EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY

**SPEECH**

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# Topical developments on pensions: an EIOPA perspective


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Ladies and Gentlemen,

I would like to congratulate Pensions Europe for organising for the ninth time the European Pension Funds Congress here in Frankfurt as part of the Euro Finance Week. This event has become a key annual gathering where different stakeholders debate the future of pensions in the EU, the ways to deal with the challenge of an ageing society and deliver safe, sustainable and adequate pensions for EU citizens.

I would also like to thank Pensions Europe for the opportunity to speak to you today. In my intervention I will talk about EIOPA's vision, strategy and objectives on pensions and how we are implementing it.

The percentage of the EU population that is covered by decent pension systems is still too low. We are indeed facing an EU pension's landscape in need of reforms. Reforms require choices and courage.

The European pension's landscape we are facing is very heterogeneous, with public pay-as-you-go, occupational, and personal pension vehicles playing a very different role in the 28 Member States.

Despite such diversity that understandingly reflects the different cultures and traditions, pension systems have one thing in common. They are all facing tremendous challenges to deliver on their promises. Challenges like longevity growth, a sluggish economic environment, low employment, budget deficits and debt burdens, low interest rates, volatility of asset values.

Public pay-as-you-go pension schemes face an increasing expenditure, meaning growing pressure on public finances and on the younger generations, and are affected by lower contributions due to higher unemployment. Reforms of public pension systems are introduced as part of current initiatives to restore confidence in government finances.

On the other side, private funded schemes are affected by the volatility of asset values and by reduced returns which lower the funding ratios in defined benefit schemes and diminish the ultimate value of pensions paid by defined contribution schemes. These effects are not always transparent to members and beneficiaries, contributing to an environment of lack of confidence.

To ensure that citizens will have a chance to maintain appropriate standards of living in their retirement it is self-evident that we need a comprehensive package of reforms. Changes to ensure the future sustainability of public pay-as-you-go pension systems need to be accompanied by reforms incentivising the creation of funded complementary private schemes be it 2nd pillar occupational pensions or 3rd pillar personal pensions.

From a policy perspective this should be the first strategic priority at national and EU level.

I believe that an important strategy to achieve this goal is to provide a robust and proportionate EU regulatory framework capable of regaining the trust and confidence of EU citizens in private complementary pension savings.

This regulatory framework needs to deliver on three fundamental objectives: **enhanced sustainability, strong governance and full transparency**.

These are the fundamental building blocks of EIOPA’s pensions’ vision.

**Enhanced sustainability**, because the first step to ensure protection of members and beneficiaries is to make sure that any pension scheme disposes of sufficient assets to fulfil its liabilities within a realistic valuation scenario.

The QIS that we performed last year showed that pension funds in many member states have vulnerabilities. Local measurements sometimes provide a more optimistic view on pension funds solvency than applying a more realistic measurement.

In these cases, the reliance on future payments by the sponsoring employers is very large. We need to recognise this and assess if this dependency is sustainable in the long run.

**Strong governance**, because pensions deserve to be governed by fit and proper persons, with the appropriate skills, experience and integrity; because conflicts of interest need to be identified and managed in order to make sure that Board Members act in the sole interest of members and beneficiaries; because strong risk management capabilities and robust internal controls are fundamental to deliver to pensioners the promises made or the expectations created.

**Full transparency**, because if we want to regain trust of citizens we cannot hide anymore behind “jargon”; in the digital era we cannot justify difficulties of providing information; we need to provide full disclosure of all costs, be it investment or transaction costs; we need to give members and beneficiaries a full picture of the returns that they get on their pension products.

In all our work we recognise that pensions are different from other areas.

Pensions are different because of their “embeddedness” in social and labour law; because of their social objectives; because of their particular governance, involving employers and social partners; different because of their unique distribution of risks.

But, in spite of these differences, members and beneficiaries are citizens who deserve adequate protection, who have the right to know the sustainability of the promises that are made to them, who need to understand the risks that they are running, the costs that they are paying, who deserve that pension funds are properly governed and that pension schemes have a high degree of quality.

So pension funds need specific regulation that takes into account these differences and that’s what EIOPA has been advocating and practising.

- By developing an innovative “Holistic Balance Sheet” approach that takes into consideration all benefit adjustment and security mechanisms, such as sponsor support and pension protection schemes, capturing the specificities of pension funds in the various member states;
- By recommending an upgrade in the governance of pension funds, reinforcing the importance of proper risk management and control functions, while applying due proportionality to avoid undue burden and costs to smaller schemes;
- By advocating the development of a Key Information Document that should provide standardised information on contributions, costs and charges, investment options and expected benefits.

But also recognising that “too much” information kills information and that we should adopt a layering approach where members will receive simple and comparable information on the key elements and would have easy access if they wish to all the other more detailed material.

As a result of all of this work we have now a proposal from the EU Commission to adjust the IORP Directive covering governance and transparency requirements that we very much welcomed.

To improve IORPs' decision-making much stronger governance is needed.

Robust governance is, in my view, crucial to protect the interests of members and beneficiaries. EIOPA welcomes the Commission’s proposal which ensures a comparable level of governance principles regarding fit and proper requirements for boards of trustees and sound remuneration policies.

Through stronger governance IORPs will too improve their decision-making as they are required to prepare a Risk Evaluation. The Risk Evaluation for Pensions will stimulate IORPs to identify, manage and control their risks both in the short- and long-term. The Risk Evaluation should also be proportionate to the nature, scale and complexity of the risks inherent in the IORP’s activities. By making IORPs more aware of their commitments to their beneficiaries, the preparation of the Risk Evaluation will help them make better informed decisions about investments in long-term assets.

Furthermore, IORPs should enhance transparency towards members and beneficiaries on the key features of occupational pension schemes, in particular of Defined Contribution schemes. Also in Defined Benefit plans, the financial situation of IORPs and how it affects benefits should be understandable to a member. Therefore, we welcome the Commission's proposal for an annual Pension Benefit Statement. We need to provide standardised and simplified information to active scheme members on contributions, costs and charges, investment options and expected benefits. Nevertheless a balance needs to be found on the amount of information given and on the capacity of members to digest and use appropriately that information.

I am confident that the ongoing and future discussions in the EU Council and the EU Parliament will allow for some further refinements that will contribute to achieve the defined goals, in particular concerning the Pension Benefit Statement.

On the solvency side, we all recognised that further work was needed to develop a robust and tested proposal.

Recently EIOPA published a consultation paper on further technical work on the holistic balance sheet to gather input from stakeholders. The paper constitutes a further step in EIOPA's work on a risk-based framework for occupational pension funds. EIOPA is undertaking this work on its own initiative, in its role as independent advisor to the European political institutions.

The consultation paper proposes improved definitions and methodologies to value the holistic balance sheet, covering areas such as the valuation of sponsor support, the benefit reduction mechanisms and discretionary decision-making processes and the definition of contract boundaries.

Most importantly, the paper consults on different possible uses of the holistic balance sheet within a supervisory framework, ranging from an instrument to establish funding requirements to a risk-management and transparency tool to assess the long-term sustainability of IORPs.

The scope of this consultation paper is broader than previous work done by EIOPA in this area. There are indeed various ways to shape a market-consistent and risk-based supervisory framework.

The consultation paper not only considers the holistic balance sheet being used to set solvency capital requirements at the EU level, but also to establish minimum funding requirements and as a risk management tool to assess the sustainability of pension funds.

I would like to emphasise that using the holistic balance sheet as a risk management tool should in my view not be a requirement without consequences. First of all, the outcomes of assessments should be disclosed to raise awareness about the financial situation of the pension fund and, where necessary, stimulate reforms. Secondly, if it was concluded that the pension fund is providing unsustainable pension promises, I believe that national supervisory authorities should be empowered to take supervisory action, using a flexible approach.

We are not promoting an EU 'one size fits all' approach. A common prudential regime should have built-in flexibility to deal with a wide range of occupational pension schemes in Member States.

I would like to emphasize that any supervisory framework should in my view be sufficiently flexible to also avoid short-term, pro-cyclical investment behaviour of pension funds during adverse market developments.

It is also essential for me that the holistic balance sheet can be implemented in a proportionate way and without imposing high costs on pension funds. The consultation paper proposes that pension funds with strong sponsors may establish the value of sponsor support as a ‘balancing item’. I am convinced that such an approach will considerably simplify the valuation of the holistic balance sheet for a large number of pension funds. In addition, it provides the right incentives by requiring pension funds with weak sponsors to do more detailed assessments.

The further work on the holistic balance sheet has to be tested through a quantitative assessment. EIOPA expects to publish draft technical specifications for such an assessment by early 2015. Our final aim is to deliver robust, tested proposals to the EU political institutions by the end of 2015, beginning of 2016.

I want to thank all stakeholders for the level of engagement and contributions received in our previous consultations.

I believe that we showed that we take consultations seriously and that we are ready to listen, discuss and evolve in our proposals, remaining faithful to our vision, but using pragmatic and proportionate solutions.

Please continue to engage with us in this important consultation. Your views, positions and suggestions will be duly considered and will increase the quality of our work and its adherence to reality.

Remaining vigilant to the risk of financial instability is important as well to EIOPA.

One of the lessons from the recent global financial crisis is the need to understand and assess the interplay between the financial sector and economic stability as well as the transmission mechanisms between different market participants.

Recent events have highlighted the need for supervisors to remain vigilant about systemic risk and the importance of expanding the scope of stress tests.

EIOPA is now preparing a pensions stress test. We are taking a two-stage approach: preparatory work in 2014 and running the stress test in 2015.

Our aim is to develop a stress test framework that is appropriate and suitable for pension funds.

An important part of the preparatory work is to gain insight in the role of IOPRs in financial stability. To analyse transmission channels of IORPs to financial markets, EIOPA started a data collection exercise covering a sample of defined benefit, hybrid and defined contribution schemes in Member States with a significant IORP sector.

This exercise will allow us to assess the pro-cyclicality of pension funds investment behaviour during the past decade, including the financial crisis in 2008.

We would be very grateful for the participation of pension funds in this exercise.

The stress test will assess the resilience and the behaviour of IORPs in adverse market developments, such as a prolonged low interest environment or a sudden material reassessment of risk premia. It will also incorporate stresses in longevity as one of the major risks in pension funds overall financial condition.

Our intention is that the pension stress test will cover IORPs that provide defined benefit schemes as well as the ones that finance hybrid or defined contribution plans. We will conduct the stress test in parallel with the quantitative assessment on the solvency side in order to avoid the duplication of calculations. This will limit to the extent possible the burden on pension funds and supervisory authorities.

But our work on delivering on the three objectives mentioned before is also more and more focused on defined contribution plans.

We are looking at costs and charges in the occupational defined contribution world and at different best practices to establish default options.

As part of the construction of a more integrated Europe we all should show readiness to implement a truly internal market for private pensions.

EU citizens are increasingly mobile: 6.6 million EU citizens live and work in a member state other than their own. That is already 3.1% of workers in the EU.

A further 1.2 million live in one EU country but work in another. How many of these millions have been able easily to transfer their pension rights? How many of their employers have been able easily to establish a pan-European pension scheme?

Of course, questions of cross-border pension rights are not the only issue which determines whether someone works in another Member State. But they may play an increasing role in whether or not a citizen can stay for the long term in another Member State. And even if it is not the primary consideration in deciding to work abroad, the individual should be able to avail of coherent and continuing pension arrangements while abroad. And those arrangements should be similar to the way that can be achieved by staying at home.

An important step towards facilitating worker mobility in the EU was taken earlier this year when the European Parliament and the Council adopted the 'Directive on minimum requirements for enhancing worker mobility by improving the acquisition and preservation of supplementary pension rights’.

The Directive does not foresee any minimum requirements concerning the transferability of supplementary pension rights. Nevertheless, pension transferability remains an important aspect of worker mobility, and Member States are encouraged to improve the transferability of vested pension rights.

In this context, EIOPA received last June a formal Call for Advice from the Commission to provide an overview of the existing arrangements for transfers of acquired supplementary pension rights between occupational pension schemes in different Member States. In addition, the Commission asked EIOPA to highlight any good practices related to the transfers of acquired supplementary pension rights as well as identify the main obstacles/difficulties affecting (or preventing) transfer, both within countries and across borders.

EIOPA will provide its response to the Commission's Call for Advice by the middle of next year.

Finally EIOPA is also working on personal pensions. Following the publication of our preliminary report "Towards an EU single market for personal pensions", EIOPA received last July a Call for Advice from the Commission with a view to support the development of an EU-wide framework for personal pension products.

EIOPA will explore how the development of simple, standardised and fully transparent personal pension products could help to reduce costs and mitigate miss-selling. We are also keen on finding a proportionate regulatory treatment to these products to ensure that there are no “excessive burdens” for market participants.

A single market for personal pensions can be advantageous for consumers, providers, and for the broader EU economy. EU citizens will have the opportunity to participate in different schemes across Europe according to their preferences and needs, in particular with respect to investment strategies.

Developing a truly internal market for pensions can increase member protection, transparency and be the catalyst for better outcomes for citizens, through economies of scale. Pension providers will also have the opportunity to achieve economies of scale, especially in the case of standardised products, which allow for successful cross-border selling. Overall, the EU economy could benefit from personal pensions becoming a main driver for sustainable long-term investments, contributing to the Capital Markets Union.

As you see EIOPA has a clear vision on pensions, important objectives to achieve and a comprehensive work plan for the coming years.

We will continue to extensively involve our Occupational Pension Stakeholder Group that gives an excellent contribution to EIOPA, by providing advice and challenge in a cooperative way.

We will continue to engage with all stakeholders in a clear and transparent manner.

To conclude, creating sustainable and adequate pension systems will be one of the major challenges for Europe in the coming years. It is a goal worthy of all the efforts. At the EU level, EIOPA will continue in its efforts to ensure that:

- EU citizens are well informed about their private pension schemes, get a fair deal and can trust that the promises made to them will be fulfilled;
- Financial markets are stable and resilient to shock;
- The internal market is well-functioning and contributes to a strong EU economy.

EIOPA is committed to creating a sustainable, safe and adequate pension system through a robust and proportionate EU regulatory framework. Not for the sake of regulations or supervision, these are only tools for a more important goal: creating real benefits for the EU, its economy, businesses and citizens.

When will we witness a sustainable, safe and adequate European pension system? I don’t know. Progress may happen slower than we wish, but when it happens it might go much faster than we expected.

I like to end by quoting Barack Obama who said: “If you're walking down the right path and you're willing to keep walking, eventually you'll make progress”.

Thank you.