



EIOPA-OPSG-14-07

26 November 2014

OPSG Feedback Statement - proportionality principle in the context of the new Proposal for a Directive on IORPs

1. Context

The OPSG in its meeting of 7 July 2014 decided to have a look at the proportionality principle in the context of the new Proposal for a Directive on IORPs .

The OPSG meeting of 15 October 2014 discussed a draft statement that has been amended following the considerations made at that meeting.

The document will be referred as a feedback statement.

2. Proportionality , a core principle in EU law

“Proportionality” is a core principle of EU legislation as enshrined in art. 5.1 of the TEU. It is an over-arching principle – often used in conjunction with “subsidiarity” but with a meaning of its own. Art. 5.4 tries to define the concept : “Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties”.

Protocol n° 2 on the application of the principles of subsidiarity and proportionality to the TEU and the TFEU, in its art. 1 requires “constant respect” for the principle of proportionality. Art. 2 imposes that the Commission before proposing legislative acts, shall “consult widely” while taking into account the regional and local dimension of the action envisaged.

Both these articles of constitutional EU law demonstrate that proportionality is a core principle that requires to be applied in every single EU legislative action, including also quasi legislation such as technical standards and guidelines from prudential supervisors.

Commission President, Jean-Claude JUNKER, puts it at the core of the work of the upcoming Commission.

In his Mission Letters to the incoming Commissioners we read:

“Respect for the principles of subsidiarity, **proportionality**¹ and better regulation will be at the core of the work of the new Commission. We will concentrate our efforts on those areas where only joint action at European level can deliver the desired results. When we act, **we will always look for the most efficient and least burdensome approach**. Beyond these areas, we should leave action to the Member States where they are more legitimate and better equipped to give effective policy responses at national, regional or local level. “

3. How to apply proportionality and its objectives

The principle applies to:

- the overall Directive, not only to those articles with explicit or implicit reference to proportionality.
- Commission must ensure proportionality is applied in Delegated Acts
- EIOPA must ensure application when developing (Implementing and Regulatory) Technical Standards , endorsed by Commission
- EIOPA must ensure application in its Guidelines and Recommendations.
- Member States must apply proportionality in the implementing legislation
- the exercise of supervisory powers – both EU level (EIOPA) and national one (Competent Authorities) must apply proportionality.

The **objectives** of considering proportionality can be seen as being the following: ensure that the regime

- is not too burdensome for SME’s by taking account of the **nature, scale and complexity** of the business
- takes account of the particular nature of specific institutions/industries, e.g. corporate IORPs, DC schemes, DB schemes

4. Proportionality applied to IORP II - general

The Explanatory Memorandum affirms that the “Proposal complies with the principle of proportionality, (.....).The selected policy options seek to strike a balance between public interest, the protection of members & beneficiaries, as well as the costs for institutions, sponsors and supervisors. The options have been carefully considered, crafted as minimum standards and tailored taken into account different business models. This is why, overall, the proposal will stimulate occupational retirement provision.”². One could be sceptical about this last sentence yet this is the Commission view.

¹ Bold by author

² COM(2014)167 final, p.6, par. 3.2.

5. Specific application of proportionality in IORP II

Although being applicable throughout the Directive, the proposal explicitly mentions the proportionality requirement in a number of matters:

5.1. SMALL INSTITUTIONS (ART. 5)

As under IORP I, Member States have the option whether to apply the Directive, in whole or in part, to entities which have less than 100 members in total, except if they want to operate cross border for which case those institutions have to comply with all the provisions of the Directive.

This Article makes no explicit reference to proportionality and the exemption is applied having regard only to the scale (= head count of members) of the IORP without consideration of nature or complexity. It seems essential though to keep this rule since there are around 125.000 IORPs in the EU, the majority of which is small. *OPSG welcomes this approach.*

There have been voices advocating also other variables/criteria could be taken into account, such as assets under management.

5.2. EFFECTIVE GOVERNANCE SYSTEM (ART. 22.2 AND 22.5 REC. 36)

Article 22 establishes that institutions need to have in place an effective system of governance which provides for sound and prudent management of their activities. This system shall be **proportionate to the nature, scale and complexity**³ of the activities of the IORPs^o “as to ensure that the **governance requirements will not be too burdensome for example for small institutions**”⁴⁵.

Once again it is made clear that size is an important factor for applying proportionality.

IORPs shall also take reasonable steps to ensure continuity and regularity in the performance of their activities, including the development of contingency plans. The systems to achieve that shall be appropriate and proportionate.

5.3. REMUNERATION POLICY (ART. 24.1 AND 24.3A; REC. 37)

Rec. 37 affirms that “principles and disclosure requirements for remuneration policies applicable to other types of financial institutions (...) should be made applicable also to IORPs, bearing in mind, however, the **particular governance structure of institutions in comparison to other types of financial institutions and the need to take account of the size, nature, scope and complexity**⁶ of the activities of IORPs.”

Proportionality is explicitly applicable to the remuneration policy for those persons who effectively run the institution (art. 24.1).

It is also explicitly applicable to the remuneration policy for “key functions or any other activities, including outsourced and subsequently re-outsourced key functions” (art. 24.3a,^{4th} bullet).

³ Bold by the author

⁴ COM(2014), 167 – Explanatory Memorandum, art. 22

⁵ Bold by the author

⁶ Bold and und. by author

Art. 24.3. lists a number of principles that should underpin remuneration policies that a delegated act will further lay down in detail. It remains to be seen how the proportionality rule will be applied taking into account the nature, scale and complexity of the institutions AND of the national environment in Member States.

5.4. RISK MANAGEMENT SYSTEM (ART. 26)

According to the Commission, risk management should be improved and therefore IORPs are required to have in place an effective risk-management system as well as a ditto function.

It is suggested that under par. 2 of art. 26 “appropriately to their size” should be interpreted as or replaced with “proportionate to their size” to achieve consistency with the overall proportionality concept meaning that requirements be tailored to the size and nature, scope and complexity (= critical definitional elements for proportionality) .

OPSG suggests amending the text in that sense.

5.5. RISK EVALUATION OF PENSIONS - REF (ART. 29)-

The risk evaluation for pensions should be proportionate to the size, internal organisation and the nature, scope and complexity of the IORPs’ activities. Clearly proportionality is specifically present in this clause.

Similar to art. 26.2, art. 29.1. refers to “appropriately to their size, internal organization and the nature, scope and complexity of their activities” to define the proportionality ingredient for carrying out IORP’s own risk assessment.

Also the methods (cfr. Art. 26.3) to identify and evaluate the risks shall be proportionate to the nature, scale and complexity of the risks inherent in its activities.

OPSG thinks it is of utmost importance that proportionality is rigorously applied to this particular process. Specific attention shall be given to the delegated act (art. 30) that will further transpose the principles listed under art. 29.

5.6. DEPOSITARY (ART. 35)

The safe-keeping and oversight duties related to the assets of institutions should be strengthened, according to the Commission, by clarifying the depositary’s roles and duties. Only IORPs operating schemes where members and beneficiaries bear all the risks should be required to appoint a depositary.

Without explicitly referring to proportionality, the Commission proposal has applied it taking the view that according to the nature, scale and complexity, a different rule was to be preferred according to the degree of investment risk borne by the members, the sponsoring undertaking or the IORP respectively. The Member States have the option to require appointment of a depositary only if the members and beneficiaries do not fully bear the investment risk; otherwise, there is no option for them.

5.7. GENERAL PRINCIPLES OF PRUDENTIAL SUPERVISION (ART. 63)

As an over-arching principle for prudential supervision – both at EU and national level – art. 63.4 states : “Supervisory powers shall be applied in a timely and **proportionate** manner.” Here, more than in other dispositions, the proof of the pudding will be in the eating !

“In this context proportionality not only means that supervisory authorities are obliged to avoid making excessive demands on institutions, it also requires them to take the nature, scale and complexity of an institutions’ activities into account when taking action against the institutions, i.e. treat the institutions in a different way where this is appropriate on account of their different risk profiles, for example.

Supervisory resources are limited. In order to employ them most effectively supervisors will endeavour to divide their attention between the supervised undertakings in a proportionate manner. Risk profile, quality of the management, soundness of the financial situation and the extent to which policyholders would be affected if an undertaking were to fail are amongst the criteria that will be taken into account when supervisors decide how much attention they pay individual undertakings.”⁷

6. Points of attention

- Requirement that at least 2 persons must take up the effective management of the institution (art. 22,6)
 - Although part of the overall general governance requirements, containing in different sections reference to proportionality, one could wonder why at least two persons should effectively run the institution denying the possibility to small IORPs to work with one person to effectively run the institution.
 - There is no scope for proportionality in the propriety requirements. It is assumed that there is only one relevant level of propriety and it applies to all key functions and every institution irrespective of its risk profile. Every person who holds a key function or is effectively running the institution, should be of good repute and integrity.(art 23)
- The Pension Benefit Statement will be harmonised and leaves little room for national specificities. *There is no specific proportionality requirement for the delegated act (art. 54) which seems worrying to OPSG.*

7. Conclusion

The over-arching principle of proportionality offers opportunities to make upcoming legislation and quasi-legislation adapted to specificities of institutions as to their size, nature, scope and complexity.

Proportionality must be applied also to the benefit of the scheme members and although it is related to scale it cannot be reduced to a mathematical ratio. Size does matter to improve member outcomes and OPSG recommends to give sufficient attention to the convergence of outcomes also for smaller schemes.

The concept is vague yet potentially powerful especially if the new Commission really wants to place it at the forefront for better legislation.

⁷ CEIOPS-DOC-24/08, Advice to the European Commission on the Principle of Proportionality in the SII Framework Directive proposal, section 73