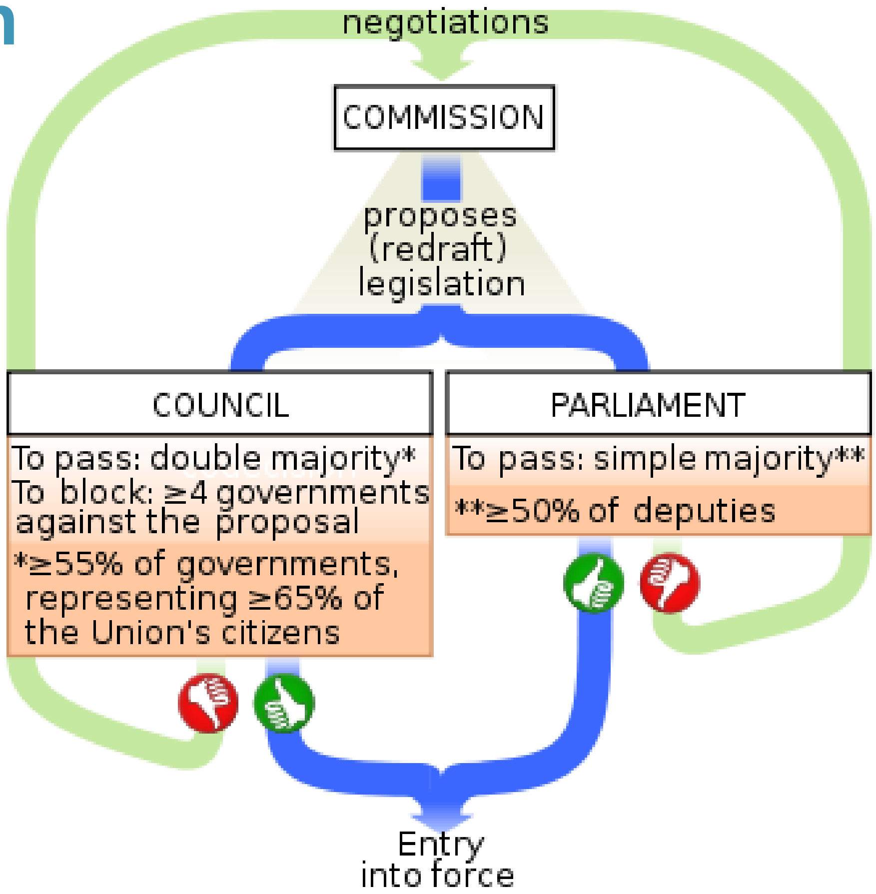
EU Legislation Process



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EU Legislation

Regulation

- Law, applying in its entirety

Directives

- **Bind member states to certain goals which they must achieve**

Decisions

- Instrument focussed on a particular person or group

Recommendations and opinions

- Non-binding declaration

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European Insurance and Occupational Pensions Authority (EIOPA)

EIOPA is an independent advisory body to the European Parliament, the Council of the European Union and the European Commission

- Chairman – Gabriel Bernardino
- Board of Supervisors (includes PRA and tPR)
- Management Board
- Board of Appeal
- Stakeholder Groups
- Review Panel
- Committees, Task forces and Panels

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EIOPA – Missions and Tasks

EIOPA's core responsibilities are to support the stability of the financial system, transparency of markets and financial products as well as the protection of policyholders, pension scheme members and beneficiaries. EIOPA is commissioned to monitor and identify trends, potential risks and vulnerabilities.

- Protecting consumers
- Effective and consistent regulation and supervision of financial institutions
- Harmonisation and coherent application of rules & coordinated supervisory response
- Oversight of cross-border groups

The EU Legislative Journey

- In 2011, the EU Commission asked EIOPA to conduct a quantitative impact study (QIS) on Institutions for Occupational Retirement Provision (IORPs)
- QIS carried out in 2012
- Preliminary results of QIS presented in April 2013
- In May 2013, EU Commission announced it was postponing Solvency 2 capital requirements (Holistic Balance Sheet) from new IORP Directive
  - Followed an alliance of UK, Ireland, Germany, Belgium and Netherlands Governments opposing any introduction of a Solvency 2 capital regime for pensions
- EIOPA final report on QIS presented in July 2013

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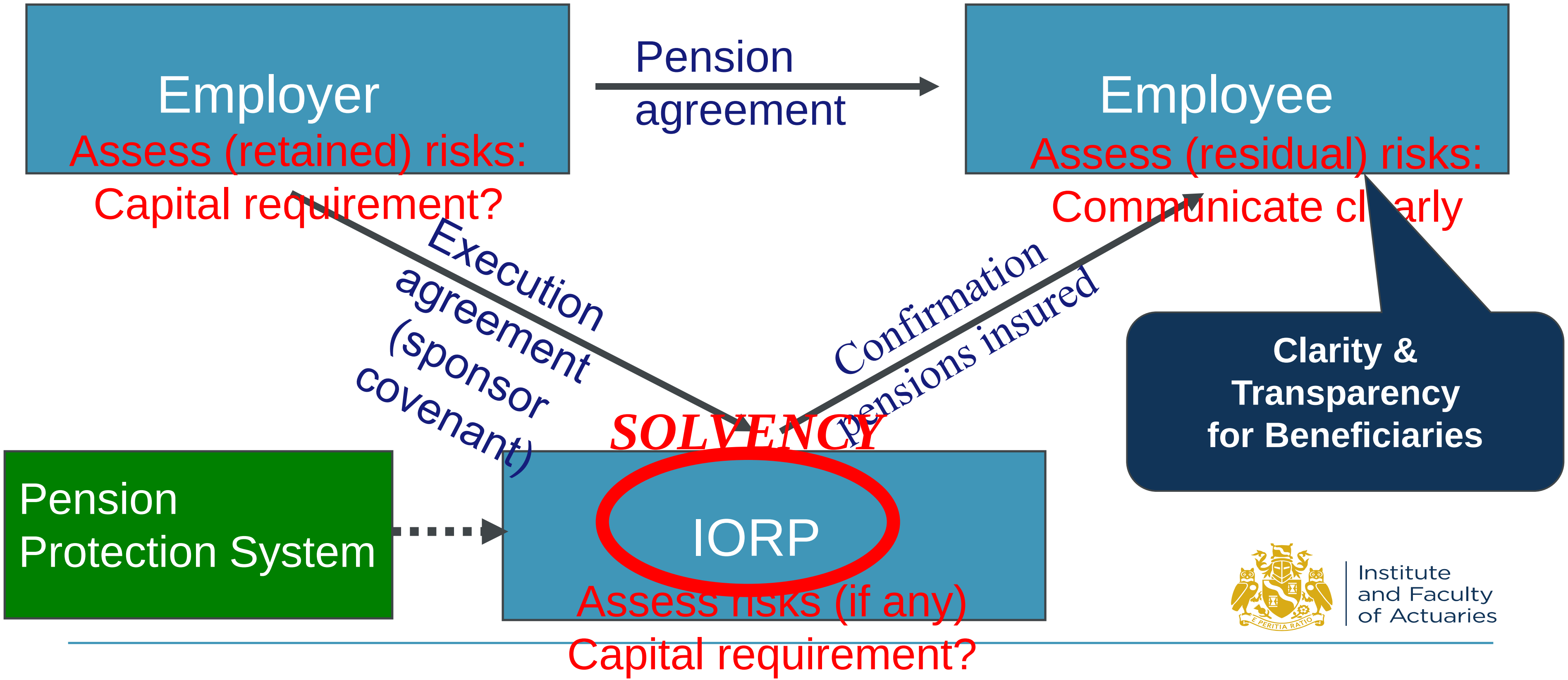
More Capital? Better Communication? Both?



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Solvency 2 Framework

Pillar 1

Rules for valuation of:

-Assets

-Liabilities

-Capital requirements

Pillar 2

Supervisory review process including:

-Effectiveness of risk management

-Corporate governance arrangements

Pillar 3

Disclosures:

-Public

-Private (to the regulator)

EU Directive on IORPs

- Original IORP Directive in force since 2003, proposal to revise this Directive issued by **EU Commission** in March 2014, covering cross border activity, governance and supervision, and disclosure to members
  - Significant new governance requirements ➔ Number of articles increased from 24 to 80.
  - Introduction of new Risk Evaluation for Pensions report
  - Professional qualifications for trustees
  - Disclosable remuneration policies for pension schemes
  - Introduction of an EU harmonised annual Pension Benefit Statement
- No changes to quantitative aspects i.e. calculation of technical provisions or capital requirements
  - Cross-border schemes must be fully funded

EU Directive on IORPs

- To come into effect, Directive must be agreed by the 3 co-legislators
  - EU Commission, Council, European Parliament
- **Council** issued a revised draft in November 2014, proposed changes include
  - Trustee fit and proper requirements collective rather than individual
  - Pension Benefit Statement and Risk Evaluation report simplified
  - More flexibility in implementation by national regulators

*"this Directive is aimed at **minimum harmonisation** and therefore should not preclude Member States from maintaining or introducing more stringent provisions in order to protect members and beneficiaries, provided that such provisions are consistent with Member States' obligations under Union law. This Directive does not concern issues of national social and labour law, fiscal and contract legislation nor the adequacy of pension provisions in Member States"*

EU Directive on IORPs - Council

Pension – Social or financial contract?

Institutions for occupational retirement provision are **pension institutions with a social purpose that provide** financial service**s. They are responsible** providers which bear a heavy responsibility for the provision of occupational retirement benefits and therefore should meet certain minimum prudential standards with respect to their activities and conditions of operation. Their social function and the triangular relationship among the employee, the employer and the institution should be adequately acknowledged and supported as guiding principles of this Directive.

Review after 6 years?

In order to ensure the smooth functioning of the internal market for occupational retirement provision organised on a European scale, the Commission should, after consulting EIOPA, review and report on the application of this Directive and should submit that report to the European Parliament and to the Council **6** years after the entry into force of this Directive. This review should **focus on relevant issues, as identified by the Commission, and should** be produced after consulting EIOPA, **on its analysis of** occupational pensions schemes.

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EU Directive on IORPs

- **European Parliament** to decide on its position by end 2015?
  - But it is starting from the original March 2014 draft

- Trilogue to agree final Directive (2016?)

- Member States then have 2 years to implement (2018?)

Back to EIOPA

- Consultation Paper on Further Work on Solvency of IORPs
  - Issued 13 October 2014, closed 13 January 2015
  - EIOPA's own initiative, no brief from European Commission
- EIOPA continues to work on "open issues" from QIS, including methodologies for establishing the holistic balance sheet and the supervisory framework
- Established Occupational Pensions Committee Solvency Subgroup
  - Chair: Marius Wenning (Germany),
  - Work streams: Valuation of Sponsor Support, Supervisory Responses, Discretionary Mechanisms, Reduction of Benefits, Contract Boundaries

EIOPA consultation - AAE response

The Holistic Balance Sheet

- The concept HBS is interesting as it aims to put a value on all the different building blocks of the pension deal including how it is financed
- The words Holistic Balance Sheet are therefore not appropriately describing the meaning of it.
- AAE proposed the term **Holistic Framework**.
- For supervisory purposes the HBS needs to be decomposed into the parts that relate to the obligations/risks of the IORP, of the sponsor and to the risks of the beneficiary.

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EIOPA consultation - AAE response

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The Holistic Balance Sheet

- The HBS could possibly be used in the communication with the (representatives of the) beneficiaries. AAE view the HBS first of all as a possible part of communication between experts and not immediately as a suitable tool for communication with the beneficiaries
- The HBS could be one of the tools to perform a risk evaluation of pensions. The risk evaluation will likely go beyond the point of ‘just’ a valuation at a certain point in time. In AAE’s view the risk evaluation for pensions should assess also future developments and include non-financial risks as well.

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EIOPA consultation - AAE response

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Supervisory Framework: should reflect and respect the pension deal

- The supervisory framework should not require guarantees where they are not part of the pension deal nor require a too low discount rate where it would increase the value of the pension deal beyond that agreed between employers/employees. Neither should the supervisory framework accept higher discount rates than what would reflect the nature of the pension deal – as governed by social and labour law of each member state.
- The supervisory framework should be aimed at understanding all elements of the pension deal and its financing, monitoring how the plan is performing versus its objectives, requiring management actions if there is a (significant) deviation from the path to fulfilment of the pension deal and so ensuring that employers/employees live up to what they have agreed and that communications are in line with the pension deal, the actual financial position and the expected future financial development.

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EIOPA consultation - AAE response

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Impact and transitional arrangements

- Any approach adopted should aim not to alter - to a material extent - the strength of any ‘pension promise’ that has already been agreed between employer and employee.
- Existing member-state specific valuation standards, minimum funding requirements and accompanying recovery periods etc. for benefits already accrued to date or to be accrued in future under existing promises (i.e. for current employees) should be retained (either indefinitely or if this was not workable for effectively a very extended period)
- Any reasonable approach could potentially be adopted for benefits under new promises, depending on how politicians decide to balance the conflicting demands of continuity, proportionality, market impact, transparency, member protection, consistency with insurance framework, harmonisation and respect for diversity between member states

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EIOPA Quantitative Assessment

- Launched in May 2015 (NB not a QIS), will run to August 2015
- The stress test assesses resilience to adverse market scenarios and a longevity scenario (for both DB and DC schemes)
- The stress test provides insight and raises awareness of the occupational pensions' sector risks and vulnerabilities
- Quantitative assessment to support advice to European Commission on solvency
- Selection of participating IORPs by national supervisors (tPR), to cover >50% of DB assets under management and tPR has contacted a sample of schemes requesting voluntary participation

EIOPA Quantitative Assessment

Gabriel Bernardino:

- *"Pension funds are already experiencing a challenging environment with low interest rates and rising life expectancy. A key vulnerability for the occupational pensions sector is a prolonged period of low interest rates combined with a fall in asset prices due to a re-appraisal of risk on financial markets. The stress test will retrieve valuable information on the sensitivity of IORPs, sponsoring undertakings and members and beneficiaries to such a scenario. "*
- *"…never said Solvency 2 should be applied to pensions … we want to provide the supervisory community with a framework to analyse the sustainability of the system"*

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EIOPA Quantitative Assessment

Gabriel Bernardino:

- *"if pension promises are assessed to be unsustainable, then local supervisors should get the power to interfere"*
- *"this will never be a one-size-fits-all approach"*
- *"… [there would be] no cross-border pension arrangement without a more standardised approach to supervision on a European level"*
- *" … [assessing sustainability and funding should] not be harmonised on all levels"*

EIOPA next steps

EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY

- In September, EIOPA quality assurance and analysis of submissions
- EIOPA final report published December 2015
- EIOPA expects to deliver its Advice to the European Commission in March 2016
- This will likely be too late to affect the current IORP Directive
- And as the work was EIOPA initiative and not requested by European Commission will it go any further …?
- European Commission focussed on Capital Markets Union

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In Conclusion ...

- New (revised) IORP Directive, will likely see:
  - More governance requirements
  - More focus on risk evaluation
  - More member disclosure / communication requirements
  - Unrealistic pension promises may trigger more transparent member communications
- But we are not likely to see (for several years at least) :
  - The introduction of any Solvency 2 capital requirement test, or
  - The introduction of the Holistic Balance Sheet (Holistic Framework), except possibly as part of member communications

Of course ...

- … in 2017 we could vote to leave the EU
- And then we could forget about EIOPA and IORP Directives
- And maybe we'd return to the MFR … ??!!

Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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