| Comments Template on EIOPA-CP-11/006<br>Response to Call for Advice on the review of Directive 2003/41/EC: second consultation | | Deadline<br>02.01.2012<br>18:00 CET |
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| Company name: | IMA (Investment Management Association) | |
| Disclosure of comments: | EIOPA will make all comments available on its website, except where respondents specifically request that their comments remain confidential.<br>*Please indicate if your comments on this CP should be treated as confidential, by deleting the word **Public** in the column to the left and by inserting the word **Confidential**.* | Public |
| | The question numbers below correspond to Consultation Paper No. 06 (EIOPA-CP-11/006).<br><br>**Please follow the instructions for filling in the template:**<br>⇨ <u>Do **not** change the numbering</u> in column "Question".<br>⇨ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a question, keep the row <u>empty</u>.<br>⇨ There are 96 questions for respondents. Please restrict responses in the row "General comment" only to material which is not covered by these 96 questions.<br>⇨ Our IT tool does not allow processing of comments which do not refer to the specific question numbers below.<br>○ If your comment refers to multiple questions, please insert your comment at the first relevant question and mention in your comment to which other questions this also applies.<br>○ If your comment refers to parts of a question, please indicate this in the comment itself.<br>**Please send the completed template to *CP-006@eiopa.europa.eu*, <u>in MSWord Format</u>, (our IT tool does not allow processing of any other formats).** | |
| **Question** | **Comment** | |

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| General comment | The IMA is pleased to have the opportunity to respond to the EIOPA consultation on its draft advice to the European Commission on the review of Directive 2003/41/EC (IORP).[1] In various capacities, IMA member firms have a significant interest in the future of EU 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.<br><br>**I. GENERAL COMMENTS**<br><br>Before commenting in detail on the questions posed by the document, we would like to make three general comments:<br><br>1. <u>Absence of methodological detail and impact assessment</u>. It is very difficult to respond in any meaningful sense to one of the central issues of the consultation: new quantitative prudential requirements and the possible role of a holistic balance sheet. We appreciate that EIOPA is itself under timetable pressure from the European Commission. However, a technical consultation with such potentially far-reaching consequences for a number of national pension systems should not be undertaken without providing both a detailed overview of how the holistic balance sheet might operate and an impact assessment.<br><br>In this context, we would also like to reiterate a broader point about the nature of the exercise that the European Commission has embarked upon. It has always been unclear how a policy process designed to | |

[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.

promote cross-border pension provision has failed to identify why there is so little cross-border occupational provision. Indeed, we note that in its first consultation earlier in 2011, EIOPA commented that:

*"It is possible that the lack of take-up is not due to failings of the Directive or Member States' interpretations, but to other reasons such as a basic lack of demand. A reason for this lack of demand may be that pension arrangements must operate as part of each Member State's overall legal systems in respect of occupational pensions - for example taxation and social and labour law - and it is difficult for a foreign IORP to manage this, so they are unattractive to sponsors." (7.3.13-7.3.14)*

There are important observations and questions raised here, particularly with respect to taxation, that have not been adequately explored. While we understand the limitations of the current technical consultation, there is a significant evidence gap in the analysis. This should not pass without comment from stakeholders or from EIOPA given its previous remarks.

2. <u>Inappropriateness of other regimes as pension benchmark</u>. There has been considerable controversy over initial suggestions that Solvency II could be a template for EU occupational pension quantitative prudential requirements. We agree with those across Europe who have suggested that this is inappropriate and we elaborate on this further in our response below. At a broad level, we do not agree with the assertion in paragraph 6.2 that a difference in regulatory approach between occupational pensions and insurance will need to be justified. The reverse is true, in our view. The case has yet to be proved. Occupational pensions are not the same as insurance, for a variety of reasons, notably:

- Occupational pensions have traditionally been offered as part of an employer benefit, not a commercial contract. This entails a different set of relationships and promises between 'provider' and ultimate beneficiary. In particular, DB schemes have recourse to an employer covenant (more commonly via a non-financial firm) which has no obvious parallel in the insurance market.[2]

[2] For discussion on the difference between insurance and pension provision, see for example, E Philip Davis, 'Prudent person rules or quantitative restrictions? The regulation of long-term institutional investors' portfolios', *Journal of Pensions Economics and Finance* 1(2), 2002.

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| | • Pure DC pension schemes, in the accumulation phase at least, are more akin to an investment or mutual fund model than a traditional insurance vehicle. In the decumulation phase, an income can be paid in a variety of ways, most usually an annuity which will fall under Solvency II regulations. However, there are other approaches which would continue to look more like investment structures.<br><br>We would also encourage EIOPA to be cautious about borrowing from other parts of the EU regulatory landscape: for example, as the consultation recognises, the option to require the use of a depositary (as per the UCITS and AIFM directives) depending on the legal personality of the IORP does not sit well with the existing oversight structure of trust-based schemes.<br><br>3. Focus on transparency and consumer information. The IMA welcomes EIOPA's emphasis on transparency and disclosure, particularly as the shift towards DC pension systems accelerates. It believes the idea of an adapted Key Investor Information Document (KIID) within the scope of the IORP directive is an interesting and potentially valuable development, even if a KIID for pensions would be a very different kind of document compared to a KIID in the investment funds space. | |
| 1. | The IMA broadly agrees with the analysis of the options. In particular, we welcome the recognition that the "dividing line between 1st, 2nd and 3rd pillar is not always clear" (4.3.11). This is particularly the case given the nature of DC schemes, which in many cases will essentially be individual accounts whatever the underlying role of the employer or the legal structure of the scheme. We also agree that it is not the role of EU institutions to attempt to clarify the distinction. | |
| 2. | We see no reason why the provisions in Article 4 for optional application of the Directive to insurance companies should not extend to other forms of financial provider, accepting that this would not require the | |

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| | carve out relative to Directive 2002/83/E that is currently at heart of Article 4. Rather, the Directive would recognise that entities such as asset management firms would be able to operate as IORPs. | |
| 3. | The IMA welcomes the rethinking of options originally outlined in EIOPA's first consultation to the response on the Call for Advice, particularly the move away from Option 5. We still consider that 'no change' (Option 1) is a sensible starting point given that the Directive is about cross-border occupational pension schemes issues and not a pan-European prudential regime for pensions per se. | |
| 4. | We are not aware of particular examples. | |
| 5. | It is important to ensure greater consistency across the EU. However, in changing the definition of cross-border activity, there is always the danger of unintended consequences. One potential issue with Option 2 could be the creation of accidental cross-border schemes where the sponsoring undertaking is in a separate country (possibly outside the EU) from both the IORP and its members, which could be in the same member state. This would need to be addressed.<br><br>A more general comment arises from the conjecture at several points within this section (eg. 5.3.4-5.3.5) about the reasons why cross-border market activity is very small. As we note earlier in this response, in a national and EU policy-making environment that is increasingly characterised by evidence-based policy decisions, it is surprising to us to see these questions left unaddressed while quite significant policy adjustments are proposed that may (or may not) result in improved outcomes for scheme members. | |
| 6. | For confidence to be built and maintained in funded pension arrangements, it is important to ensure a clear ring-fencing of assets, both between sponsor and pension fund, but also between providers and the underlying assets. However, there are many ways of ring-fencing assets in pension schemes and we would be concerned if attempts were made to determine these in detailed EU legislation. In particular, care needs to be taken not to create uncertainty regarding the ability of IORPs to enter into standard market transactions. | |

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| 10. | We do not have a firm view on the options presented. National social and labour law remains one of the most significant obstacles to cross-border pensions activity in the EU. As the evidence collected as part of the CEIOPS analysis of this area demonstrates, national practices vary widely.[3] While we appreciate the potential clarity offered by Option 2, there remain, as the document points out, significant grey areas. Instead of the focus on harmonisation of prudential requirements seen in the Commission CfA, we would have welcomed greater exploration of national regimes and the ways in which prudential regulation and social and labour law constitute a problem in practice for the operation of cross-border IORPs. This would help all stakeholders to gain a better understanding of what minimum requirements would be necessary to improve a single market in this area. | |
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| 12. | At a general level, we welcome the move by EIOPA to respond to the Commission's call for a *sui generis* approach to pension provision rather than simply transposing the approach currently being developed for the insurance industry under Solvency II. In this respect, the holistic balance sheet does indeed appear at first sight to try to take account of the specific features of national regimes: eg. the role of the employer covenant and Pensions Protection Fund in the UK defined benefit environment.<br><br>However, as we mention in our general comments, it is impossible to difficult to respond further on key areas, such as the employer covenant, as there is insufficient detail. Our concern remains that the template for implementation measures will still remain Solvency II with the result that there will be a significant challenge for DB pension schemes and a threat to the sustainability criterion that is at the heart of the Commission's Green Paper agenda. We believe this threat could primarily be in the form of risk-free discount rates, increasing technical provisions without taking into account either the specific | |

[3] See https://eiopa.europa.eu/fileadmin/tx_dam/files/supervisory-disclosure/CEIOPS-OPC-Survey-Law-applicable-to-IORPs-Appendix.xls

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| | circumstances of individual schemes or the nature of employer-backed trust-based provision. As work by Punter Southall has pointed out, depending on how these changes are calibrated, this could lead to an increase of up to 90% in technical provisions.[4]<br><br>In the context of the forced de-risking of pension schemes that could follow the introduction of such changes, we would also draw attention to the broader potential impact on both equity markets and the wider economy. While it is the case that UK DB pension funds have been both reducing their equity exposure and specifically their domestic equity exposure for some time, they are still substantial holders of UK equities. Forced redemptions could have a significant destabilising effect both on market valuations and on the future ability of UK companies to raise capital via equity issuance.<br><br>With respect to DC schemes, we would like to see more elaboration regarding the operational risk component of the balance sheet. We agree with EIOPA that pure DC should see a precise matching of assets with liabilities. We also agree that that operational risk is an issue that needs to be addressed in DC provision. However, where DC provision is outsourced to an external provider (in a bundled or unbundled form) by the IORP, much of the operational risk associated with the pension will be assumed by the providers. It is therefore not clear whether there might be duplication if the IORP itself is also required to make provision for certain aspects of operational risk.<br><br>Overall, and particularly given the absence of detail surrounding the impact of the holistic balance sheet approach, we support the retention of the distinction between different types of IORP (Option 1), particularly to take into account the different nature of sponsor-backed IORPs. | |
| 13. | Valuation of assets, liabilities and technical provisions is a complex and difficult area, not least because it could have dramatic implications for the sustainability of certain models of provision. With respect to the questions posed in this section (CfA5), we do not believe there is a compelling case for moving beyond current requirements in the IORP Directive, particularly as it is so unclear how the holistic balance sheet | |

[4] Punter Southall, *Solvency funding in pension schemes: the application of solvency regimes to European pensions*, 2008.

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| | approach would take account of key elements such as the employer covenant. | |
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| 21. | It is unclear why applying a risk-free interest rate to calculate the technical provisions of IORPs would be appropriate. Once again, this appears to be a read-across from Solvency II that does not take into account the specificities of pension schemes. In particular, the long-term nature of their liabilities, the risk-pooling mechanisms embedded within those schemes and the existence of employer support allow significant exposure both to relatively liquid risk assets and more illiquid investments. Moving to a risk-free interest rate would sharply force up technical provisions and likely make it both unattractive for employers to continue funding DB provision. | |
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| 36. | We do not believe that a uniform security level for IORPs should be introduced across Europe and agree with EIOPA's decision not to recommend a specific probability methodology. | |
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| 42. | Operational risk exists in all schemes, both DB and DC, regardless of investment approach and where member risk lies. In DC, there are a number of areas of operational risk, but the holistic balance sheet approach needs better to specify these as providers of IORPs will already have mechanisms in place to deal with operational risk.<br>**Should these capital requirements be uniform or tailored to the actual risk profile?**<br>If the issue is operational risk, rather than investment risk, it is difficult to see what is meant by risk profile.<br>**Do stakeholders find it sensible to distinguish between DC and other schemes in the area of operational risk?**<br>In investment terms, the distinction may not be particularly helpful. However, with respect to administration, we do find a distinction sensible. There are a range of areas relating to specific member contributions and the investment and attribution of these that are fairly unique to DC. | |
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| 47. | Yes. Prudent person should be a starting point, but effective investment decision-making at the level of the IORP or its appointed agents is also essential. This is a governance (ie. process) issue and not one that requires substantive prescriptive intervention. As we comment further in our answer to Q.49, the issue of governance is one that arises in both DB and DC pensions, and is one that is likely to grow in importance as the transition to DC accelerates. | |
| 48. | There should be no option to impose limitations in addition to those set out in the IORP Directive. Should host Member States be allowed to impose such limitations, this would undermine the intention of the Directive with respect to cross-border activity. | |
| 49. | Investment managers should have the ability to invest in an appropriate range of instruments, regardless of the nature of the pension provision. The key issue is to ensure good governance and to ensure that member interests are considered in a balanced way, particularly with respect to the design of the default option in DC pension schemes. In this respect, there may be a role for EU institutions in sharing good practice from across the EU as the DC market evolves. We do not agree with the observation in 11.3.68 that minimum standards should be decided at EU level. As the diversity of approaches currently in existence (for example, guarantee requirements in certain jurisdictions) illustrates, there is no consensus as to what this minimum should constitute. Furthermore, given the complex balance between state, occupational and supplementary private saving that characterises all national systems, this is not an area that can best be addressed by EU institutions. | |
| 50. | <u>CfA 7.1 - Understanding and control of the investment risks</u><br>Our view is that Option 1 (no change) is the best approach, since it is not clear why the current wording is deficient:<br><br>1. As paragraph 11.3.5 points out, the IORP is itself likely often to outsource investment decision-making, which raises questions about the identification, measurement, monitoring, management, control and | |

reporting of risk. We firmly agree with the observation from EIOPA that onerous requirements on the IORP where investment is outsourced could limit the efficiency of asset management activity (11.3.6). In our view, this rules out Option 2. The proposed work-around in Option 3 actually complicates matters further since it does not really clarify which areas the IORP would need to have expertise in.

2. The wording proposed in Options 2 itself demonstrates the inappropriateness of trying to import solvency rules from an insurance regulation into the pensions environment. It is far from clear in the DC pensions environment how and why an IORP should be taking into account "its overall solvency needs" in its investment risk control functions. DC should operate, as the holistic balance sheet demonstrates, with a balance between liabilities and assets, commonly determined on the basis of a designated individual account for the scheme member. Risk generally lies directly with the latter and the solvency of the IORP is, broadly speaking, a separate issue. This is reflected in EIOPA's own comments that "where applicable" should be added to the amended text in Option 3. However, as we note above, we do not think Option 3 would be effective for reasons of broader lack of clarity regarding responsibilities.

<u>CfA 7.2 - Application of the quantitative restriction on investment</u>
We agree with EIOPA that Option 1 is the best approach.

<u>CfA 7.3 - Application of more detailed investment rules</u>
We believe that Option 2 would be the best approach. As EIOPA notes, "this would create a level playing field for the investment rules in all Members States based on the prudent person principle only." We would like to reiterate our view that DB and DC should not be subject to different investment rules. It would be a mistake to believe that the different nature of the ultimate benefit requires different forms of investment approach or that limiting certain forms of investment is the best way to protect scheme beneficiaries. Allowing national restrictions on investment risks being counter-productive in that the necessary investment flexibility and innovation to help deliver DC benefits may be stifled.

Nonetheless, we do recognise the legitimacy of the point made in the document about the risk of exposing "less financially experienced members to unexpected losses" (Negative impacts, Option 2). Once again,

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| | this issue comes back to governance and the importance of ensuring that sound investment and communication processes are in place, particularly in DC default fund design.<br><br><u>CfA 7.4 / 7.5 – Restrictions on foreign currencies and investment in risk capital markets</u><br>In line with our response to 7.3, we support the prudent person principle without allowing further quantitative or qualitative restrictions. We do not therefore view the imposition of limits in these areas as helpful, nor do we believe that a distinction should be made between DB and DC. Article 18(5)(b) and Article 18(5)(c) can therefore be deleted, as per Option 2 in both cases.<br><br><u>CfA 7.6 – More stringent investment rules on an individual basis</u><br>We do not disagree that supervisors in Member States may need to intervene on an individual basis (as opposed to more generalised investment rules). We concur with EIOPA that this issue is covered in Article 14, which should make it possible to delete Article 18(6). Article 18 can then focus specifically on the issue of general investment rules and the consistent establishment of the prudent person principle.<br><br><u>CfA 7.7 – Cross-border activity</u><br>In line with our response to 7.3, we believe that Option 2 is consistent with the prudent person principle operating across a level playing field. Article 18(7) can therefore be deleted.<br><br><u>CfA 7.8.1 – Level playing field between IORPs and insurance products where a unit-linked insurance contract may be involved</u><br><br>It is not entirely clear to us how this provision would work. If IORPS are using insurance-based investment processes, then surely they will have to be provided by an insurance provider and hence regulated under Solvency II anyway. We believe it would be helpful to have greater information on how this amendment might operate.<br><br><u>CfA 7.8.2 - Multi-funds, default funds, lifestyling</u><br>The use of compulsory or semi-compulsory DC creates a new class of investor. This is the ‘accidental | |

investor' (ie. someone who may not otherwise have invested in stocks and securities, or who may not have any other form of investment products). In circumstances where individuals are compelled to save in a DC scheme or encouraged through automatic enrolment, it is not unreasonable for Member States to require that DC schemes have some form of default option.

However, this creates several issues for EU policymakers. The first is political, since there have been national contexts which have seen ideological objections to a default option (eg. Sweden in the early stages of the reforms started in the late 1990s with the Premium Pension Authority - PPM). The second is one of definition. Once there is a requirement to have a default option, there is a potential need to specify what that might constitute.

We believe that such decisions – whether to require a default fund and if so, how it should be defined – should be left to national authorities and can be addressed in a way that does not undermine the prudent person principle. In other words, we favour Option 1 and would not support the imposition of quantitative restrictions at either national or EU level, but believe there is potentially room for guidance that encourages a focus on addressing investment issues such as volatility and possible duration mismatch (vis-a-vis annuity rates) in the run-up to retirement. There is also room, as the consultation document suggests, for principles and exchanges regarding good or best practice.

While 'lifestyling' is a convenient term, and the general intent is reasonably clear, another reason for being careful in this area is the evolving nature of investment processes. 'Lifestyling' is associated with the prevailing mechanistic approach to de-risking in the last five or ten years of working life that is already being challenged by other forms of approach. Some of these approaches are using more sophisticated forms of de-risking strategy towards the end of the accumulation phase. Others are adopting a wholly different approach across the accumulation phase. There is no single 'right' or 'wrong' answer. A plurality of approaches is likely to be a defining feature of the DC investment market

<u>CfA 7.8.3 – VAR measure</u>
We agree with the EIOPA assessment that there is no prudential justification to introduce such a

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| | requirement at EU level.<br><br><u>CfA 7.9 – Additional requirements regarding biometric and inflation risk</u><br>We agree that there are a range of risks to which members may be exposed, which may have a significant impact on investment approach. The obvious biometric risk in DC is in fact not in the accumulation phase, but in the decumulation phase in a non-pooled pension product (eg. income drawdown). However, it is neither clear that such risks are best addressed in the IORP Directive (or indeed at EU level at all), nor whether the approach should be based around regulation of the investment process as opposed to other regulation such as on information or advice. We support the pragmatic approach taken by EIOPA in the consultation document.<br><br><u>CfA 7.10 - Other requirements</u><br>1. Geographic diversification should be adequately covered in prudent person.<br>2. With respect to derivatives, we support retention of the current wording on the basis that it is not clear why it should be deleted, nor is it clear that decisions would be facilitated by additional definitions of efficient portfolio management within the existing clause. We feel therefore that there should be a third option, which is to leave the article sub-section unchanged.<br>3. We agree that sponsor support is a separate issue to the question of investment in the sponsor. The latter should be limited under any prudential investment approach. | |
| 51. | We do not have a strong view on the broad restriction on borrowing. However, we agree that anything that potentially restricts investment options (for example, where an investment strategy may be using leverage) requires clarification to prevent undue constraints on schemes and managers. | |
| 52. | We understand the rationale for adopting the form of both Article 27 and Article 28 of Solvency II, using a reference to members rather than policyholders. But the protection of members and beneficiaries should not be the sole primary objective. There are other objectives which should not be relegated to second place, notably market confidence and financial stability. Indeed, the latter has been shown to be key to the | |

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| | assurance of member protection. If the Solvency II approach were adopted then financial stability is relegated to an issue which is considered only in relation to the impact upon it of actions taken for member protection. | |
| 53. | A general comment that we could make on Q.53-60 is that aspects of the insurance supervision that EIOPA is proposing to transpose into IORPs are inappropriate. For example, stress-testing is not relevant for pure DC schemes (Q.55), nor would capital add-ons be required (Q.60). We would strongly encourage EIOPA to start by looking at the nature of the different pension regimes across Europe and asking what regulatory oversight they might benefit from. In this respect, the OECD Principles of Occupational Pension regulation are a much better starting point. | |
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| 61. | We are concerned, as EIOPA is, to ensure that any changes in this area do not result in unduly onerous requirements. We agree, therefore, that an impact assessment is needed (17.3.28) and it is important clearly to embed proportionality in this area. Where the entity performing the outsourcing function is itself a regulated financial entity, any requests for information etc. should come from its primary supervisor, not the supervisor of the IORP, otherwise there is a danger of duplicate requirements and the associated costs compliance | |
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| 63. | We support the proportionate application of any governance requirements. However, as we noted in our | |

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| | response to the first EIOPA consultation (paragraph 10.3.21) on the Call for Advice, we disagree with the observation 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 different nature of the benefits being provided. In pure DC, there is 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). As discussed elsewhere in the current EIOPA consultation, one of the key questions therefore is how investment governance is handled and how default funds are designed. There are also other elements: for example, how much choice should be provided, or how scheme or fund managers should be appointed and monitored.<br><br>In the UK, addressing DC governance has been the subject of a significant workstream by a sub-group of the Investment Governance Group.[5] 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. | |
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| 68. | We agree that that IORPs should have adequate risk management mechanisms in place with the understanding that their scope and complexity may vary according to the type and size of pension plan, fund and entity and the type and extent of risks faced (eg. DC will be totally different to DB).<br><br>We also agree it must be the responsibility of each IORP to define and implement a consistent and adequate solution for carrying out the risk management requirement. | |

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

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| 69. | We are not persuaded that the ORSA is suitable for IORPs since once again, it assumes that an employer-sponsored scheme is somehow comparable in nature to an insurance company. It follows from our comments about the role of the employer covenant in DB schemes that application of the ORSA should be approached with great care. | |
| 70. | Given the specific nature of a DC balance sheet where members bear all risks, it is not clear to us how an ORSA would be constructed since some of the solvency issues that might be relevant for an insurance entity should not arise. Again, we would question the relevance of this approach for a DC pension environment. | |
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| 83. | The role of the depositary in the investment fund universe is very specific. As the consultation notes, it relates both to oversight of the fund and safekeeping of assets. As the consultation also correctly notes, there is a real danger of duplication by applying the principle of a depositary to pension institutions whose oversight structures (and general governance structures) are not comparable to those of investment funds. | |

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| | This is particularly evident in the case of trust-based schemes where the trustees have a specific legal duty of oversight (paragraph 26.3.22) and must ensure safekeeping of assets. UK occupational schemes will typically use the services of a custodian. For this reason, we strongly oppose Option 2 and lean towards Option 1. If the current provision is unacceptable to EIOPA, then Option 3, recognising the specificities of trust-based provision and leaving national discretion over DB schemes, would be the best option. | |
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| 91. | The nature of information required for DB and DC scheme members is fundamentally different, reflecting the fundamentally different nature of the underlying proposition. At a general level, the key information challenge in DC is to help consumers understand the precise nature of the service that they are receiving for a given fee. A focus on transparency and disclosure with respect only to issues such as charges and expected returns will miss the underlying need to improve the overall communication approach in DC. This is an issue that is a significant feature of the current governance debate in the UK and should be central to governance debates across Europe. To answer the question precisely in the light of these remarks, we do not believe that there are obvious additional requirements. We <u>do</u> believe that the pensions industry (including trust-based schemes operating under IORP) needs to do more to find ways to communicate in a comparable way the value proposition in DC pensions.<br><br>There is also an important caveat here, and one that is emphasised by consumer representatives in the debate on the evolution of DC disclosure: information without regard for consumer capability is information without value. It is essential that the policy debate over information requirements is fully cogniscent of differing – and often low – levels of consumer capability in relation to financial services | |

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| | products. Furthermore, as a recent report for the European Commission emphasised, there is an additional challenge for policymakers, which is behavioural: ie. even well-informed consumers provided with the best information may make decisions that appear sub-optimal in a rational welfare maximisation perspective.[6]<br><br>Ever more mindful of the general communication issues that arise in DC, a number of pension schemes and interested parties across the EU are experimenting with innovative approaches: for example the National Employment Savings Trust (NEST) in the UK has done a lot of work on the language of pensions; in Sweden, the Government uses the 'Orange Envelope', an approach successful introduced in 1999 to brand pensions differently. EIOPA and the European Commission could potentially examine good practice across the EU as part of its analysis. It would also be important that any harmonisation does not cut across or otherwise limit innovation in this area. | |
| 92. | The use of the KIID in investment funds reflects the high standards of transparency and disclosure that exist in the investment funds market, which has helped to make UCITS in particular a successful global brand. These high standards should in principle also exist in the DC environment, and should help consumers to undertake comparison, where they are in a position to exercise choice. However, the retail market for UCITS and the DC pensions markets are very different, not least where it is employers and not employees who are choosing schemes and default options for members. These differences need to be recognised and their implications fully understood as a part of any process of policy change in this area. | |
| 93. | The existing SRRI methodology works far better for static asset allocation (eg. an emerging market equity fund) than it does for dynamically managed funds (ie. those where the asset allocation and hence the risk profile will be changing over time, particularly during a de-risking phase in the run-up to retirement). Indeed, given the likelihood of asset allocation adjustment over the course of the accumulation phase, there may be a case for a risk/reward indicator forming part of an annual pensions statement and hence | |

[6] See *Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective*, report prepared by Decision Technology, 2010.

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| | reflecting any allocation changes. Currently, the SRRI is essentially a pre-sale tool for investment funds, although it is available in the annual report and accounts for fund holders.<br><br>In terms of adapting the SRRI methodology, a significant practical obstacle is posed by the current approach. Against the advice of a number of stakeholders including the IMA, the SRRI methodology was built on fund rather than asset class performance.[7] Using asset classes as a starting point would allow access to a long-run data set that would facilitate the reflection of both the risk premium and mean reversion across time scales that are more akin to the duration of pension accumulation. There may, therefore, well be a case for constructing a different form of indicator for DC pensions. | |
| 94. | All members should have access to a personalised annual statement. There is a broader issue about the distinction between charges (ie. services provided by fund managers, depositaries, auditors etc..) and the costs of investment (including tax, where applicable), and how these should be disclosed. The IMA believes that current practice in the investment funds environment based on the Total Expense Ratio constitutes a good starting point, with the separate disclosure of investment costs. A similar although not identical methodology is being used in the UCITS KIID, which will provide a consistent basis for comparison. | |
| 95. | Given the different nature of European DC regimes, it would be very difficult and potentially undesirable to seek to fully harmonise disclosure requirements. An initial piece of work should identify key information that pension savers might benefit from, and then assess the extent to which EU regulatory intervention can help to assist in its dissemination. | |
| 96. | The real test of the impact of changing information will be consumer behaviour. This is obviously difficult to predict and can be very hard to measure in clear causal terms. However, we think that the impact assessment should try to take account of – or at least acknowledge - the two elements that we identify in our answer to Q91: the potential that information disclosure requirements and consumer | |

[7] For an elaboration of the issues, see Andrew Clare / CAMR, *Developing A Risk Rating Methodology* (ABI / IMA Research Paper, 2010).

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| | capability could be fundamentally mismatched; and that even where capability is high, behaviour may not follow expectations. | |