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Capital Markets Union and the Future of European Pensions



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Ladies and gentlemen,

First of all, many thanks to the host of today's conference, BETTER FINANCE, as well as Jean Berthon and Guillaume Prache for the invitation to deliver one of the keynote speeches. I especially appreciate the opportunity to share with you my vision with regard to the Capital Markets Union for European Union citizens and at the same time to prepare the ground for the next panel discussion on whether "*public authorities are up to the challenge posed by the biggest ever financial time bomb*".

The topic of the next panel triggers the following questions:

- *What can European supervision and EIOPA in particular do in order to ensure adequate and sustainable pensions?*
- *How can the Capital Markets Union help to achieve this goal?*

Let me answer them as follows:

- First, I will describe the EIOPA's objectives.
- Afterwards, I will outline EIOPA's achievements.
- In my conclusions, I will address the work ahead.

EIOPA's objectives

First and foremost, private pensions – and by this term I mean both occupational and personal ones – represent an exceptional product. This exceptional nature can be explained by the high social implication of pensions. Private pensions aim to provide people with a livelihood when they no longer work and the level of pension income determines whether elderly people are in a position to lead an independent and decent life after retirement or not.

As the Persian philosopher Omar Khayyám said: "The degree of the society's civilization can be measured by the attitude of this society towards its weakest members – children and old men". So the good private pension system can be considered a European Union's civilization test.

As European Supervisory Authority EIOPA's objectives are:

- **To maintain** the sustainability of the existing pension schemes and promises;

- **To explore** regulatory opportunities for creating better frameworks for pension provision.

EIOPA's achievements

What exactly is EIOPA doing to fulfil the objectives?

We identified three necessary conditions to set up the strong private pensions system:

- 1. Strong governance**
- 2. Sustainability of pension promises**
- 3. Full transparency**

EIOPA addressed each of these conditions and achieved already results.

Strong governance

For example EIOPA's technical advice on the governance in the Institutions for Occupational Retirement Provision (IORPs) was taken on board in the revised IORP Directive (the so-called IORP II). It is crucial that the IORPs are managed by professionals with the necessary integrity, skills, knowledge and experience. Professionals, who are able to timely identify and address possible conflicts of interest, and who will act in the sole interest of the scheme members and beneficiaries.

Sustainability of pension promises

The main question of working Europeans is whether they will get the pensions they were promised and whether their monthly contributions to the pension funds will indeed at the end pay off.

To ensure the sustainability of pension promises and to preserve the rights of scheme members, IORPs need to be realistic. It will do harm if we pretend that everything is fine and ignore the existing challenges.

In order to understand the sources of problems and, hence, the possible ways to handle them, EIOPA recently made two important steps:

1. We conducted the first EU-wide stress test for occupational pensions.

2. We issued an Opinion to the EU institutions on a Common Framework for Risk Assessment and Transparency for IORPs.

In the context of the stress test, it was clear that there is a different level of protection of the pension promises in different countries. National rules implementing the IORP Directive are widely different when it comes to the valuation of liabilities, allowing the use of assumptions that are not in line with current market perspectives, especially considering the prolonged low interest rates environment. Consequently, on average, national regimes value pension liabilities 20% lower than a more realistic market adjusted value. In this context, the current overall underfunding of defined benefit promises would be multiplied by 4. This is a huge challenge and appropriate transition measures are needed to deal with this legacy issue in a smooth way avoiding market disruptions.

In our Opinion to the EU institutions, we recommended that the IORPs make their risk assessment in a standardised way, based on common, pre-defined stress scenarios. This assessment foresees that assets and liabilities on the balance sheet have to be valued on a market-consistent basis and include all available security and benefit adjustment mechanisms, such as sponsor support, pension protection schemes and benefit reductions. Following this approach would be a major step forward towards realistic, risk-sensitive information on the financial situation of pension funds. And by that an important tool to ensure that citizens get the pensions they were promised and were working for during several years.

Full transparency

In its Opinion, EIOPA referred to another fundamental issue – the transparency of pension funds. IORPs need to be transparent towards plan members, sponsors and other interested parties through regular public disclosure of the market-consistent balance sheet and the outcome of standardised risk assessment. Such disclosure will trigger a dialogue on the long-term sustainability of occupational pension promises and encourage timely adjustments. Enhanced transparency will contribute to the protection of pension scheme members and beneficiaries and to a fair distribution of shortfalls between generations.

Capital Markets Union and Personal Pensions – The work ahead

In order to unleash the full potential of the internal market and create a Capital Markets Union we need to deal with the problem of **fragmentation**. This is particularly relevant in the area of long-term retirement savings.

There is a huge fragmentation of products available, from low-performing deposits, to very often too complex and costly life insurance and mutual funds, many of them not truly retirement saving products. Consumer protection rules are very different in the European Union Member States. This fragmentation increases the cost and reduces the average returns.

This year, in February, EIOPA submitted to the European Commission its Technical Advice on a Pan-European Personal Pension Product, the PEPP, a safe, transparent and cost-effective personal savings product. We proposed a number of standardised and flexible features for this product, namely

- **Standardised information provision** based on the proposals of the KID within the PRIIP's framework
- **Standardised limited investment choices**, with one core „default“ investment option, where the investment strategy takes into account the link between accumulation and decumulation
- **Regulated, flexible caps on costs and charges**
- **Flexible biometric and financial guarantees**

Furthermore, the PEPP should have a long-term perspective in its investment policy, to better reflect the long-term nature of retirement savings. In order to allow this long-term investment horizon, the PEPP should envisage minimum holding periods. Liquid investments should follow liquid liabilities. The PEPP could be the catalyst for the following:

- **Efficiency gains** through **economies of scale** and **opportunities for risk diversification** as well for **competition** and **innovation**
- **High levels of cross-border activities** and **reduced obstacles** to further the single market
- **Opportunities for higher replacement rates** and for **multi-pillar diversification**

The analysis conducted brought us to the conclusion that a Pan-European Personal Pension Product enacted through a 2nd regime is a powerful tool to complement the much needed retirement savings in Europe to promote the Capital Markets Union.

EIOPA stands ready to continue to work on the PEPP. In my view, the next step should be the development of „product pilots“. We should explore pure individual Defined Contribution Schemes and pooling mechanisms that by design would protect citizens from extremely negative outcomes in stressed market situations.

Whilst the PEPP is a personal product, I believe that some of the learnings can benefit occupational pensions, too.

Looking forward, a further important step could be the design of a simple and transparent 2nd regime for Defined Contribution Occupational Pensions Schemes. This framework should be capable to take full advantage of the potential of the European Union internal markets, by providing a cross-border platform that would reduce costs, support long-term funding of the European Union economy and ultimately deliver better pension outcomes for the European Union citizens.

EIOPA will develop some first ideas on this possible framework.

Supervisory convergence

Ladies and Gentlemen,

The Capital Markets Union can only succeed if we are capable of regaining confidence of the European Union citizens in the financial markets. In this sense I strongly believe that **supervisory convergence** needs to be a high level priority of the Capital Markets Union.

To break the current market fragmentation and to increase cross-border provision of services we need to ensure that there are proper arrangements to achieve high quality supervision across the European Union. This should entail an appropriate mix of centralised powers and tools and a clear mandate to reinforce supervisory convergence.

To be very clear: The implementation of initiatives like the PEPP needs to be accompanied with an evolution in the powers and tools available to EIOPA, including the possibility to initiate independent assessments of national supervisory practices and provide clear recommendations to the National Competent Authorities.

The European Union is faced with tremendous challenges, but first and foremost, we need to show to the European citizens that the European project takes care of their biggest concerns. And one of them is to have an adequate level of retirement pensions.

We need ambition to overcome the identified barriers. Political courage is key.

EIOPA is committed to work closely with all the relevant stakeholders to ensure the European Union pensions project will succeed, the promises made are met and supervisory convergence is further enhanced.

Let's continue working together in the interest of all citizens in the European Union and with a European spirit. It's for sure worth going for it!

Thank you for your attention.