EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY

KEYNOTE SPEECH

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Creation of a sustainable and adequate pension system in the EU and the role of EIOPA

Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

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Ladies and Gentlemen,

It is a privilege and a pleasure for me to be here today.

The creation of an adequate, safe and sustainable pensions system is one of the key objectives of the European Union and EIOPA is committed to contribute by all means to the development of such a system. The purpose of my talk today is to demonstrate the real steps that EIOPA has been making to achieve a consistent risk-based supervisory regime for pensions and also for insurance companies in the European Union.

I will focus on EIOPA advice to the European Commission on the review of the IORP Directive; on the outcome of the first European Quantitative Impact Study that EIOPA conducted as part of this advice and on our further working plans in the pensions area. In Sweden there are a lot of "hybrid" insurers that provide both occupational pensions and life insurance. I think many of you would therefore be interested to hear about the results of our Long-Term Guarantee Assessment, in which we provided our technical advice to the EU co-legislators on the way forward for the introduction of the long-term guarantee package under Solvency II. Finally I will reflect on the mandate and powers of EIOPA and the need to enhance them.

EIOPA achievements in the pensions area

In 2012 we provided our advice to the European Commission on the review of the IORP Directive. Our advice can be seen in the light of the three main objectives: sustainability, strong governance and full transparency.

Our starting point is the protection of members and beneficiaries. We believe that all occupational schemes throughout Europe should be **sustainable**, they should have sufficient resources to meet their pension promises under a reasonable but realistic and transparent framework. That is why we strongly recommended that assets and liabilities need to be valued on a **market-consistent basis**. In my opinion, market-consistency is an objective measure that allows for a transparent and realistic assessment of the financial position of pension funds.

Secondly, EIOPA suggested a number of elements to reinforce the **governance** of IORPs: for example the performance of an own risk and solvency assessment.

Thirdly, we advised to enhance **transparency**: information in pension schemes should be correct, understandable and not misleading. For defined contribution schemes EIOPA believes that it will be useful to introduce a requirement of a pre-enrolment information document – the **Key Information Document** (KID). In particular, such a KID could contain information about the objectives and investment policies, performance, costs and charges, contribution arrangements, a risk/reward profile and/or the time horizon adopted for the investment policy. I am convinced that the KID will be a huge step towards greater transparency and confidence in the occupational pensions field.

One of the key elements of our advice is a "holistic balance sheet" concept. The aim of this approach is to capture the wide variety of occupational pension systems in the different member states in a single, European prudential regime. It is important to stress that the holistic balance sheet does not interfere with national social and labour law nor with the prerogative of employers or social partners to decide on the contents of pension schemes. The holistic balance sheet allows pension funds to recognise the value of all security and benefit adjustment mechanisms available to them. In our advice we underlined, however, that it is necessary to further investigate whether the methodology for the quantification of the security mechanisms is cost effective. For this and other purposes we conducted the quantitative impact study (QIS) as part of the process to advise the European Commission on the review of the IORP Directive.

I am proud that our QIS is a first study of its kind in assessing the financial situation of pension funds in a comprehensive and comparable way. There were seven countries participating in the QIS on a voluntary basis – Belgium, Germany, Ireland, the Netherlands, Norway, Sweden and the UK. These countries represent over 95% of defined benefit pension plans in the EU.

In my view, **two important lessons from the QIS** can be learned:

I. First, the current IOPR Directive with its minimum harmonisation approach has led to large differences in the protection of members and beneficiaries across Europe. This conclusion can be taken from the wide range of impacts: surpluses for IORPs in some Member States and at the same time large shortfalls for IORPs in other countries.

II. Second, pension funds dispose of vulnerabilities in different places:

- In some Member States pension funds are very dependent on future payments by the sponsor. It is not unusual that future sponsor support needs to cover as much as 25% of liabilities.
- In other Member States, substantial benefit reductions are expected. The QIS report shows values of ex-post benefit reductions of as much as 20% and 75% of liabilities.

I am glad to say that Sweden set a positive example in the QIS. Nine Swedish pension funds participated in the QIS exercise, representing 90% of pension fund assets, and one large insurance undertaking subject to Article 4 of the IORP Directive, representing as much as 80% of defined benefit obligations of insurance companies. In addition, some partial calculations were performed for representative pension foundations.

I would like to take this opportunity to thank the Swedish pension industry, the Swedish pension protection scheme (PRI Pensionsgaranti) and the Swedish supervisor (Finansinspektionen) for their contributions to the QIS.

Sweden was the only member state with sufficient financial assets to cover the pension liabilities as well as the solvency capital requirement. Pension funds showed on average even a substantial surplus over the SCR of 13% of liabilities. Of course, an important reason for these positive outcomes is that Sweden already imposes a prudential regime that is market-consistent and risk-based, by using the quarterly Traffic Light stress test.

In my view, this clearly illustrates that a future European regulatory regime should be:

- market-consistent in order to ensure a comparable and realistic assessment of the financial situation of pension funds; and
- risk-based in order to provide IOPRs with the right incentives for managing risks.

I welcomed the announcement by the European Commission that further technical work on the holistic balance sheet is needed. EIOPA reached the same conclusion that a number of areas of the technical specification have to be improved and we are fully committed to conducting that further work. Before the summer we already published a discussion paper on the valuation of sponsor support, which explores several directions to improve the specifications for the calculation of sponsor support.

But in general I believe that the holistic balance sheet is able to provide a comprehensive and comparable view of how far occupational pension promises are supported by financial assets, sponsor support and pension protection schemes and of how far benefit adjustments are expected to occur.

Over the coming year, EIOPA will carry out a **work programme** aimed to improve definitions and methodologies for assessing the holistic balance sheet. The programme will be based on EIOPA's own timelines and will allow sufficient time for the input from stakeholders. Our goal is to present to the new composition of the European Commission, a number of further technical proposals for a European risk-based prudential regime that appropriately reflects the specific reality of pension funds.

Long-Term Guarantee Assessment and Preparatory Guidelines

Let me now turn to those EIOPA activities related to the implementation of Solvency II.

This year, following the agreement by the EU political institutions, EIOPA conducted the long-term guarantees assessment (LTGA). The aim of the exercise was to test various measures that have been discussed in political negotiations in order to provide a basis for final agreement on the Solvency II framework. In June we published the results of the LTGA together with our recommendations.

The significant level of participation across different classes of firms and across Member States ensured a high quality sample of firms. In total 427 companies participated in the quantitative part of the exercise including 211 life, 142 non-life, 65 composite and 9 reinsurance undertakings. In terms of size we had 115 large, 166 medium and 146 small companies.

Our assessment has led us to conclude that the final Long-Term Guarantee package to be included in the Solvency II framework should fulfil a **number of principles** in order to ensure a high degree of policyholder protection, as well as an effective supervisory process:

- Alignment with the Solvency II framework and the economic balance sheet concept;
- Full consistency and comparability in order to enhance the single market;
- Efficient linking of all the three pillars (quantitative basis, qualitative requirements and enhanced reporting and disclosure);
- Proportionality and simplicity;
- Adequate treatment of transitional issues.

On the basis of these principles and of our assessment, **EIOPA supports the inclusion of the following measures**: Extrapolation, "Classical" Matching Adjustment, Transitional measures and Extension of the Recovery Period, with slight amendments to provide the right incentives for sound risk management.

At the same time we advise to **exclude the so-called Extended Matching Adjustment** on the basis that it would not provide sufficient policyholder protection and would be unduly difficult to supervise. The Counter-Cyclical Premium (CCP) was judged to be likely to have an adverse financial stability impact due to the way it would be triggered, as well as the perverse impacts on undertakings' solvency requirements that it generated.

As a consequence, EIOPA advises to replace the CCP with a simpler, more predictable measure, the **Volatility Balancer**, which would deal with the unintended consequences on undertakings' capital requirements of short-term volatility.

I am confident that we have delivered a thorough and robust study. We are certain that its results combined with EIOPA's advice provide the EU political institutions with a reliable basis for an informed decision on the long-term guarantee measures, which will be another important step towards the implementation of Solvency II.

While the negotiations are on-going, EIOPA sees it as of key importance that there will be a consistent and convergent approach with respect to the preparation for the new risk-based supervisory regime. For this reason EIOPA will issue **Preparatory Guidelines** to ensure a convergent and consistent approach by national supervisors starting on 1 January 2014.

The Preparatory Guidelines create a solid basis for a much higher degree of convergence in the EU and, thus, will make the implementation of Solvency II smoother. Our Guidelines will cover a number of fundamental areas for the effective preparation for Solvency II: system of governance, including risk management; forward looking assessment of the undertaking's own risk (based on the ORSA principles); submission of information to National Supervisors; pre-application for internal models.

It is up to national supervisors to determine how to comply with EIOPA's Guidelines by incorporating them into their regulatory or supervisory framework in an appropriate manner with due proportionality to be applied.

This year in spring we publicly consulted on the Guidelines and plan to finalize them by the end of this autumn.

In my view this initiative of EIOPA is beneficial not only for industry and supervisors but also for consumers. The sooner and more efficiently Solvency II is implemented, the better policyholders will be protected and financial stability guaranteed.

Enhancing EIOPA mandate

During the now almost three years of our existence we identified certain "gaps" that don't allow us to fully perform the mandate assigned to EIOPA by EU law.

For example in the pensions area our mandate only covers occupational pensions, the so called 2nd pillar. However, I believe that the implementation of the EU agenda for adequate, safe and sustainable pensions calls for a sufficient level of regulation and supervision of personal pensions, the so called 3rd pillar. Consequently, EIOPA's mandate should be extended to all 3rd pillar pensions. This is also recommended by EIOPA's Occupational Pensions Stakeholder Group in their comment to the Commission's White paper on Pensions.

EIOPA has already started to work on the personal pensions issue. Last year the EC asked our Authority to provide technical advice on the prudential regulations and consumer protection measures needed to create a single market for personal pensions. In May 2013, as a first step to deliver this technical advice to the Commission, we issued the Discussion Paper on a possible EU-single market for personal pension products.

I think that we should also explore the development of an "EU retirement savings product". This product could be developed to finance individual or collective DC plans and should clearly differentiate from other types of investment products by being focused on the long-term nature of their objective (retirement savings), avoiding the traps of the short term horizon. It should be based on a simple framework, allowing for reduced cost structures and be managed using robust and modern risk management tools. It should have access to a European passport allowing for cross-border selling. An EU certification scheme could give to EU citizens certainty in the quality of all marketed "EU retirement savings products".

So there is a lot to do for EIOPA in order to contribute to the better protection of scheme members and beneficiaries and given that some work has already been started, the relevant amendment of the EU law would bring more clarity to our mandate.

During the public hearings on the review of the European System of Financial Supervision (ESFS) in May this year, I also mentioned the need to have a legal power to ban or restrict financial activities, to introduce a centralized oversight role for EIOPA in the field of internal models and to ensure EIOPA's access to individual information.

Internal models is an innovation introduced by Solvency II. The supervisors don't have sufficient experience to deal with them. Our recent peer reviews identified a lot of differences in supervisory practices of pre-application process for internal models.

In May I also mentioned that in the medium term, as part of a step-by-step approach, consideration should be made to assign EIOPA an enhanced supervisory role for the largest important cross-border insurance groups. Again we are not talking about direct supervision. But, EIOPA can certainly contribute to a more consistent approach to the supervision of groups by getting more information about their position and by playing a more active and challenging role in colleges of supervisors.

In order to ensure an adequate and consistent level of supervision, for the benefit of consumer protection and financial stability, it is fundamental to strengthen EIOPA's independent challenging role towards National Competent Authorities.

We need to:

- Ensure EIOPA's access to individual company information, for example on the Solvency II harmonized templates.
- Extend the current powers of EIOPA to conduct enquiries into a particular type of financial institution, type of product, or type of conduct.

Conclusion

Ladies and Gentlemen,

For the sake of protection of policy holders and members and beneficiaries, the insurance and pensions regulatory regimes need to face the "economic reality test". One of the lessons of the crisis is that to use valuations and risk assessments that deny economic reality is not an answer:

- It does not contribute to a better management of the risks;
- Fails to reflect the true risks that different stakeholders are running;
- Helps to preserve promises that are clearly unsustainable, postponing the taking up of appropriate measures in due time;
- "Kicks the can down the road" creating the grounds for an intergenerational conflict.

It is our collective responsibility to face reality. Please help us to move in the right direction.

Thank you for your attention.