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KEYNOTE ADDRESS

EIOPA'S INITIATIVES TO EMPOWER THE PENSIONS SECTOR

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

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Ladies and Gentlemen,

First of all, thank you very much for the invitation to speak at today's Handelsblatt conference. This is always an interesting event and it is my pleasure to be here again this year.

Pensions should provide Europeans with an adequate income in retirement and are there to allow people to enjoy decent living standards after the active employment. However, nowadays Europe faces **severe concerns about sustainability and adequacy of pensions** which forces all of us to re-examine the retirement strategies. **We need to respond and act promptly. Why?**

Demographic and labour market changes challenge national pensions systems, as well as put pressure on national budgets. National pensions systems more and more rely on supplementary private pensions but traditional employment-based pensions systems are not **necessarily prepared to support the changing environment** of the labour market and **cannot cater for unemployed, entrepreneurs or mobile workers**. Traditional patterns where the resources to pensioners were transferred from workers can therefore not be the only solution anymore. It's clear that in order to address these pertinent problems, we need **occupational and personal pension schemes.**

But, **Institutions for Occupational Retirement Provision (IORPs)** also experience a **challenging economic environment**, including falling asset values and bond yields in an extremely low interest rate environment. Pension liabilities have significantly outgrown related assets.

In my intervention today, I would like to address the following topics:

- First, I will talk about the need to **promote consistency and supervisory convergence** in key areas of the European regulation of pension funds, particularly in the area of **risk assessment** and **transparency of Defined Benefit schemes**
- Second, I will give a brief preview of the **upcoming IORP stress test** that provides an up-to-date view of the vulnerabilities of the occupational pensions sector in Europe

- Third, I will elaborate on **EIOPA's initiative relating to the 2nd regime for Defined Contribution Occupational Pensions Schemes**
- Finally, I will conclude with EIOPA's work on private pensions and the **PEPP, a pan-European Personal Pension Product**

Ladies and Gentlemen, let me start with EIOPA's recommendations to enhance risk assessment and transparency for Defined Benefit pension funds.

The low interest rate environment and rising life expectancy have put the funding position of Defined Benefit schemes under severe pressure. It has increased the costs of providing life-long pension guarantees, thereby straining their affordability and sustainability. According to the quantitative assessment conducted by EIOPA in 2015, aggregate deficits of European Defined Benefit pension funds amount to 1,200 billion euros under a common more realistic valuation basis. European companies will have to pay the greater part of these shortfalls, while at some stage in the future the remainder will be borne by pension scheme members and beneficiaries through reductions of their pension benefits.

To support the occupational pensions sector in addressing these current and future challenges, there is a **clear need to modernise the European regulation of pension funds**. In April last year, EIOPA issued its **Opinion on a Common Framework for Risk Assessment and Transparency for IORPs** to the European Union institutions. The Opinion recommends strengthening risk assessment and transparency in Pillar II and Pillar III of the IORP Directive, while maintaining existing funding requirements in Pillar I at this point in time.

The **key elements** of the **proposed common framework** are:

- Pension funds to establish a **market-consistent balance sheet** which includes all available security and benefit adjustment mechanisms, such as sponsor support, pension protection schemes and benefit reductions
- Pension funds to conduct a **standardised risk assessment** on a regular basis, applying common, pre-defined stress scenarios to the balance sheet

- Pension funds to **publicly disclose the balance sheet information** and the **main outcomes of the risk assessment**, accompanied by appropriate explanation
- National Supervisory Authorities to be provided with sufficient powers to take **supervisory actions in response to the conclusions of the risk assessment**

To minimise the burden on smaller IORPs, it is important that the standardised risk assessment is applied in a **proportionate manner**, allowing for simplified methods and approaches. EIOPA's proposals also allow to exempt small IORPs and to lower the frequency of their risk assessment from annually to once every three years.

I believe these proposals constitute a **major step forward towards realistic, risk-sensitive information on the financial situation of pension funds**. The common framework provides for a better understanding of the risks and vulnerabilities of pension funds, stimulating a dialogue between the social partners on timely reform measures and contributing to the **resilience and sustainability of Defined Benefit schemes**.

Let me be clear, EIOPA's recommendations were not intended to be already taken into account in last year's revision of the IORP Directive. However, we encourage Member States to consider the **common framework for risk assessment and transparency in view of the current implementation of IORP II**.

The IORP II Directive which entered into force in January this year and requires Member States to apply it in two years' time is a step forward.

IORP II addresses a number of areas that are important to promote occupational pensions and that enable IORPs to generate good outcomes for their members and beneficiaries.

Here I want to highlight **two key policy areas** which are of particular importance in facilitating efficiency gains through a European approach:

- **Streamlining** the **authorisation of cross-border IORPs** and **transfers**

- **Promoting consistency and supervisory convergence** in key areas, such as **transparency**, including information to members and beneficiaries, **governance requirements** and **risk management**

Currently the occupational pensions' landscape with 79 active cross-border IORPs in Europe has a strongly heterogeneous character. One of the crucial tasks of EIOPA will be to take a more active role in **supporting the authorisation and setting up of cross-border IORPs**. EIOPA welcomes the **express right to mediate in more complicated cases**.

EIOPA has been **promoting more transparency in the pensions sector** and will **further research good practices at national level to support relevant national implementations and consistency of information to empower national and European pensions tracking services**. In terms of information regarding the pension promises, clear **transparency about cost and charges, performance and pension projections is of paramount importance**.

For the occupational pensions sector and in line with the political agreement on IORP II we believe that **IORPs can be strengthened to deliver better outcomes for members and beneficiaries by**:

(1) **Using the internal market:** Setting up cross-border IORPs should bring economies of scales by extending the **funding pool and cost efficiencies** by streamlining administrative costs.

(2) **Enabling IORPs** via good governance and risk management, **to invest in the best interest of members and beneficiaries**. Promoting sustainable investments, considering factors like environmental or social impacts of those investments, is natural to the business of providing retirement income.

(3) **Being transparent:** This is about **comparable and relevant information to current and future members and beneficiaries**, but also about **relevant data to be submitted to supervisors** and **regulators**. More **analysis on the macro- and micro-impact of pension funds on the real economy, financial markets and financial stability** is needed.

IORP II provides **a good basis** to tackle another challenge, which is the often unavoidable **shift from Defined Benefit to Defined Contribution**. We believe this shift should be designed as a beneficial one for future and current members. **Improving the risk management, exploring options for risk sharing, promoting intergenerational fairness and sustainable investments, taking into account environmental, social, governance factors, shall prepare European IORPs for the future.**

In the current reforms of the pensions sector, where there is a move from guarantees to protections, elements such as governance and transparency gain an even greater importance.

Let me continue with the **second pensions' stress test** being conducted by EIOPA this year. This stress test will provide an up-to-date view of the risks and vulnerabilities facing the **occupational pensions sector**. An important aim is also to deepen our understanding of the effects on financial stability and the real economy, like the impact on sponsoring companies.

Similarly to the first stress test in 2015, this year's pensions stress test will constitute a **European-wide exercise**, including all countries in the European Economic Area with material IORP sectors and covering both Defined Benefit as well as Defined Contribution schemes.

The main objectives of the stress test are:

(1) To assess **the resilience of IORPs to an adverse market scenario** developed in cooperation with the European Systemic Risk Board (ESRB)

(2) To analyse the **transmission mechanisms of pension funds** towards the real economy – through sponsor support and benefit adjustments - and financial markets

Defined Benefit pension funds have to apply the adverse scenario to the national balance sheet, to assess compliance with funding requirements, and the common framework's, market-consistent balance sheet to obtain a realistic and comparable view of their financial situation. Elaborating on the 2015 exercise, **the Defined Benefit-part of the stress test will consider the impact on the real economy by analysing to what extent national**

prudential mechanisms allow for the absorption of shocks over time and by **assessing the impact on sponsoring companies**.

Defined Contribution pension funds have to calculate the effect of the adverse market scenario on the **market value of assets**. In addition, the **Defined Contribution-part of the stress test will estimate the impact of the scenario on future retirement income of plan members** and, hence, the real economy.

Occupational pension funds are large institutional investors with assets in the European Economic Area amounting to almost 3,600 billion euro. This means that IORPs may not only affect the real economy, but also financial markets through buying and selling of assets. The 2017 stress test will analyse **expected short-term and longer-term investment behaviour of participating pension funds**, assuming that lower asset prices and lower-for-longer interest rates are a prolonged reality.

The 2017 pensions' stress test will be launched mid-May. And please allow me to make use of this opportunity to call upon **the German *Pensionskassen* and *Pensionsfonds*** to take part in this important exercise.

Let me come to my third point: **The 2nd regime for Defined Contribution Occupational Pensions Schemes**

Looking forward, a further important step would be the design of **a simple and transparent 2nd regime for Defined Contribution Occupational Pensions Schemes.** This framework should be capable to take full advantage of the potential of the European Union internal market, by providing a cross-border platform which European companies could use to manage the retirement plans of their employees, reduce costs, support long-term funding of the European Union economy and ultimately deliver better pension outcomes.

There is evidence of market fragmentation in occupational pensions at a European level. Cross-border IORPs remain clustered to 17 host Member States and 8 home Member States.

The framework could significantly improve the functioning of the **internal market by strengthening the role, development and geographical spread of cross-border Defined Contribution pensions across the**

European Union as well as help European companies and pension funds to manage more effectively the occupational Defined Contributions pensions of their employees based in several locations of the European Union.

It could also bring access to retirement saving to some employees for the first time. Last but not least, the framework could help **unlock capital markets by providing a critical mass of investments** at a pan-European level which support the long-term funding of the European Union economy, as well as deliver better pension outcomes for European employees.

Building on IORP II, EIOPA is currently developing **first ideas on the components of this framework and on the design of potential scheme solutions** that, while allowing the control of costs by sponsors, would mitigate for the members the increased risks coming from the move towards pure Defined Contribution plans.

To develop appropriate proposals, EIOPA has launched a **survey to gauge stakeholders' views** for creating a framework. I would like to invite all interested parties to visit the EIOPA website and provide their feedback **by 4 April.**

Finally, let me turn to my last point: EIOPA's work on private pensions and PEPP, a pan-European Personal Pension Product

In response to the European Commission's Call for Advice, EIOPA issued its advice on how to develop a European Union Single Market **for personal pension products**. Personal pension savings will only deliver on the promise of enabling adequate replacement rates in the future, if those **products are fair and savings are safe** - in the sense of **trustworthiness -, cost-effective and transparent**, as well as **sufficiently flexible to cater for a European labour market.**

EIOPA developed the idea and the regulatory outline to create **an attractive Pan-European Personal Pension Product (PEPP) in the form of a 2nd regime personal pension product**. This PEPP exhibits standardised features taking into account the specific objective of a personal pension product to provide for future retirement income, alongside some flexible elements taking into account national specificities. PEPP is a powerful tool to **encourage personal pension savings** and to enable **important long-term**

investments. We proposed a number of standardised and flexible features for the PEPP:

- **Standardised information provision**
- **Standardised limited investment choices**, with one core „default" investment option, where the investment strategy takes into account the link between accumulation and decumulation
- **Regulated, flexible caps on costs and charges**
- **Flexible biometric and financial guarantees**

I believe that life-long annuities should play role in the decumulation phase of the PEPP. Nevertheless, the decumulation phase should be more tailored to the personal circumstances and needs of the consumer, allowing him more flexibility and choice. **There is a large room for innovation in this area.**

The PEPP should have a **long-term perspective in its investment policy** to better reflect the long-term nature of retirement savings. This is particularly welcomed from a macro-perspective because long-term investors are needed to provide stable funding to the European Union economy. In order to allow this long-term investment horizon, the **PEPP should envisage minimum holding periods to mitigate the surrender risk**. **Sustainable investment in illiquid assets should match liabilities with a correspondent illiquid profile**. **Furthermore, a key element for the success of the PEPP is the tax regime applicable. We believe that the PEPP should have the same tax advantages than the national personal pension products.**

The PEPP should consider pure individual Defined Contribution Schemes with lifecycle investment strategies designed to adjust investment risk throughout the live of the contract, thus reducing risk for members, but also collective Profit Sharing Products allowing the **pooling of investments** with the smoothing of returns across members of the pool, so that all members benefit from **average long-term returns** of the fund and are **protected from extremely negative outcomes** in stressed market situations.

The design of the PEPP need to ensure conditions to allow European Union citizens to invest in a balanced portfolio including assets such as **equities, property, infrastructure and green technologies**. With the appropriate safeguards, this will provide a good chance to accumulate a pension that outperforms inflation and grows to levels that can provide a decent standard of living. Finally, the PEPP need to be designed in a way to ensure the **highest standards in transparency, fairness, governance and risk management**.

In particular, the transparency of the PEPP towards the European Union citizens could be greatly enhanced with the development and maintenance of a centralized information system by EIOPA providing **online updated and easily accessible information of the costs, risks and returns** of **all PEPP's sold** throughout the European Union.

As for the next steps, the European Commission is preparing a legislative proposal on the PEPP to be launched still this year.

Conclusion

Ladies and Gentlemen, it is of utmost importance that retirement savings are based on truly long-term strategies, and that pension plans offered to European citizens are fair and cost-effective.

EIOPA's proposals are stemming from this principle. Our aim is to have European companies and pension funds that efficiently manage the retirement plans of their employees, reduce costs, support long-term funding of the European Union economy and ultimately deliver better pension outcomes.

IORP II is an extremely important step in modernising the pensions sector. EIOPA believes that enhanced **risk assessment**, more **transparency** and **cross-border solutions** in the pensions sector are required.

We should all **be committed to deliver better pension outcomes to European citizens**.

Thank you for your attention.