Keynote Address

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Sustainable finance – sustainable pensions?

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

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Ladies and Gentlemen,

Good morning and thank you for the invitation. It is a great pleasure for me to be here again, a good opportunity to take stock of progress made by governments, regulators and the industry since last year's conference. The focus of my intervention today is "sustainability" – does sustainable finance mean sustainable pensions? In this context I will provide an update on EIOPA's recent and ongoing activities such as the occupational pensions' stress test, the supervisory expectations for the implementation of the IORP II Directive, EIOPA's activities to improve the European occupational pensions' statistics and data relevant for financial stability analyses – as well as the Pan-European Personal Pension product.

But let me start with a short reflection on the reality which we are facing from a pensions' perspective. Living considerably longer than ever before is certainly a positive fact, but at the same time this presents a number of challenges and opens up questions how to reserve for retirement. Projections show that there will be fewer and fewer people paying into the pensions systems to support an ever-increasing number of pensioners. People living longer and low birth rates in developed countries, paired with low interest rates, mean that there is pressure on any pensions system, as funds have to cater for much longer periods of time.

For a number of years, the growing gap between what people perceive as what they will receive as retirement income and what they will actually receive – as well as the basic adequacy of retirement income – has been on the agenda of governments, policy makers and regulators. There have been a number of studies showing that in Europe, yet also in many other developed and developing countries, not just the pensions gap, but also the **funding gap of pension funds, is increasing and will be hard to close**. Recent corporate failings showed the impact on the safety of individuals' future retirement income in case of significant underfunding of pension funds.

The outlook on the sustainability of pension promises, from state, occupational pension funds or private savings, is anything but comforting.

Last year, EIOPA carried out a **stress test of Institutions for Occupational Retirement Provision** (IORPs), which assessed the resilience of 195 European pension funds from twenty countries to a severe, yet plausible, 'double hit' stressed market scenario. The scenario combined a drop in risk-free interest rates with a fall in the price of assets held by IORPs. The exercise also assessed the potential transfer of shocks from IORPs to the real economy and financial stability through sponsor support and benefit reductions.

The stress test revealed that the challenging market environment has taken its toll on the sector and has put funding positions of defined benefit IORPs under severe pressure, resulting in substantial shortfalls even under pre-stress conditions. The results showed that the European defined benefit occupational pension sector has, on average, insufficient assets to meet pension liabilities on the national balance sheet, both in the baseline and adverse market scenario. The shortfalls on the common balance sheet - EUR 349 billion in the baseline and EUR 702 billion in the adverse scenario - would need to be covered by increased sponsor support and/or by benefit reductions. The vulnerabilities increased when applying a common, market-consistent valuation.

The defined contribution IORP sector would experience a drop in asset values in the adverse scenario, reducing the individual accounts of defined contribution members and, if the scenario persists, leading to significantly lower future retirement income.

Concluding, sponsors of over a quarter of IORPs might face severe challenges meeting their obligations, so the pensions sector's vulnerabilities could spill-over to the real economy either through the adverse impact on sponsors and/or on beneficiaries through benefit reductions. Whilst national recovery mechanisms mitigate the short-term effects on financial stability, in the longer-term the burden of restoring the sustainability of pension promises will affect younger generations disproportionately.

So, how to go about these challenges? Can we make pensions safer and more sustainable to reduce the burden for younger generations?

There is a lot in front of us but the first step in the right direction will be the effective implementation of the IORP II Directive.

The IORP II Directive, which will be transposed into national law by January 2019, will strengthen IORPs' regulatory framework to bring benefits 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 therewith cost efficiencies** by streamlining administrative costs. As part of the IORP II implementation, EIOPA is already reviewing the Budapest Protocol that promotes the cooperation between national supervisory authorities,

which will also improve procedural efficiency and transparency for cross-border activities and transfers.

(2) **Enabling IORPs** via good governance and risk management, **to invest in the best interest of members and beneficiaries**. Promoting sustainable investments, considering environmental or social impacts of those investments, is natural to the business of providing retirement income. The occupational pension sector with its long-term obligations and its corresponding long-term investment horizon is most affected by risks stemming from unsustainable asset classes and bears a social responsibility to assess environmental, social and governance factors. As of next year Member States will require from IORPs to explicitly disclose how such factors are considered in their investment strategies. EIOPA also sets high expectations on the effective implementation of the IORP II Directive's provisions aimed at enhancing the risk management and investment governance with regards to ESG.

(3) **Being transparent:** This means that IORPs have to provide **comparable and relevant information to current and future members and beneficiaries**, but also submit **relevant data 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.

In 2018, EIOPA will also be focusing on the following tasks contributing to securing the **future sustainability of pensions** while taking into account the protection of pensions' scheme members:

- We will **continue developing regulatory work** arising from IORP II requirements in areas such as information to members, governance and the evaluation of risks.
- Our goal is to ensure the **smooth and consistent implementation of new requirements**, **provide national supervisory authorities with practical solutions**, **stimulating consistent, efficient and effective supervisory practices across the European Union**. We will be using relevant recommendations from past peer reviews on the supervisory practices with respect to the conditions of operation of IORPs and the Statement of Investment Policy Principles which identified gaps that could be addressed during the implementation of the IORP II Directive.

- EIOPA will also further **pursue its recommendation for a common framework for risk assessment and transparency,** providing a **realistic and risk-sensitive view of the sustainability of defined benefit promises**. We will consider, in close cooperation with the national authorities, how the common framework can assist and contribute **to strengthening national supervision**.
- Fostering the take-up of the **common framework in national supervision** we will **facilitate EIOPA's biennial EU-wide stress tests** of the occupational pensions sector by establishing a common, market-consistent language. This year we will start preparing for the 2019 occupational pensions stress test. In designing next year's stress test, EIOPA will also explore the best way to consider risks from investing in 'brown' or stranded assets, as well as risks from climate change.
- The on-going shift from Defined Benefit to Defined Contribution, accelerated by the low-interest rates and the pressure on sponsors, and supported by recent pension reforms in Europe, shifts investment risks – and often the burden on investment decisions - on members of pension funds. Therefore, the **provision of relevant information** to members and beneficiaries, together with **appropriate governance structures for pension funds**, tailored to Defined Contribution structures, are **high up in EIOPA's strategic business priorities for 2018.**
- EIOPA will also be focusing on **enhancing the availability of occupational pensions' data at European level** by developing **one single framework** where regular annual and quarterly information is requested from national supervisory authorities. **High quality data is essential for EIOPA to take informed policy decisions, to effectively monitor and analyse the situation of the European occupational pensions sector, to highlight potential gaps and corresponding risks as well as to advise on required actions**. Currently, we are issuing regular and ad-hoc reporting requests such as the provision of information for the bi-annual Financial Stability Report, the annual Market Developments Report on occupational pensions, the annual Consumer Trends Report, the pension register, the pension database and the data gathered during ad-hoc surveys.
- In order to **further enhance EIOPA's monitoring and assessment of market developments** in the occupational pensions sector to foster the protection of pension scheme members and beneficiaries, to undertake

economic analysis and to properly analyse financial stability implications**, EIOPA developed a relevant, yet fairly limited, reporting set of Institutions for Occupational Retirement Provisions' data.** The pensions' data framework will be broadly aligned with similar European and international reporting standards - like the European Central Bank, Eurostat, the Organisation for Economic Co-operation and Development - to ensure an efficient use of information. The work is based on a public consultation that EIOPA conducted between 26 July and 27 October 2017. Addressing the comments from the public consultation, we have developed a proportionate approach to small IORPs and have been looking into further streamlining the package. We are planning to finalise the requirements in the second quarter this year, using the same reporting timeline as the European Central Bank, which published its Regulation last month. The first quarterly data to be reported will refer to the third quarter of 2019 and the first annual data to end 2019.

To find relevant solutions to the challenges European pensions face, one needs to seriously appreciate the different starting points of the European Member States: there are a number of countries that do not have any – or only a few – occupational pension funds, some of the countries have fairly young pension markets and state or occupational pensions rely on employers and employed citizens contributing to the systems, whereas the workforce is increasingly mobile and is more and more characterised by unconventional careers.

That is why EIOPA is convinced that a **Pan-European Personal Pension product (PEPP)** is a promising legislative initiative, and **if successfully implemented it will be a tangible improvement for the European citizens.**

Personal pension products often have suffered from being perceived as too costly, too in-transparent and too complex to make them a savings option for the majority of consumers, and in particular for those with limited available income to save for future retirement income. PEPP is designed to be a safe, transparent and cost-effective long-term retirement savings product that will offer pensions savers new opportunities to strengthen their future retirement income within a European personal pension framework. It is a powerful tool to encourage personal pension savings for individuals and to enable important long-term investments. The building blocks of PEPP, in particular the standardised elements shall ensure to reap economies of scale and help to increase transparency and consumers' trust. Further, it will provide a level playing field for providers, encourage competition, increase trust among consumers and cater for the European labour market. The PEPP will not replace existing national personal schemes, but will be a complimentary regime alongside national regimes.

According to the European Commission's proposal, EIOPA would take on the **responsibility in ensuring fully consistent quality criteria for the authorisation, licensing and therewith pass-porting of PEPP**.

EIOPA's mandate to promote supervisory convergence throughout Europe, close cooperation with and amongst national supervisory authorities is of paramount importance for the proper functioning of the European internal market. EIOPA is of the view that a stronger coordination and collaboration in view of the development of supervisory plans and approaches for PEPPs is needed to support the initiative of a truly pan-European product.

For EIOPA setting consistently **high-quality standards for the authorisation of PEPPs** is key to the success of PEPP in terms of consumer's acceptance and promoting trust in PEPPs. Further, standardised, comparable and relevant information about available PEPPs need to **be easily accessible to consumers** to help them make well-informed and conscious decisions about their plans to save for retirement.

The information about PEPPs needs to be relevant. Therefore further **development of pension-related disclosures for the pre-contractual and the regular benefit statements** is needed. EIOPA welcomed the initiative by the European Commission to explore the best way to proceed to collect, analyse and report on cost and performance indicators of the main long-term investments personal and pension products. Outcomes of this initiative will enhance the proposed disclosure requirements for PEPP.

Similarly, the supervisors will need to receive relevant information about PEPP providers and products to enable consistency and transparency. Therefore, the development of standards around reporting to the supervisors will be equally important.

Ladies and Gentlemen,

Although the European Member States are at different starting points as regards pensions systems, the challenges of rapidly ageing populations and low interest rates environment are common. **The European pensions sector is under pressure to address urgently its challenges and to promote sustainable pension promises.**

Let's be realistic**. Challenges need to be faced and decisions to be taken sooner than later**. Members of the schemes and beneficiaries should be entitled to receive a fair and adequate level of protection across the European Union.

EIOPA is there **to bring the benefit of providing the European perspective**, **to develop legislative initiatives that support the pensions sector to become stronger** and **to make sure that the existing systems and regulations work best for consumers.**

We believe that a tool box of efficient risk management, improved funding, tailored systems of governance, a proper assessment of sustainable finances – together with the introduction PEPP, will contribute to make European pensions future-proof.

Thank you for your attention. I am now happy to answer your questions.