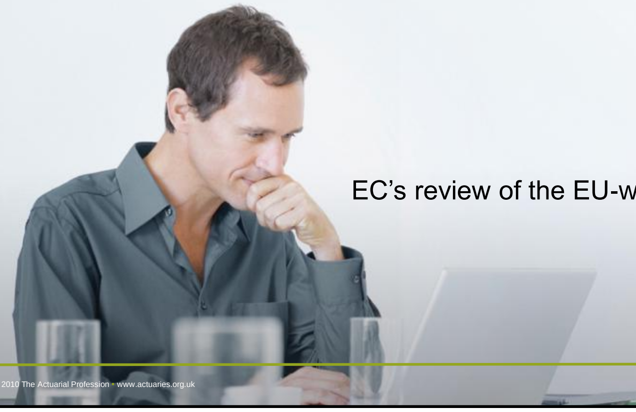
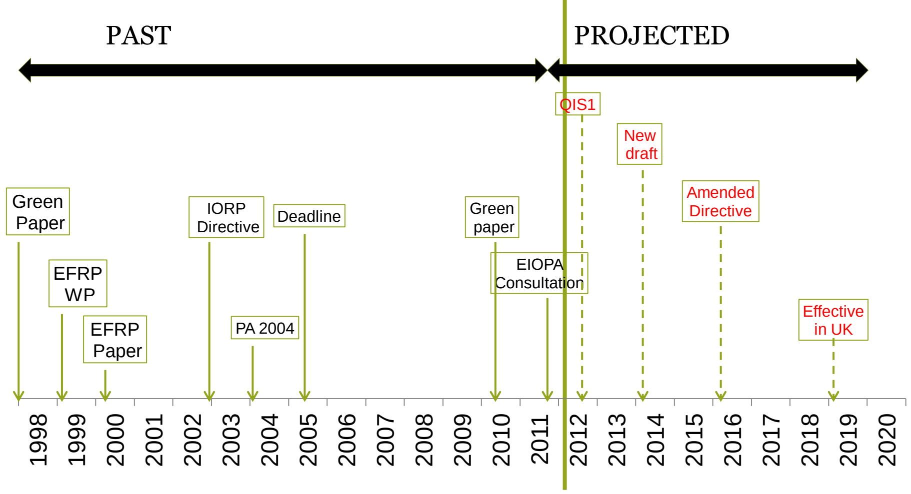
The Actuarial Profession
making financial sense of the future

Current Issues in Pensions – April 2012
UK Pensions and Europe



EC's review of the EU-wide framework for IORPs

SECTION 1 – BACKGROUND
Where are we and how did we get here

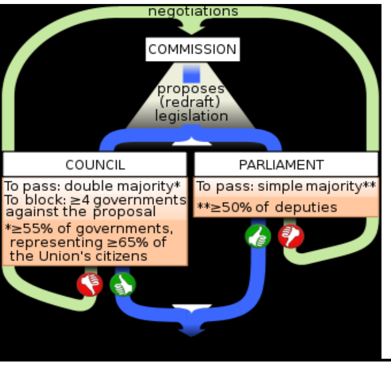


IORP Directive (2003/41/EC)

- EU effective September 2003
  - to be enacted by member states by September 2005
  - Basis for PA2004 in UK (i.e. basis for all we do in pensions)
- Objectives:
  - Encourage freedom of movement across EU
  - Allow cross border retirement provision
  - Protect beneficiaries
  - Encourage suitable investment strategies and portfolios
  - Respect subsidiarity

Who's involved?

- European Parliament – MEPs elected
- European Commission – the EU civil service (comprising Directorates)
- Council of Ministers – Represents member state interests
- How they interact



EC Directorates General (DG)

- 33 Directorates – each with own subject matter
- Propose laws to Commission to propose to Parliament
- IORP and insurance supervision under DG XV (Single Market)
  - Objective is freedom of movement of labour and services/goods

- EIOPA (European Insurance and Occupational Pensions Authority)
  - Sits under DG XV
  - Replacement for CEIOPS
  - Supervisor for both insurance and for occupational pensions
  - The (UK) Pensions Regulator will report to EIOPA

DG XV - Role

The first role of the Directorate-general is therefore to bring forward proposals for legislation aiming to remove barriers, thus simplifying life for consumers and for businesses, stimulating competition, reducing prices and widening choice. This involves not only making it easier for goods and services to circulate, but also making it easier for EU citizens to work and to live in other EU countries.

Simplification

The second responsibility of the Directorate-General is to ensure that the opportunities offered by the Single Market are fully exploited. It does so by controlling the full and timely respect of Community law in co-operation with the Member States and by monitoring closely how EU law is being applied in practice.

Cross border

The third task for the Directorate-general is to inform citizens and businesses about the rights they have within the Single Market and of the benefits available to them.

Communication

More details on our mission, activities and priorities can be found in the DG Internal Market and Services' Annual Management Plan for 2012.

Why is there a need for change to IORP Directive?

- Lack of consistency
- Lack of transparency in supervisory systems
- Impact of financial crisis
- **EIOPA desire to harmonise insurance and occupational pensions supervision**
- **Only 84 cross border schemes (approx 250,000 schemes across EU)**

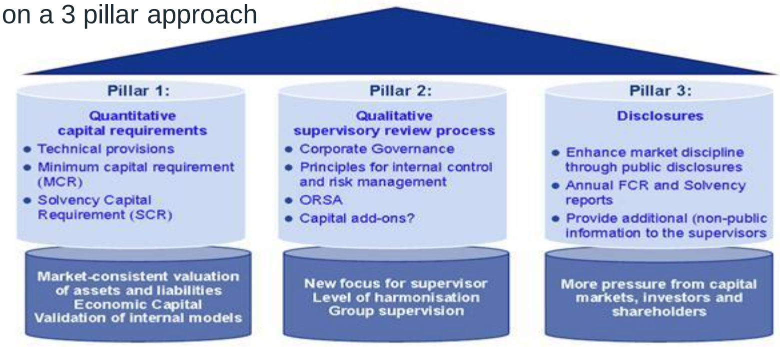
SECTION 2 – PROPOSALS FOR PENSIONS
Do they really mean Solvency II for pensions?

PRINCIPLES

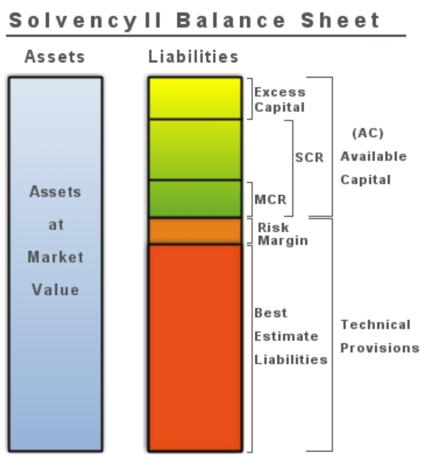
- Transparency
- Comparability
- Comprehensiveness
- Harmonisation with insurance supervision

What is Solvency II?

- Is new European wide capital regulatory regime for insurance which aims to protect policyholder interests and make business easier across the EU.
- Due to be fully implemented in January 2014
- S2 based on a 3 pillar approach

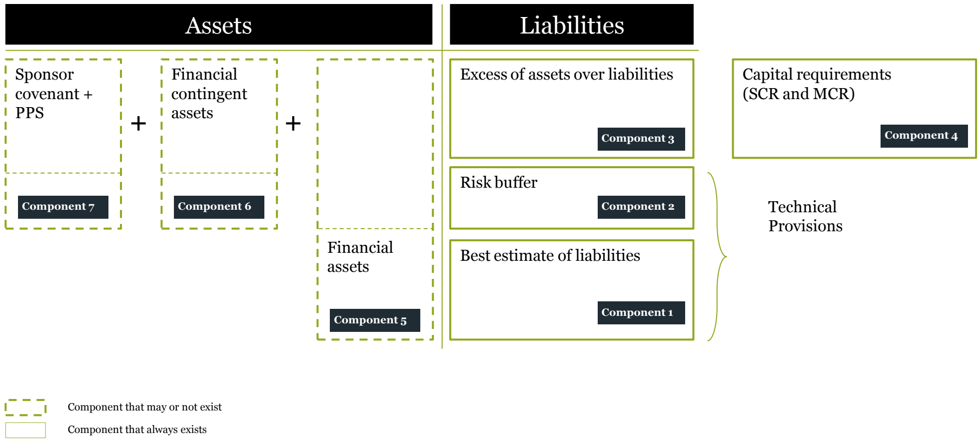


Solvency II



- Best estimate liabilities use "risk free" discount rates. Swap rates adjusted for credit risk.
- Risk margin is the cost of holding required capital
- MCR – Minimum Solvency Requirement - is minimum allowable capital between 25% and 45% of SCR
- SCR – Solvency Capital requirement – is the capital required to cover a 1 in 200 event (99.5%ile confidence level)
  - Can be calculated by standard formula, or
  - Internal model
- Annuity business expects to be able to benefit from an matching premium where the discount rate is higher to allow for illiquidity

SECTION 3 – PROPOSALS FOR PENSIONS
Comprehensiveness - The Holistic Balance Sheet



Cross border definition “clarified ” ...

	Currently cross border (UK)?	Cross border in proposed definition (UK)?
[1] Scheme contains employees subject to overseas social and labour laws	**YES**	**NO**
[2] Scheme has sponsors overseas	**NO**	**YES**

NOTE: A sponsor includes anybody that may have an obligation to pay into the scheme at any time

EIOPA – Governance and Supervision

Governance Policy

Conflicts policy

Code of conduct policy

Controls over outsourced activities

Risk
At every level. Different frequency of monitoring
Cover risks within outsourced activities

Sound Remuneration policy
(if pay Trustees)

Internal audit
3 options

Sensitive information
Confidentiality
Improper use

Compliance
Assess regularly
Wider than Pensions Act

Whistleblower
Member states can decide

SECTION 3 – COMMENTARY AND REACTIONS

- What have industry experts been saying …

PENSIONSAge

Armageddon

Solvency II remains contentious as EIOPA publishes advice on IORP review

17th February 2012

Spearheading opposition is the UK government's pensions minister Steve Webb. In a recent speech he made it clear the UK would not accept a change of this nature, warning it would cost companies sponsoring DB funds £100bn ($160bn) and lead to widespread fund closures.

Webb's figure would appear to be an underestimate. JP Morgan Asset Management estimates Solvency II regulation would cost DB fund sponsors £600bn; and JLT Pension Capital Strategies has put forward a staggering figure of £1trn.

Raj Mody, head of PricewaterhouseCoopers' UK pensions group, said: "While attempting to improve pension scheme security, these new rules could actually kill off occupational pension schemes altogether.

"We estimate the cost on UK business would be in the range of £250bn to £500bn. In terms of the impact on the UK economy, this is like wiping out a quarter of the FTSE100."

Insurance Daily

ABI speaks out on IORP Directive

Out-Law.com

Legal news and guidance from Pinsent Masons

27th March 2012

A new survey, commissioned by business advisory firm Deloitte, found that firms believe that their scheme liabilities will increase by between 20% and 50% if the European Insurance and Occupational Pensions Authority (EIOPA) goes ahead with its proposals. This would amount to an increase of as much as £2.5 billion for the average FTSE 100 company.

13th February 2012

Speaking to Money Marketing, The Pensions Regulator chief executive Bill Galvin says the proposals could be "destructive" for the UK.

He says: "My personal view is that a transcription of Solvency II rules onto pension schemes is absolutely the wrong way to go.

"At the moment there are still a range of possible outcomes, some of which could have a minimal impact on the UK and some of which could be very destructive."

Industry experts claim the reforms, if implemented, could cost the UK economy up to £1trn. Full analysis of the impact Solvency II for pensions could have on the UK is available here.

PENSION FUNDS ONLINE
16th February 2012
Solvency II nightmare still looms but worst-case scenario averted

Professor Paul Sweeting of JPMorgan Asset Management told Pension Funds Insider in January that accepting employer covenants and PPF guarantees (which currently cover 90% of all UK pension liabilities) could see Solvency II having no cost at all to British pension funds.

Armageddon???

INVESTMENT & PENSIONS EUROPE

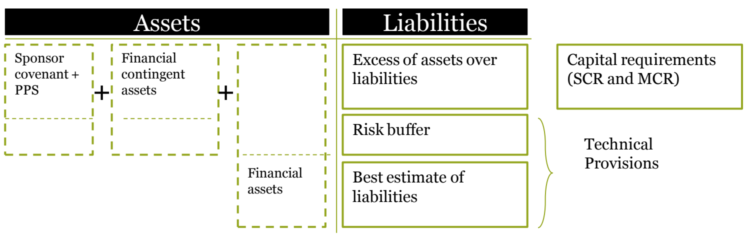
2nd April 2012 (referring to 1 March meeting)
But the EU single market commissioner, Michel Barnier, speaking at the European Commission's public hearing on the IORP Directive, spoke of the "hyperbole" of claims for the economic cost of Solvency II-type rules if applied to occupational pensions. He was undoubtedly referring to the estimates of JP Morgan and PwC relating to the cost of Solvency II rules if applied to pensions. Or those of the Dutch minister for social affairs, Henk Kamp, who said that a move to 99.5% certainty under Solvency II would cost his country's employers and employees €11bn in extra capital buffers.

PwC estimates the potential cost to the UK could be as much as £500bn (€600bn), "depending on how much leeway there is for healthier businesses". The CBI estimates that schemes that comply with Solvency II would need to offload more than £800bn of equity, while JP Morgan says UK companies will be forced to pour another £600bn into their defined benefit (DB) schemes.

So, who is right?

It depends on ...

- How will the discount rate be specified?
- How will cross border scheme deficits be treated?
- If you have a strong covenant how much will have to be held within the pension scheme?
- How will covenant be valued?



Possible structure for Technical Provisions

- Option for a two-tier TP
- Level A: Solvency TP, to reflect value of liability on buy-out (or a practical low cost run-off strategy)
  - Determined on market-consistent principles
  - To reflect nature of pension promise (accrued benefits only, no discretionary benefits)
  - Independent of investment strategy pursued
  - Harmonised basis
- Level B: Funding TP, to reflect decisions at the IORP level on how the liability is expected to be financed over a suitable time period
  - Assessed on going concern principles
  - May take advance credit for expected future investment returns
  - Could be Member State specific
- Level B might be required to harmonise towards Level A over time.

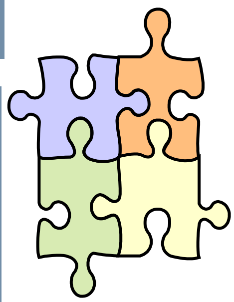
Who decides the right balance?

Level 1 (Council of ministers and parliament)
Uniform and binding principles respecting partnership, flexibility and subsidiarity

Level 2 (EC)
Implementing measures
Level 4 (EC)
Enforcement measures

Level 3 (EIOPA)

Achieving regulatory convergence, working with national regulators through binding standards and advisory guidance.



Level A (member states)

Legislation and regulation within Level 1 principles

Level B (national supervisors)
Detailed supervisory process within Level A legislation and consistent with Level 3 guidance and standards

Level C (sponsors and trustees)
Decisions within level A freedoms, underpinned by Level 3 and Level B supervisory process

Qualified Majority Voting

France	29	Bulgaria	10
Germany	29	Sweden	10
Italy	29	Denmark	7
United Kingdom	29	Finland	7
Poland	27	Ireland	7
Spain	27	Lithuania	7
Romania	14	Slovakia	7
Netherlands	13	Cyprus	4
Belgium	12	Estonia	4
Czech Republic	12	Latvia	4
Greece	12	Luxembourg	4
Hungary	12	Slovenia	4
Portugal	12	Malta	3
Austria	10		

A qualified majority is at 258 out of 345 (74.8%) – 88 to ‘block’

1 March 2012 Public Hearing

- EC fielded A-list team
- Strong representation from UK, Germany, Holland, Belgium, Ireland almost all delegates and panel members pushed back strongly on changing the solvency rules
- Greater acceptance of “Pillars 2 and 3”
- EC appeared to hear the discontent but:
  - Do not seem to want to drop Pillar 1
  - Claim that they never intended exact copy across from Solvency II for insurer

What happens next?

- EIOPA and the Commission are preparing QISs (Quantitative Impact Assessments) and aim to publish results in September 2012.
- Commission “may” consult on QISs
- Draft legislation by the end of the year? (seems unlikely now)
- A live topic for some years to come