European Pensions Policy & Regulation

Philip Shier
Stephen Lalor

Outline

- European Institutions and how they operate
- A brief summary of European pension regulation to date
- Current developments and the future

European Institutions

Philip Shier

The European Council

- The EU consists of 27 Member States
- The European Council comprises the heads of state or government of the EU member states, along with the President of the European Commission and the President of the European Council, currently Herman Van Rompuy.
- While the European Council has no formal legislative power, it is charged under the Treaty of Lisbon with defining "the general political directions and priorities" of the EU.
- The meetings of the European Council are chaired by its President and take place in the Justus Lipsius building, the headquarters of the Council of the European Union in Brussels.
- The European Council was established as an informal body in 1975; it became an official EU institution in 2009 when the Treaty of Lisbon entered into force

The European Commission

- The European Commission is the EU's executive body and represents the interests of Europe as a whole
- 27 Commissioners (one from each EU Member State) are appointed every five years.
- The current Commission's term of office runs until February 2014, and its President is José Manuel Barroso from Portugal.
- Divided into Directorates General - the key ones for pensions are Internal Markets and Services (Michel Barnier), Employment, Social Affairs and Inclusion (László Andor) and Economic and Financial Affairs (Olli Rehn)
- The Commission's main roles are to:
  - set objectives and priorities for action
  - propose legislation to Parliament and Council
  - manage and implement EU policies and the budget
  - enforce European Law (jointly with the Court of Justice)
  - represent the EU outside Europe (negotiating trade agreements etc.)

The European Parliament

- Members of the European Parliament are directly elected from each Member State
- 754 Members elected for 5 year term
- Parliament generally meets in Strasbourg
- President Martin Schulz (Germany) appointed this year
- The European Parliament shares legislative power equally with the Council of the European Union. This means it is empowered to adopt European laws (directives, regulations etc). It can accept, amend or reject the content of European legislation.
- Parliamentary Committees review proposals for legislation prepared by EC
- The Committee’s report is discussed (and revised) in plenary session, and Parliament ultimately adopts its position.

Impact of the financial crisis

- The EU financial supervision “architecture” was redesigned following the onset of the global financial crisis in 2008
- de Larosière report in February 2009 recommended
  - a new regulatory agenda
  - stronger coordinated supervision
  - effective crisis management procedures
- Creation of European Systemic Risk Board and three European Supervisory Authorities w.e.f. 1 January 2011:
  - European Banking Authority (EBA),
  - European Securities and Markets Authority (ESMA)
  - European Insurance and Occupational Pensions Authority (EIOPA)
- Substantial increase in resources and powers of EIOPA compared with predecessor CEIOPS

EIOPA responsibilities

- Better protecting consumers, rebuilding trust in the financial system.
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- Ensuring a high, effective and consistent level of regulation and supervision taking account of the varying interests of all Member States and the different nature of financial institutions.
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- Greater harmonisation and coherent application of rules for financial institutions & markets across the European Union.
- Strengthening oversight of cross-border groups.
- Promote coordinated European Union supervisory response

Who and what is EIOPA?

- Based in Frankfurt
- Chairman: Gabriel Bernardino
- Management Board of 6
  - Includes Matthew Elderfield (Central Bank of Ireland)
- Occupational Pensions Committee
  - Chair – Brendan Kennedy (Pensions Board)
- Occupational Pensions Stakeholder Group
  - 30 members drawn from IORPS, representatives of employees, employers and beneficiaries, professional associations and academics.
  - Includes Philip Shier (Ireland; Groupe Consultatif Actuariel Européen)
  - The main tasks of the Group are to advise EIOPA on, and to assist in assessing the potential impact of, actions taken concerning regulatory and implementing technical standards, guidelines and recommendations

European Federation for Retirement Provision

- EFRP is the European umbrella body for national pension fund associations e.g. IAPF, NAPF in UK etc
- The EFRP wants to promote occupational retirement provision in the EU that:
  - is affordable for large sections of the population
  - helps to maintain living standards in retirement
  - provides a degree of intra- and inter-generational solidarity and
  - is administered through funding institutions. These institutions must be able to operate throughout the European Union on the basis of a single licence, taking into consideration the principle of subsidiarity and national diversity.
- Main activities
  - Lobbying the appropriate European institutions
  - Conducting research to deliver Europe-wide pension information
- Current Chair is Patrick Burke (Irish Life Investment Managers)

Groupe Consultatif Actuariel Européen

- Established in 1978 to represent actuarial associations in the countries of the European Union (EU)
- 9 founding countries, 12 associations
- Original mission was to provide advice and opinions to various organisations of EU (Commission, Council of Ministers, Parliament) on issues relevant to the actuarial profession – i.e. insurance and pensions
- Now more proactively, a focal point for communication on professional and technical matters among all European actuarial associations, but not restricted to European issues
- Current membership
    - 32 Full Member associations (30 countries), 3 Observer Member countries
    - Representing approximately 18,600 actuaries
- Current Chairman – Gabor Hanak (Hungary)

European Pension Regulation to date

Stephen Lalor

IORPs in 15 Questions

1. What are IORPs?

Institutions for Occupational Retirement Provision

2. What is the point?

- Common standards of supervision across EU
- Single market
- Pan European Pensions

3. Where is it coming from?

- Directive 2003/41/EC
- Known as IORPS Directive
- Set Europe wide standards for scheme management
- Enabled cross border membership
- Deadline for transposition September 2005
- All 30 EEA States have transposed Directive
- Exceptions allowed for schemes under 100 members

4. How was it implemented in Ireland?

- Social Welfare and Pensions Act, 2005
- Part XII to the Pensions Act
- Amendments to Pensions Act (S59)
- Additional Regulations (amended in 2006)
  - SI 292/2006 - Cross Border
  - SI 293/2006 – Trusteeship
  - SI 294/2006 – Investment
  - SI 295/2006 – Funding

5. What are the implications?

Common Standards of Supervision

- Trusteeship
- Information to Members
- Investment
- Funding

6. How does it affect trustees?

NOT

- Undischarged Bankrupt
- Person who made arrangement with creditors, not yet discharged
- Convicted of offence involving fraud or dishonesty
- Person disqualified under s 150 of Companies Act
- Company if any director affected by above

- Possess investment skills

    OR

- Written agreement with someone who does

7. What information is prescribed?

- On request
  - Annual report and accounts
  - SIPP
  - Target benefits
  - Investment options (where member bears risk
  - Leaving service benefits
  - Transfer options

- Automatically
  - Changes to rules, in reasonable time
  - Financial state of scheme, annually
  - Benefits and options, on retirement

8. What are the investment rules?

- Prudent person principle
- Best interest of beneficiaries
- Security, quality, liquidity, profitability
- Nature and duration of liabilities
- Predominantly on regulated markets
- Other at prudent level
- No borrowing except for short term liquidity
- Derivatives only for risk reduction or efficient portfolio management
- Limit counterparty risk
- Diversification, not excessive concentration
- Collective investment and insurance policies if assets diversified
- Exception possible for government bonds
- Member States may apply limited additional restrictions

9. What are the funding requirements?

- Where guaranteed benefit (i.e. DB) or guaranteed return
- Sufficient Technical Provisions
- Calculated annually
- May be every 3 years with annual adjustments
- Calculated by actuary or other specialist
- Prudent basis
- Home country rules
- Biometric risks

- Sufficient assets
- Limited time for recovery

- Fully funded all times if Cross Border

10. What is a cross border scheme?

– Scheme set up in one State “HOME” country

– Members located in another State “HOST” country

– May be several Host countries

– Employer need not be located in Home country

– No need for connection between employer/employees and Home country

11. How are they regulated?

- Scheme established in Home country
- Subject to law and regulation in Home country
- Tax and labour law of Host country / countries

- Application to supervisory authority in Home country
- Notification of Cross Border activity
- Regulator contacts Host country
- Commencement in 3 months unless prohibited

12. What are the advantages?

- Economies of scale
- Avoid duplication of cost and effort
- Corporate governance
- Company branding
- Consistent investment
- Benefits philosophy
- Mobile workers
- Developing countries
- Regulatory regime

13. Are there any disadvantages?

- Asset pooling the objective?
- Multiple schemes
- Language
- Different tax and labour law
- Remoteness
- Benefit levels
- Social security
- Defined Benefit

14. Where are we now?

- Total of 84 cross border schemes (78 In 2010)
- Of which
  - All but 15 were two country only
  - 28 based in Ireland
  - 24 Ireland/UK
  - 31 based in UK
  - 13 UK/Ireland
  - 39 (?) in existence before the Directive
- 11 Home countries
- 23 Host countries

EIOPA July 2011

15. Is this the biggest damp squib ever?

- “Disappointing”
- “Adequate, sustainable and safe pensions”
- “Something needs to be done”

Developments

Philip Shier

European Pensions Policy

- Green Paper consultation – Toward adequate, sustainable and safe European pensions systems – in 2010 adopted an holistic approach
  - sponsored by 3 Commissioners: Employment, Social Affairs and Inclusion, Internal Markets and Services, Economic and Monetary Affairs
- White Paper to set out policy issued in February 2012.
- This "sets out an agenda for making pensions adequate and sustainable in the long term, by creating the conditions for a high level of labour force participation of women and men throughout their lives and enhancing the opportunities to build up safe complementary retirement savings".
- A key theme is to link retirement ages to increases in longevity and to support longer working lives.
- Emphasises that Member States have primary responsibility for designing their pensions systems

"EU initiatives in support of Member States' efforts"

- The White Paper lists 20 areas in which the EU can “support” the development of pensions policy in member states.
- Amongst these are 12 items relating to supplementary pensions including:
  - Optimise the efficiency of tax incentives
  - Review best practice in provision of information to individuals
  - Review IORP Directive – the stated aim is "to maintain a level playing field with Solvency II and promote more cross border activity and to help improve overall pension provision in the EU"
  - Ensure more effective protection for pensions on employer insolvency
  - Resume work on the pensions portability directive – this stalled several years ago due to the proposal to harmonise vesting and preservation requirements which were seen as a member state competence
  - Develop pension tracing services which could operate cross border

Proposal to revise the IORP Directive

- The IORP Directive review is the responsibility of Internal Markets and Services, who are also responsible for the implementation of Solvency II for insurance and reinsurance companies
- Reasons for the review
  - "To complete the Single Market for occupational retirement provision"
  - "To facilitate cross-border activity and develop risk-based regulation"
- EC issued Call for Advice to EIOPA in April 2011
- Asked questions on 23 topics
- EIOPA consultations between 7 July 2011 and 2 January 2012
- EIOPA response to EC on 15 February 2012 (515 pages)
- EC public hearing on 1 March 2012
- Impact assessment (EIOPA/EC) by September 2012?
- EC proposal for revised Directive before end 2012?
- Adoption by Council and Parliament???

Fundamental questions

- Should there be maximum harmonisation or Member State options?

- Should there be a consistent level of security of the pension promise across EU?

- Is there a need for a "level playing field" with insurance?
  - Are they playing the same game?
    - Employment contract
    - Not for profit provider
    - Not competing for market share
  - Proportionality - there are 140,000 IORPs, many of which are very small, compared with about 5,000 insurance companies

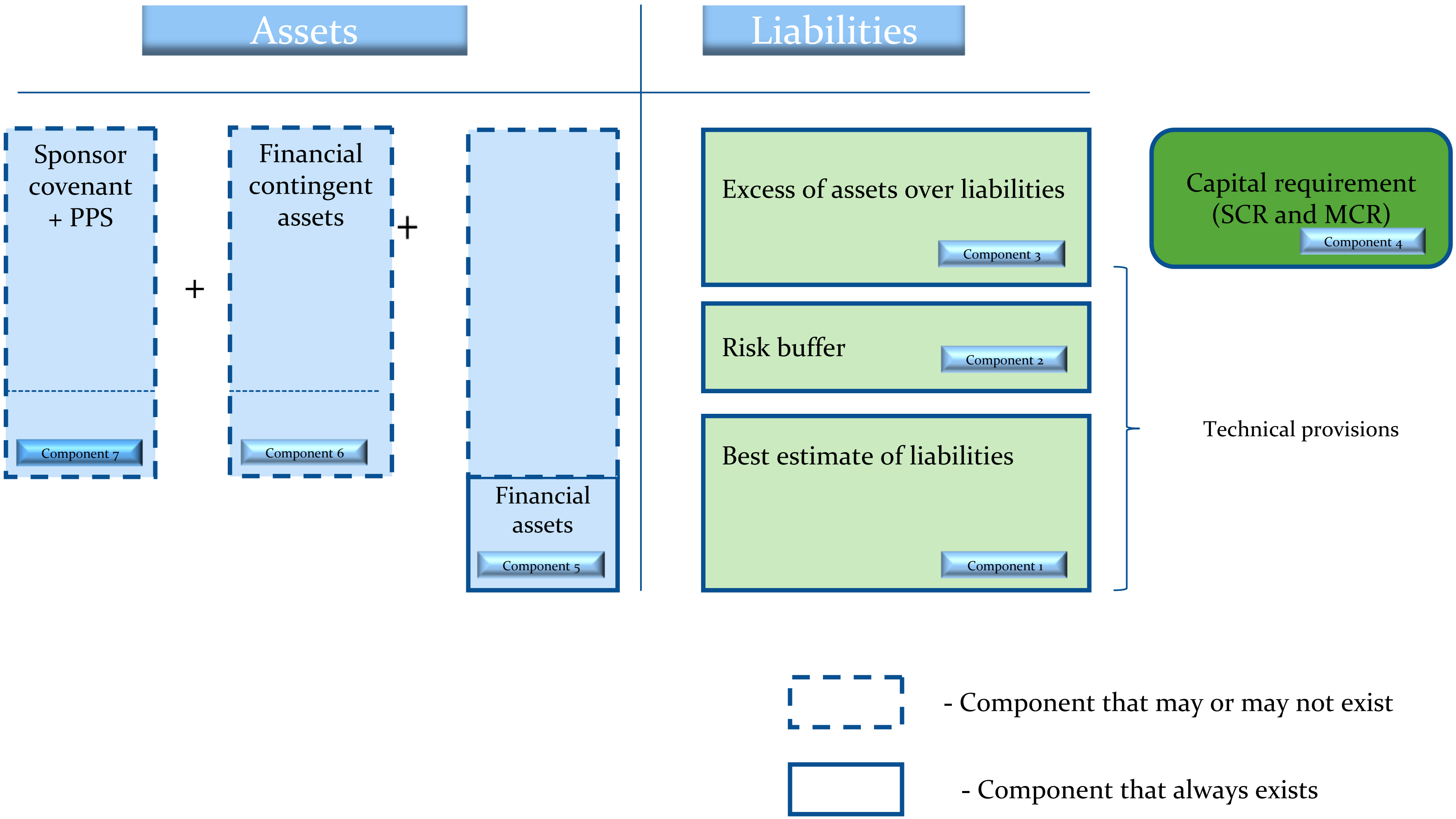
23 questions

1. Scope
2. Cross-border
3. Ring Fencing
4. Prudential regulation
5. Valuation
6. Security mechanisms
7. Investment rules
8. Objectives and pro-cyclicality
9. Supervision
10. Supervisory powers
11. Supervisory review/capital add-ons
12. Supervision of outsourced functions
13. Governance
14. Fit and proper requirements
15. Risk management
16. ORSA
17. Internal control system
18. Internal audit
19. Actuarial function
20. Outsourcing
21. Custodian/Depository
22. Information to Supervisors
23. Information to members

In summary

- Questions relate to
  - Scope of Directive
    - But book reserve and pay as you go exclusion to remain
  - Cross border operation
    - Definitions, ring fencing
  - Valuation and capital requirements,
  - Investment rules
    - Quantitative restrictions
  - Supervisory powers and Governance
    - Functions, fit and proper
  - Disclosure of information
    - To supervisors
    - To members

Holistic Balance Sheet



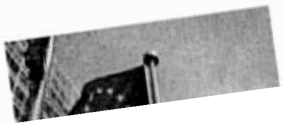
Some key issues

- Discount rates
  - “risk-free” or “expected return on assets” ?
  - Term structure/extrapolation to ultimate forward rate/illiquidity premium?
- Risk margin – relevance and measurement
- Cash flows/benefits
  - Discretionary and conditional benefits
  - Future salary increases?
  - Future accrual of benefits?
- Relevance of SCR and MCR which apply to insurance undertakings?
  - Confidence levels – 99.5% probability over 1 year time horizon?
- What supervisory action is triggered and when?
- How to allow for the power to reduce benefits?
- Measurement of Sponsor covenant
- How to allow for Pension Protection schemes?

Hostile Reaction

Industry associations call on Brussels to drop solvency rules for IORPs

01 Mar 2012



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funds, stressin
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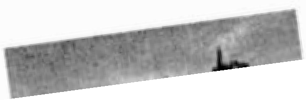
Barnier attacked over 'implied' backing of Solvency II

02 Mar 2012

EUROPE – Industry heavyweights have criticised yesterday's speech by European Union commissioner Michel Barnier, noting he refused to withdraw support for Solvency II regulations despite insisting no d... been reached.

Dutch government 'up in arms' over IORP directive proposals

01 Mar 2012



NETHERLANDS – The Du... "up in arms" over the harmful
effects it believes a revised

Liabilities and contributions to double under EU IORPs plans

Professional Pensions | 21 Dec 2011 | 11:34

Webb: Government has 'grave concerns' over Solvency II proposals

Professional Pensions | 29 Nov 2011 | 12:32

Impact Assessment

- Much criticism of the lack of quantitative impact assessment in consultation document
- EIOPA working on QIS specification at present
  - 8 countries participating (including Ireland)
  - Identify key issues to keep it manageable
  - Quantification difficulties
    - Sponsor covenant
    - Pension protection schemes
    - Contingent assets
    - Benefit adjustment mechanisms
- Likely to be further QIS?
- Wider issues will be considered by EC
  - Macro-economic, behavioural, impact on capital markets, social security

Conclusion

- This is an important point in development of EU pension systems
- Will this lead to “adequate, sustainable and safe pensions”?