	Comments Template on EIOPA-CP-11/001 **Draft response to Call for Advice on the review of Directive 2003/41/EC** ***Scope, cross-border activity, prudential regulation and governance***	**Deadline** **15.08.2011** **18:00 CET**
Company name:	**Investment Management Association**	
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The question numbers below correspond to Consultation Paper No. 01 (EIOPA-CP-11/01).

	Comments Template on EIOPA-CP-11/001 Draft response to Call for Advice on the review of Directive 2003/41/EC *Scope, cross-border activity, prudential regulation and governance*	Deadline 15.08.2011 18:00 CET
Reference	**Comment**	
General Comment	The IMA is pleased to have the opportunity to respond to the EIOPA consultation.[1] In various capacities, IMA member firms have a significant interest in the future of European pension provision. They manage assets for the full range of pension schemes and funds operating both in the UK and internationally, including defined benefit (DB) and defined contribution (DC) schemes and national pension reserve funds. Some IMA members also have specific pension company subsidiaries operating bundled (ie. administration and investment platform) DC schemes domestically and abroad. We would summarise our response as follows: we support the cross-border mobility of people, services and capital across the EU and are keen to work with the European authorities to advance the single market. However, we are not convinced that there is sufficient clarity about the role of the IORP directive in helping to achieve this. We are also concerned about the use of insurance regulation as a paradigm for the potential pan-European regulation of pension schemes. While we wish to participate in full in the debates regarding the future of pensions regulation in Europe, we found the short deadline for this consultation extremely challenging, given the wide ranging issues at stake. We urge both EIOPA and the Commission to retain longer time frames for future consultations to allow stakeholders full opportunity for input.	

[1] The IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the in-house managers of occupational pension schemes. They are responsible for the management of over £3.9 trillion of assets in the UK on behalf of domestic and overseas investors.

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1.	**Q.1-4: We believe there is currently inadequate evidence presented to judge the options on changing the directive. Until this is available, we believe that no change (Option 1) is the most prudent response.** The consultation paper contains a range of options for changing the scope of the IORP directive. These move from no change at all, to the more radical alternative of including all forms of workplace provision. While we recognise why both EIOPA and the Commission would wish to see a minimum level of harmonisation for cross-border products, the discussion concerning scope fails adequately to focus on the ultimate objective of the IORP directive (which we believe primarily to be about cross-border mobility). For example, the document makes several references to the compulsory funded pension systems in the new Member States, currently out of IORP scope. We would like to clarify whether these systems are natural candidates for the benefits of cross-border activity. If so, what are the specific obstacles inhibiting IORPs / financial services providers in this area? At a fundamental level, therefore, it is not evident to us whether the scope of IORP should be widened in response to the perceived or actual needs of specific pension institutions to operate cross-border, or whether it should be widened to ensure that all pension models fit within IORP. These are very different questions, with very different potential consequences. This lack of clarity largely determines our response. We support efforts to ensure pension portability and cross-border commercial mobility across the EU, ie. the original intention of the Directive. In this respect, we believe that all three central tenets of the single market – the free movement of labour, capital and services – are relevant and important, and we support the ambition to create a single EU pensions wrapper. However, we do not accept that there needs at this stage to be a pan-European pensions directive that seeks to regulate in similar ways the wide variety of workplace pension provision that currently exists across the EU. In this respect, an IORP directive that extends, as Option 5 suggests, across all forms of pension provision, does not appear to be desirable and indeed could be counterproductive. Nor is it clear how this Option would interact with existing insurance regulation that governs the	

operation of certain forms of workplace pension scheme across the EU.

We would also like to see a more detailed analysis as to why it is that less than 100 schemes are operating cross-border in the EU. Is this a leading indicator that IORP is not providing the right kind of framework for the facilitation of EU cross-border pension provision, or is it a reflection of a lack of interest among occupational pension schemes? We welcome the explicit recognition by EIOPA of this issue (paragraph 7.3.13) but we do not have the evidence to make a judgement. Until we do, it makes it very difficult to give a constructive and evidence-backed response to the question of scope or the question of definition. Our response would be therefore to suggest 'no change' (Option 1) for now.

Nonetheless, the debate over the definition of 'occupational' raises the important point that it is increasingly difficult to divide pension provision into occupational (second pillar) and personal (third pillar). In the UK, the widespread use of contract-based structures in the workplace (where the contract is between the individual and the pension provider, arranged but not operated by the employer) has blurred the division between the second and third pillar significantly. Indeed, where there are mandatory contract-based arrangements in EU states, all three pillars tend to blur. We prefer the term 'workplace' for any arrangement organised by an employer. However, this encompasses very different forms of arrangement with varying legal and governance structures.

Further to the points made above, we believe that as the transition to funded (particularly DC) schemes continues, there are a range of issues that need to be considered and distinguished:

- Cross-border provision of a pension wrapper.
- Cross-border provision of underlying fund and asset management services.
- Cross-border portability of the pension product and/or entitlement.

We recognise that some of these issues are beyond the scope of IORP. However, we do not believe it is possible to conduct a thorough review of IORP without considering the broader picture as presented in the European Commission's Pensions Green Paper. For example, the benefits of extending IORP could potentially be dwarfed by the efficiency gains and economies of scale that arise from the greater use of cross-border pension pooling vehicles. However, these gains would be

	diminished (as we discuss below) by an intrusive prudential regime that failed to distinguish between different forms of risk across the different operating models used in different parts of the pension delivery chain.	
2.	See above	
3.	See above	
4.	See above	
5.	**Q.5-8: We agree that different definitions of cross-border activity are not helpful. However, regarding the best way forward, we would refer to our answers to the previous section. We seek clarification as to the extent to which the low level of cross-border IORP activity reflects problems caused by different Member State interpretations (and, by implication, defects in the current IORP legislation).**	
6.	See above	
7.	See above	
8.	See above	
9.	**Q.9-12: We agree that prudential regulation should be determined as administered by the Home Member State. At a more general level, though, we note below that great care is needed not to introduce prudential requirements into IORP that are disproportionate and that fail to take into account the different kinds of risk across the pension schemes operating in the EU.**	
10.	See above	
11.	See above	
12.	See above	
13.	**We broadly agree with EIOPA's observations about the need to have an effective system of governance, including clear documentation on control mechanisms where applicable and a sound remuneration policy. To that extent, we believe the relevant qualitative elements from Solvency II are acceptable but welcome the comments made by EIOPA in paragraph 10.3.4 of the EIOPA draft which explicitly recognises "the vast difference in the nature, scale and complexity of IORPs" and that a "new supervisory system for IORPs should not undermine the supply or the cost efficiency of occupational retirement provision in the**	

EU". The suggestion of a general proportionality clause is one that we think is a pre-requisite for any inclusion of Solvency II-type provisions.

While this section of the consultation focuses on the governance aspects of Solvency II, we would also like to make a number of more general points about what appears to be the gradual introduction of provisions from Solvency II into IORP. Insurance policies and pension funds are fundamentally different, having different objectives and fulfilling different economic purposes. For this reason it cannot be appropriate to apply a solvency regime designed for one to both. While we would agree that the concept of risk-based capital as required by Solvency II is in general terms a prudent approach, this is where the appropriateness ends. Where solvency rules are introduced, there is also likely to be an impact on the nature of investments and strategies used by a scheme, with additional changes to reporting requirements by asset managers.

A pension fund which has undefined benefits does not offer any form of 'promise'. Mandating any pension fund to hold capital against investment losses would fundamentally question the concept of investment risk and whether *any* investment product could continue to exist in its current format. A requirement of this nature would have an adverse impact on the charges being imposed on pension fund members, the level of benefits achieved, and the contribution of pension funds to the broader economy.

The related question of pension benefit guarantee systems must also consider to what extent a guarantee has been provided. Where no guarantee exists, the pension fund should not be required to participate in or contribute to any form of guarantee system. A more suitable mitigant of the risk associated with funds that are not guaranteed will be to make further advances in disclosure, transparency and financial literacy. Any proposed solution must consider the variety of funds in operation and be appropriately implemented. Even where guarantees have been provided, disclosure, transparency and literacy will be important to ensure that pension savers understand the nature and costs of the product or benefit that they are being offered.

<u>Governance in DB and DC Schemes</u>

While there are some overlaps in general governance requirements, we would disagree with the observation in paragraph 10.3.21 that there are no major differences in governance requirements

between DB and DC schemes.

In our view, there are profound differences in governance issues, primarily stemming from the fact that DC can result in a complete transfer of investment risk from the scheme and the sponsoring entity onto the individuals. This raises a range of wholly distinct issues. We would highlight particularly here the individuals' high dependence on default fund provision (80-90% of DC scheme members either default into or actively choose a fund or strategy designated as the default by the scheme or provider). One of the key questions therefore is how investment governance is handled and how default funds are designed. However, there are other elements of the governance challenge: for example, how much choice should be provided, or how scheme or fund managers should be appointed and monitored.

In the UK, addressing DC governance has been the subject of a significant workstream by a sub-group of the Investment Governance Group.[2] This has resulted in a series of principles, which it is hoped will be at the basis of good investment governance as the automatic enrolment process begins in 2012.

We do not believe that detailed regulation around the way in which DC investment governance is handled would be a helpful way forward for the authorities, the industry or consumers.

For the authorities, there are a range of risks:

- Potential perceptions of prescription with respect to how schemes operate.
- A danger of being out of date as practice within the industry evolves.
- A risk of perceived responsibility for specific approaches.

For the industry, it may be more difficult to innovate in an evolving environment as people across the EU become increasingly dependent on funded pension provision for their retirement income.

For consumers, there is a danger of being forced into potentially sub-optimal investment solutions,

[2] http://www.thepensionsregulator.gov.uk/about-us/investment-governance-group.aspx

	depending upon the view of regulators and/or legislators at a given time. For example, the US Thrift Savings Plan for many years ran a default fund invested wholly in specially-issued government bonds, under legislative requirement.	
14.		
15.		
16.		
17.	**We believe that care is needed not to impose requirements that cut across current national regulatory arrangements.** As the consultation document notes, many elements of IORP activity, including investment management, tend to be outsourced. EIOPA proposes to tighten the requirements for outsourced providers to respond to issues raised by the IORP regulator. In the UK, asset managers (and investment fund managers) are subject to the regulatory authority of the Financial Services Authority. The IORP (as defined in the UK as a trust-based occupational pension scheme) is regulated by The Pensions Regulator. It is important that any amendment to the IORP directive which changes the supervision requirements of outsourced providers does not cut across national regulatory structures. These structures may not (certainly in the UK's case) be based on a unified regulatory architecture.	
18.		