



# Enhancing the European market for occupational pension provision

**Gabriel Bernardino**  
**EIOPA Chairman**

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- **Ageing population** – urgency of reforming the pension system
- The European Commission's **Call for Advice** on the review of the IORP Directive
- **EIOPA's Advice** as a whole package and its limitations
- Quantitative Impact Study (**QIS**)

# Ageing population – urgency of reforming the pension systems



- **Future - ? – is now**
- By 2060 in the EU countries there will be only **2** working people (aged 15-64) for every person over 65
- **Elderly population** (in OECD countries) has increased more than **1.5** times faster than the total population between 1995 and 2008
- Economic and financial **crisis**
- Need to find an adequate balance between different objectives like **security and affordability**
- Switch **from DB to DC** – information to members is crucial

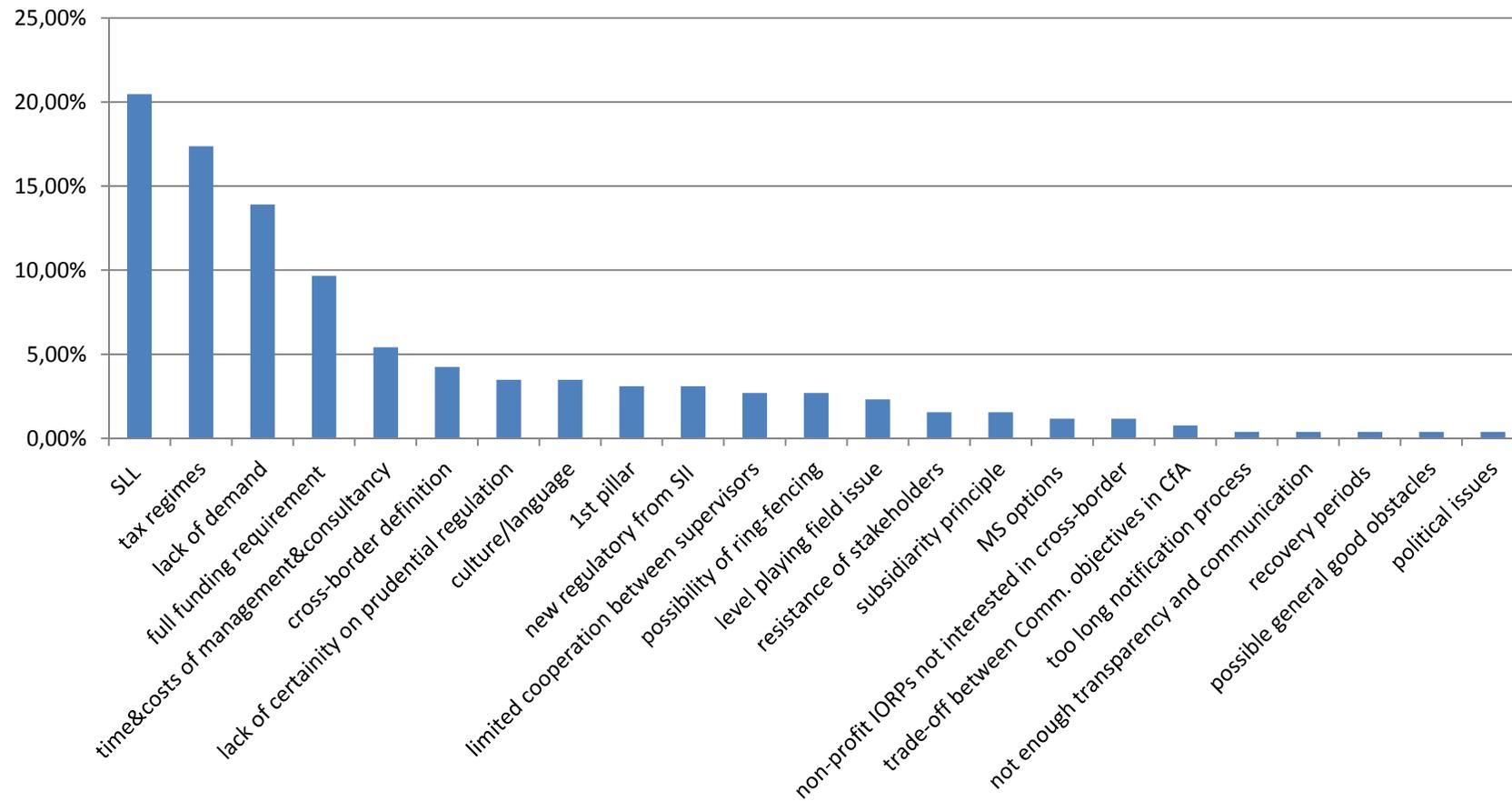
- Why does the Commission want to review the IORP Directive:
  - o to facilitate cross-border activity
  - o to complete the Single Market for occupational retirement provision
  - o to develop risk-based regulation
- EIOPA's Advice as a whole package and its limitations:
  - o **whole package** - scope, cross-border activity, governance and supervision, information to members and beneficiaries, holistic balance sheet
  - o **limitations** - technical not political, legislation remit, questions asked by the Commission

# Advice as a whole package: **Cross-border activity**



- Benefits of Pan-European pension schemes for employers and employees
- Internal market - potential to improve
- 140,000 pension schemes of which **only** 84 are cross-border
- Development of the internal market easier and quicker with **convergence** towards common standards and processes

# Obstacles to cross-border activity - stakeholders' view



## **Governance:**

- High level of consensus
- Importance of **proportionality**
- IORP's **management**
  - o competence
  - o integrity
  - o fit and proper
- IORP's robust **internal** and **external controls**
  - o risk management
  - o internal control
  - o audit
  - o appointment of a custodian and a depository

## **Supervision:**

- Common **set of principles of supervision**
  - o prospective approach
  - o risk-based approach
  - o proportionality in implementing the principles
  - o transparency of conduct, structures and processes
- Set of principles on ring fencing assets and liabilities
- Protection of members and beneficiaries and sound and prudent management as objectives of supervision
- Potential **pro-cyclical impact** of supervisors decisions
- Power to carry out **stress tests** on IORPs

# Advice as a whole package: Information to members



**Information** to members and beneficiaries of **defined contribution** schemes should be:

- **Correct** – regularly updated
- **Understandable** – all documents written in a way and having a lay-out:
  - o Clear
  - o Understandable
  - o Useful
- **Not misleading** – members should not receive information that gives unjust impression of the functioning of the pension scheme

## **Key Information Document (KID)**

- identification of the IORP
- brief description of objectives and investment policies
- information on performance
- costs/charges
- risk/reward profile and/or time horizon of the investment policy
- contribution commitments of employer and employee as a % of the salary
- practical information - allowing MS to add its specifics
- cross-references to other relevant documents

# Advice as a whole package: **Holistic balance sheet (HBS)**



- Principles for the valuation and capital requirements of IORPs:
  - Transparency
  - Comparability
  - Comprehensiveness
- Valuations should be **market consistent**
- Incl. actuarial value of all enforceable obligations and all security mechanisms
- Different ways of providing secure pension provision throughout Europe:
  - key role of the sponsoring employer or
  - key role of the pension protection schemes
- Prudential supervisory assessment tool rather than a “usual” balance sheet based on general accounting standards
- Conditional on the results of the **Quantitative Impact Study**

- The Commission asked EIOPA to prepare a quantitative impact study (QIS) of its Advice
  - o provide all stakeholders with information on the quantitative impact of the EIOPA's Advice on IORPs
  - o collect quantitative and qualitative data for the Commission's impact assessment
- EIOPA stressed the importance of performing QIS and the Advice was made conditional on its outcomes:
  - o test feasibility of implementing holistic balance sheet
  - o test feasibility of common level of security
  - o test policy options in the EIOPA's Advice

- QIS limits itself to assessing the impact:
  - on financial requirements for IORPs / Art. 4 insurers
  - of quantitative part of the EIOPA's Advice
  - under the different options
- QIS will not assess:
  - IORPs providing only pure DC schemes
  - Impact of the qualitative part of the EIOPA's Advice
  - All costs and benefits, but will be a part of the Commission's impact assessment

- Member states participating in QIS: Belgium, France, Germany, Ireland, Netherlands, Portugal, Sweden and United Kingdom
- Member states have considerable freedom in performing the QIS:
  - IORPs themselves
  - Supervisory authorities
  - Actuarial firms on behalf of supervisor
  - Combination of the above
- EIOPA will ensure consistency of the outcomes during and after the QIS exercise

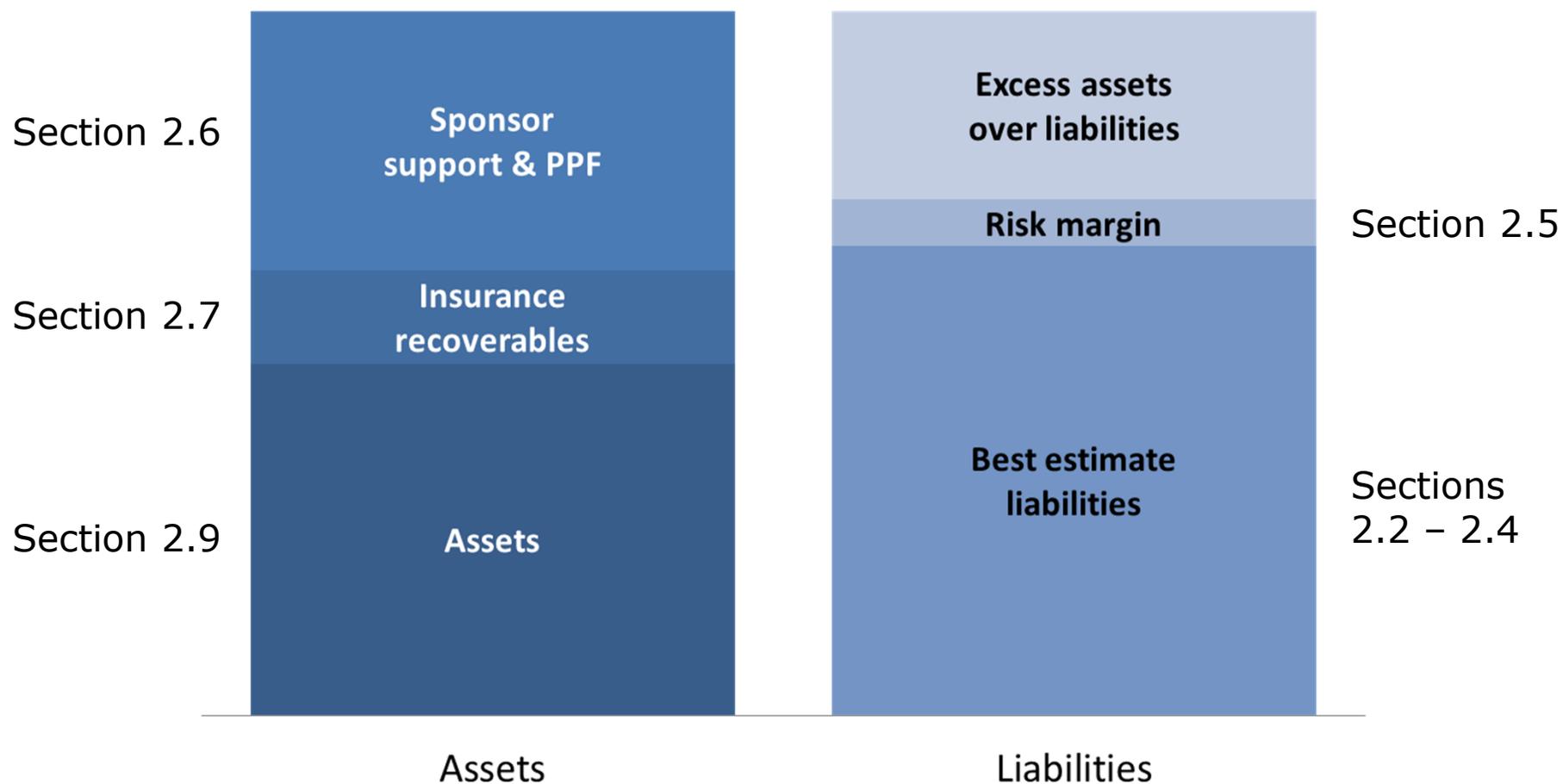
# First step: consultation paper draft technical specifications



- Consultation paper published on 15 June 2012
- Technical specifications provide instructions and guidance to participating IORPs to:
  - o value items on holistic balance sheet
  - o calculate solvency capital requirement (SCR)
- EIOPA invites feedback from stakeholders on consultation paper no later than 31 July 2012

- Build on specifications for Solvency II, but significant differences:
  - adjustment mechanisms (conditional & discretionary benefits, last resort benefit reductions)
  - security mechanisms (sponsor support, pension protection schemes)
- Not all elements of draft technical specifications are relevant for all IORPs
  - Degree of materiality will depend on the nature of IORPs in member states

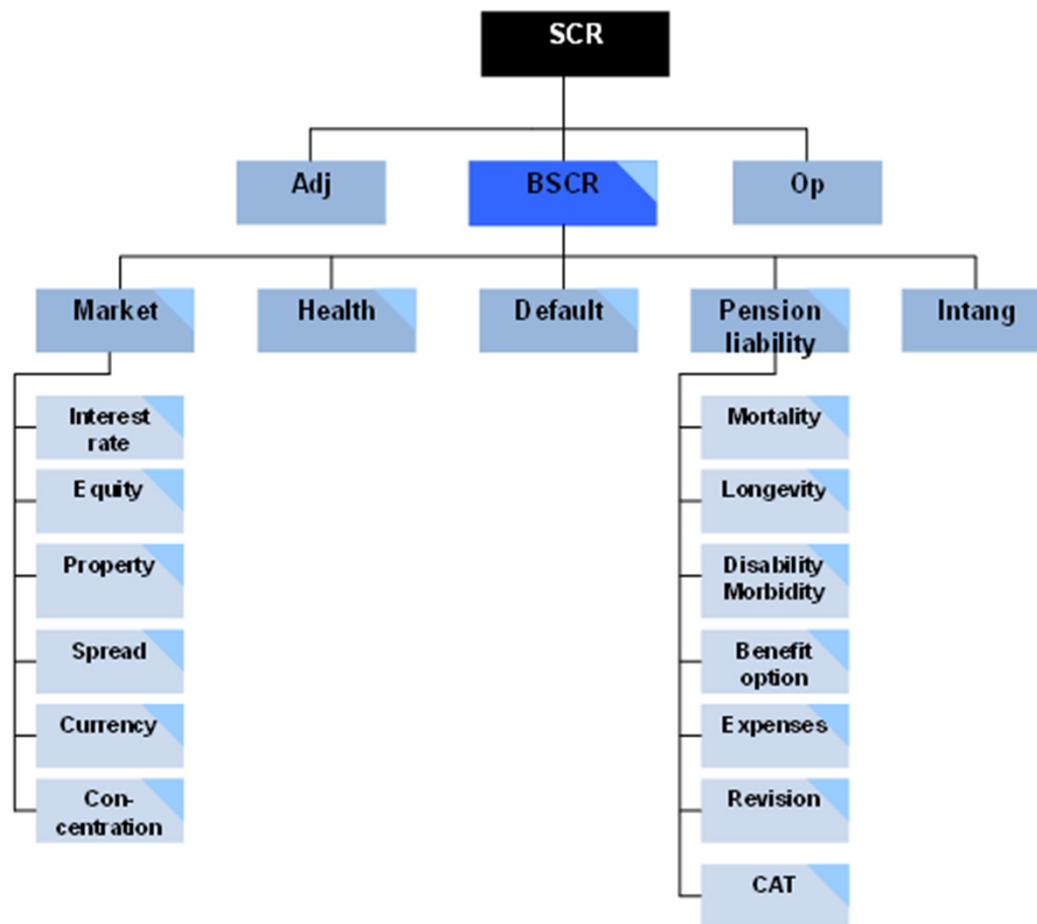
# Valuation of holistic balance sheet



- Assets and liabilities should be valued on market consistent basis
- Value corresponds to probability weighted average of discounted cash-flows in future scenarios
- Simplifications may be used, if appropriate:
  - Deterministic valuation
  - Simplifications provided for sponsor support and pension protection schemes

- Basic risk-free interest rate
  - Swap rates until last liquid point (EUR 20yrs, GBP 50yrs and SEK 10yrs)
  - Ultimate forward rate: 4.2%
  - Maximum convergence period: 40 years from last liquid point
- Adjustment for long-term nature pension liabilities
  - Counter cyclical premium (50bp)
  - Matching adjustment
- Long-term guarantee package for insurers still under discussion

# SCR – standard formula



- Adjustment for loss-absorbing capacity of IORP's adjustment and security mechanisms
- Sponsor default risk part of counterparty default risk module
- Not all risks will be relevant for all IORPs

# Options analysed



Main text:	Options:
<b>99.5% confidence level</b>	<b>97.5% confidence level 95% confidence level</b>
<b>Basic risk-free interest rate</b>	<b>Long-term and illiquid nature adjustment Extrapolation of risk-free rate using QIS5 parameters</b>
<b>Risk margin cost-of-capital</b>	<b>Risk margin adverse deviation No risk margin</b>
<b>Include pure discretionary benefits and mixed benefits</b>	<b>Exclude pure discretionary benefits Exclude pure discretionary benefits and mixed benefits</b>
<b>Include pension protection schemes as an asset</b>	<b>Include pension protection schemes as impacting on the default risk of the sponsor Exclude pension protection schemes</b>
<b>Include ex post benefit reductions</b>	<b>Exclude ex post benefit reductions</b>
<b>Equity dampener</b>	<b>No dampener Duration-based dampener</b>
<b>Sponsor support as asset</b>	<b>Sponsor support as ancillary own funds</b>
<b>Minimum capital requirement</b>	
<b>Level B best estimate of technical provisions: expected return on assets</b>	

- 15 June – 31 July : Public consultation
- August – September : Revision of technical specifications
- end September – beginning October : Commission's consideration
- beginning October – mid-December : QIS exercise
- May 2013 : EIOPA's final report on QIS
- June 2013 : Commission's legislative proposal

# Looking forward: The “economic reality” test



## **Continue to use valuations and risk assessments that deny economic reality is not an answer:**

- Does not contribute to a better management of the risks
- Fails to reflect the true risks that the different stakeholders are running
- Helps to preserve schemes that are clearly unsustainable postponing taking up of measures in due time
- Inevitable consequences in the short to medium term - lower pensions for members and beneficiaries, higher concentration of costs for employers and ultimately intergenerational conflicts

# Looking forward: Key words on pensions



- **Sustainability**
  - o cannot ignore risks embedded in pension promises
  - o security *versus* affordability
- **Risk sharing**
  - o encourage 2<sup>nd</sup> Pillar arrangements
  - o role of the financial sector in managing risks
- **Simplicity**
  - o increased demand for simple products
  - o reduces costs and mitigates misselling
- **Transparency**
  - o on risks, costs and commissions
  - o improve selling practices



Thank you

Gabriel Bernardino  
Chairman of the European Insurance and Occupational  
Pensions Authority

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