Financial Stability Report 2010
Second half-yearly report
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Introduction
CEIOPS’ Financial Stability Committee (FSC) presents its second half-yearly report on the financial conditions and financial stability of EU/EEA insurance and occupational pension fund sectors. The current report covers developments in the insurance, reinsurance and occupational pension fund markets for the periods 2008 and 2009, including observations and outlook for 2010 and beyond.

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1. SUMMARY OF MAIN ISSUES AND CONCLUSIONS

CEIOPS considers that the risks described in CEIOPS Spring Report 2010 have not significantly changed during summer 2010, i.e. the risks remain at a high level. On the one hand, market volatilities have peaked again leading to newly increased concerns about public debt and the macro-economic outlook. All in all there still is uncertainty on the future developments, specifically with regard to the development of interest rates and asset prices. Portfolios of insurance undertakings and occupational pension funds seem in general diversified. On the other hand, regarding financial market conditions, some positive signals have emerged, e.g. since recently the number of insurers on negative rating watch has decreased.

Insurance sector

In 2008 the financial market turmoil reduced demand for life insurance products significantly, and recessionary pressure on household income is expected to continue to reduce demand further throughout 2010 in many Member States. Nevertheless the developments in 2009 differ a lot between Member States and business lines, and some considerable increases in life insurance premiums can be observed in some Member States.

Solvency positions of insurance undertakings deteriorated in 2008 and some undertakings received capital injections. In 2009 solvency margins have slightly increased due to the recovery of financial markets. Few insolvencies occurred in the insurance sector, mainly of smaller undertakings indicating that most insurance undertakings’ solvency margins still include shock absorption capacity helping them to get through the recession period.

Going forward, the insurance industry as a whole faces several risks and challenges, the most prevalent of which are financial risks, in particular the risk of persistently low or even again decreasing interest rates as well as risks related to depressed equity markets and volatility of credit spreads on bond instruments. A prolonged period of economic recession would be particularly challenging for the underwriting performance.

Reinsurance sector

In 2009/2010 many reinsurers managed not only to restore their balance sheet, but to raise additional capital, leaving the industry overall well capitalised. On the other hand, 2010 has been a challenging year for reinsurers. The reduction in reinsurance rates has accelerated despite the highest level of insured losses seen in the first half of 2010 as a result of severe natural catastrophes. The second half of 2010, however, saw insured losses from natural catastrophes that were below average. With no positive outlook to grow profitability due to uneconomic rates and an investment environment, that provides an alternative between record low yielding or high risk assets, it is expected that M&A is to become again increasingly interesting.

Pension Funds sector

The recovery of financial markets, especially after the third quarter of 2009, led to relatively high investment returns, appreciation of assets and higher funding ratios of Institutions for Occupational Retirement Provisions.
The impact of the financial turmoil on the European occupational pension system had not been as severe as seen in other financial sectors, as the long term nature of the liabilities affords some protection in this respect, and IORPs had not experienced the liquidity problems seen elsewhere. However, the crisis hit pension funds primarily in their role as institutional investors and had a significant impact on consumer confidence, in those countries where occupational pensions account for a large part of retirement benefits.

Signals are mixed regarding the funding ratios of defined benefit (DB) schemes. The recent decrease in long-term interest rates has most visibly impacted funds in countries where market rates are used for discounting liabilities. In countries that use a fixed discount rate for calculating assets and liabilities, coverage ratios were not directly affected by low long-term interest rates. In some countries the funding conditions were strengthened quite substantially thus reducing the need of substantial increases in contributions or reductions in benefits. In others, some pension funds needed to increase the capital/contributions required from sponsors or to extend funding periods taking account of the underlying economic conditions. The financial turmoil directly affected the portfolio of defined contribution (DC) members, with the greatest impact being on those close to retirement and/or heavily invested in equities. However, almost all DC systems are relatively young, so the number of older workers affected is small in absolute as well as in relative (to DB schemes) terms. For those members further away from retirement age, there is a good potential to recover the losses – the recovery of equity markets in the last year has partially offset the losses experienced previously.

In response to the crisis, supervisory authorities focused on the flexibilities allowed within the framework of the IORP Directive and the different security mechanisms available. No major changes in the supervisory approaches have been reported or are expected. However some EU governments have started to consider how to induce improvements in the management of IORPs and how to reduce risks affecting members. In DC systems, a careful plan design, such as suitable default (i.e. selected automatically for a member) and life-cycle options, and the promotion of financial literacy are increasingly considered crucial to allow people to minimise the effects of the financial crisis as well as being able to make sensible and informed choices regarding their pension provisions in the future.
2. RECENT FINANCIAL MARKET DEVELOPMENTS

**Macroeconomic environment**
During the first half of 2010, both economic and financial indicators showed signs of further recovery. In several European countries, signs of economic recovery have since been reinforced by growth figures that exceeded market expectations. The outlook for future economic growth in developed counties remains uncertain, however, as governments face the task of fiscal consolidation in response to rising debt burdens. Rising government debt levels have, meanwhile, dented financial market sentiment within the Euro area during spring 2010, causing divergence in government bond yields between individual issuer countries. Although large-scale measures in support of financial stability successfully reassured markets in May 2010, this divergence has since been persistent (Figure 1).

![Figure 1: European government bond yields](image)

**Interest rates**
The sluggish and uncertain macroeconomic outlook, combined with low inflation expectations, has caused long-term interest rates to fall since the beginning of the crisis. During the course of 2010, these factors were further reinforced by increased investor demand for assets that were perceived as risk-free. These forces combined have pushed the yield on low-risk assets to historically low levels, although there has recently been a slight reversal (Figure 2 - 10 year Euro benchmark bond).

A sustained period of low long-term interest rates is especially challenging for life insurers and pension funds. These institutions typically have long-run obligations to policyholders and pensioners. These future obligations become more expensive in today’s terms when low interest rates push up the value of their liabilities. The financial position of these institutions therefore worsens, even though an increase in the value of invested assets may mitigate this effect. For life insurers, this problem can be
compounded if guaranteed return rates have been offered to policyholders.

**Figure 2: European short- and long-term interest rates**

![Interest Rates Graph](image)

Source: Datastream

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**Share prices** After their substantial contraction between autumn 2008 and the first quarter of 2009, equity markets have experienced a long-lasting rebound during the remainder of 2009 and 2010 – albeit from a low level (Figure 3). During this period, the MSCI world index recovered by 50 percent from its lowest level. The recent sovereign debt crisis has, however, halted this rebound from April onwards. Markets have since been volatile and moved mostly horizontally. As a result, European stocks underperformed vis-à-vis world markets since the beginning of 2010. Still, stock prices remain significantly above the levels seen in March 2009. Pension funds and insurance companies have benefited from the increase in stock prices through asset price revaluations. However, stock prices in most parts of the world are still well below the levels seen in 2007.
Since mid-2007, share price indices of listed life insurers fell behind the European wide share index (Figure 4). Life insurers recorded the worst equity performance in the first quarter of 2009, falling well below the DJ Euro Stoxx index. Since mid 2007 until end March 2009, European life insurers have lost more than 70 percent of their market value. This large loss is, by virtue of their business model, related to life insurers’ above average sensitivity to stock market developments, as a result of their sizeable equity investment portfolios in many Member States. A further rationale behind it is that the life insurance business is more cyclical in nature compared to for example the reinsurance sector. While European reinsurers have also taken a hit, their stock prices have generally outperformed broad indices like the DJ Euro Stoxx index. This is partly due to a risk-averse investment strategy favouring secure government bonds over equity investments. With the rebound of stock prices over the last year, European insurers have regained a sizeable part of their original market capitalisation at the beginning of 2007. However, in line with broader stock indices, their share prices have on average been stable since April.
The financial strength ratings of European insurers have been subject to more downgrades than upgrades in 2008 and 2009 (Figure 5). Since the end of 2009, the rating outlook for large insurers seems to be improving. Two have recently been upgraded to a positive outlook, while the number on negative outlook has decreased (Figure 6). Rating outlook distributions remain slightly negatively skewed, however, suggesting that financial industry analysts still forecast a challenging operating environment in the coming period.
The sharp widening of Credit Default Swaps spreads for European insurance groups towards the end of February 2009 reflected concerns about the sustainability of the global financial system. From March 2009 onwards credit spreads have come down substantially in light of the more favourable developments for the sample of large European insurance groups in recent months (see Figure 7). However, since the turmoil on sovereign markets CDS spreads have increased and stayed consistently higher for several institutions.  

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1 CDS spreads are averages of price quotes from leading CDS market makers. As with all OTC derivatives, these spreads can be driven by illiquidity.
Figure 7: Development of 5-years CDS spreads European Insurance Companies

CDS spreads European Insurance companies
July 1, 2009 - Dec. 7, 2010

Aviva
Prudential
Royal & Sun Alliance
Swiss Re
Munich re

Source: Datastream

CDS spreads European Insurance companies
July 1, 2009 - Dec. 7, 2010

Aegon
ING Insurance
AXA
SCOR
Allianz
3. Developments in the European insurance sector in 2009

Data sources
The following analysis of developments in the European insurance sector in 2009 is based on the reporting of key figures and on the qualitative reports provided by CEIOPS Members in autumn 2010. In the qualitative part of the report also developments in the first half of the year 2010 are described. In some Member States the reporting basis has changed from previous years. Not all Member States have provided a response and so the analysis refers only to available information.

MARKET TRENDS
The ratio of gross premiums to gross domestic product, an indicator of insurance penetration, is of a very different size across Member States showing only gradual change over time in total. For example in IE the penetration ratio is one of the highest, about 17 percent in total due to significant reinsurance business. In the non-life business penetration is highest in NL (due to the privatisation of health insurance in 2006).

Figure 8: Insurance penetration: Gross Written Premiums in percentage of GDP (2009)

Number of enterprises
Total insurance activity, when calculated as the number of national enterprises and branches of non-EU/EEA and of EU/EEA countries, decreased in some larger Member States (DE, NL, UK). In other Member States the number has remained at the

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2 Due to the adoption in 2008 of a new accounting regime in Portugal, on an IAS/IFRS-consistent basis, the reporting of information to the Supervisory Authority has been changed accordingly, with significant impacts on several variables. Therefore, any comparison with previously reported information (namely regarding previous Financial Stability Reports) must be performed taking the impacts of such change into consideration. The most visible impact is the fact that a large part of life business is now classified as investment contracts instead of insurance contracts (and therefore this part of the business is not included in CEIOPS’ analysis under “insurance premiums” and “technical provisions”

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same level for several years. The total number of national enterprises and branches increased from 2007 to 2008 to 5.094 and decreased in 2009 to 4.354 across Member States.

**Figure 9: Total activity per Member State**

(1) Enterprises with their head office in the country (including gross premiums written abroad)
Source: CEIOPS

Although a large number of companies have asked for authorisations to enter foreign markets through freedom of services, the actual market share of these activities abroad is almost negligible. Most of international business is still done through subsidiaries and branches. Figure 9 shows the numbers of national enterprises, branches of third countries and branches of EU/EEA countries. IS and FI have no branches, PL only two, SI has only three. The share of EU/EEA branches (number of branches/total number of enterprises) is biggest in BE, DE, ES, IT. No significant changes have been reported. However, one member (EE) reported increased expansion into neighbouring countries and one member (ES) reported increased conversion of subsidiaries into branches which means the potential risk that capital will be transferred to the parent company. In both instances a high level cooperation with home or host regulators was highlighted.

The average amount of assets per enterprise and branches seem to differ a great deal between Member States, FR and UK showing the biggest numbers in total. Looking at the life-insurance activity, the average sizes of companies and branches seem to be biggest in AT, DE, FR, IT, NL and UK.
Figure 10: Average assets per insurance enterprise and branches of non-EU/EEA countries

*The data for assets by non-EU/EEA branches is based on preliminary figures. Not all countries included assets of non-EU/EEA branches.
Source: CEIOPS

The share of these foreign branches measured in terms of gross premiums written is more than 10 percent only in CY, EE, IE, LT, LV, MT and NO (see Figure 11). The average share in the reporting Member States was 4.7 percent. The share has increased in IE and LT because foreign companies are active in these markets via branches rather than via domestic legal entities. The changes in other Member States were only moderate in 2009.

Figure 11: Share of premiums written by foreign branches (EU/EEA) in 2009*

*The data for the premiums written by foreign branches is based on preliminary figures.
Source: CEIOPS

Some Member States reported a decreased concentration (measured as gross premiums written by the three or, respectively, five largest companies as a % of total gross written premiums in the domestic sector) in 2009, although the situation was stable in most Member States. Following the recovery of equity markets and a return of confidence there is increased...
activity with respect to mergers and acquisitions, although only a limited number came to fruition.

The most prominent case was probably Prudential UK attempting to acquire the Asian insurance operations of AIG, which was subsequently abandoned. Other high profile cases include Resolution buying parts of AXA’s UK life portfolio and the joint proposal by AXA and AMP in November 2010 whereby AXA would dispose of its 54% stake in AXA APH to AMP and would acquire AXA APH Asian operations. Brit Insurance, based in the Netherlands, but operating in the UK accepted a takeover bid by Achilles, a newly formed company, owned by Apollo, a private equity fund, in October 2010. The insurance arm of Fortis, Aegas, continues to dispose foreign subsidiaries. Other Member states also reported minor merger and acquisitions activities.

Concentration is higher in life business than in non-life business. The life segment is a relatively concentrated market in CY, EE, IS, LV, MT, NO and SK whereas in the non-life business the concentration ratio is highest in EE, FI, IS, LI, LU, and SK. In the bigger Member States DE, ES, FR, IT, PL, UK as well as NL the sector is most fragmented. Figures 12 and 13 illustrate the degree of concentration across Member States for life and non-life enterprises (excluding business of composites).

**Figure 12: Concentration ratios* for life activities 2009**

![Graph showing concentration ratios for life enterprises 2009](image)

* Measured by gross written premiums of the largest 3 and 5 companies as a % of total gross written premiums in the domestic sector.

Source: CEIOPS
Premium growth (excl reinsurance) continued to drop in most countries in 2009 compared to 2008. The amount of premiums across Member states declined in total by 5.5 percent, in life on a decelerated basis by 4.3 percent and in non-life by 7.1 percent (see figure 14).

However, one third (in 2008 half) of the reporting Member states still showed an increase in 2009 in the total gross premiums written in local currency.
Europe accounts for 40 percent of worldwide premiums written in 2009 (see Figure 15).

**Figure 15: World Market shares in gross premiums written for 2009**

![Pie chart showing market shares for 2009 with 33% Americas, 40% Europe, 24% Asia, and 3% Other.](image)

Source: Swiss Re/Sigma

The risk of higher lapses – a risk which was a concern during and in the aftermath of the financial crisis – appears to have abated as most Member States reported declining or stabilising lapse rates, in particular in the first half of 2010. One Member state pointed out that the effect on a firm’s capitalisation is limited as mathematical liabilities have to be set at a minimum of the surrender value.

**Life Sector**

In the life sector developments in the national markets were not uniform. Half of the Member States reported a decline in premiums for 2009, particularly in some of the Baltic and in some Eastern European countries (BG, PL, RO and SK), as well as in BE and NL. In some countries (AT and DK) the premiums written picked up again.

Despite the difficult environment for insurers during the financial turmoil, in particular in the life segment, it appears that business models have largely remained unchanged. However, in a number of countries (AT, BE, FI) it was noted that unit-linked life policies have seen a revival in the first half of 2010 following a recovery of asset values and the return of consumer confidence in these products. In one Member State a reverse trend was observed, i.e. a strong shift away from unit-linked contracts to with-profit policies with embedded guarantees.

The banking crisis is having an impact on the distribution of life products, in particular in ES, where life policies are predominantly sold through the banking channel. As some of the existing distribution partners are being merged with other institutions, life insurers are forced to redesign their distribution channels.
The competitive landscape could also change where existing bankassurers have either decided or are compelled to sell their insurance arm (NL, UK).

**Non-Life Sector**

In the non-life sector developments in 2009 across national markets were equally not uniform. Gross premiums written declined in 2009 in nearly half of the Member States, whereas the other half reported an increase. Premium increase was highest in DE, indicating economic recovery.

In the non-life segment, which was less affected by a decline in capitalisation, continued or increasing price competition in some segments is taking place (DE, UK). On the other hand, PT reported that strong competition in the past is now forcing insurers to increase prices. ES informed of a slowing down in the strong competition trend that in the past years had led to lower prices in some lines of business.

**PROFITABILITY IN 2009**

**Combined ratio**

As to the technical result of the non-life business 15 of the Member States where information was available reported higher combined ratios (defined as claims and operating expenses divided by premiums, net of reinsurance) than in 2008.

In a number of Member states (AT, EE, FI) a lower expense trend results from cost cutting exercises. One Member observed the higher expense associated with the preparation of Solvency II and the need to monitor the situation especially for smaller insurers.
Figure 16: \textit{Net Combined Ratio*}

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>net claims</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>net expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Defined as claims and operating expenses divided by earned premiums, net of reinsurance. Total refers to unweighted average, based on sum of claims and operating expenses and sum of premiums across countries. Data excludes composite insurance undertakings.
Source: CEIOPS

\textbf{Return on equity}

The weighted average return on equity (defined as profit or loss divided by total of capital and reserves) in 2009 in the life sector was 21.2 percent (-15 percent in 2008). The corresponding figure in the non-life sector was 7.7 percent (4.2 percent in 2008) and for composite undertakings 9.9 percent (3.4 percent in 2008).

Figure 17: \textit{Return on equity 2009*}

* Defined as profit or loss divided by total of capital and reserves. Total refers to unweighted average, based on sum of profit or loss and sum of capital and reserves across countries.

In CZ most non-life business is conducted by composites. The negative return shown for non-life business relates only to undertakings that exclusively carry out non-life business. These entities only account for a market share of approx. 3.7% of gross written premiums and for approx. 6.5% of total balance sheet assets.

Source: CEIOPS
After a strong decline of stock prices amid volatile market conditions in 2008, high interest rate volatility and credit spread widening, leading to a substantial decline in investment income for insurance undertakings in 2008, conditions improved somewhat in 2009. Especially the results of the life insurance business are highly dependent on the yield of the investment portfolio. The average return on assets in the life sector was +1.4 percent, ranging from +12.5 percent in SE and +12.3 percent in IS to -0.2 percent in IE.

In the non-life business returns on assets were on average +1.5 percent, with only 2 Member states (CZ, SK) showing negative returns relating to enterprises that exclusively conduct non-life business. Returns range from +13.7 percent to -11.1 percent.

* Defined as profit or loss divided by total assets. Total refers to unweighted average, based on sum of profit or loss and sum of assets across countries.

In CZ most non-life business is conducted by composites. The negative return shown for non-life business relates only to undertakings that exclusively carry out non-life business. These entities only account for a market share of approx. 3.7% of gross written premiums and for approx. 6.5% of total balance sheet assets. (see also figure 17).

Source: CEIOPS

FINANCIAL STRENGTH

Following a decline in solvency margins at year end 2008 as a result of difficult market conditions, most Member states reported improved or even substantially higher solvency positions based on Solvency I requirements. There are also no concerns as regards the quality of capital. Given the satisfying solvency positions, most Member states do not see a need for additional capital. In terms of potential sources of capital some Members (AT, ES) highlighted occasional dependencies on potential funding from – foreign domiciled – parent companies. It was also stressed (by ES) that for insurers not listed on the stock exchange it is potentially more difficult to raise capital, if needed. PT emphasised the fact that a significant number of insurers are part of a banking group thus relying to some extent on the financial position of the banking parent.

In response to the market turmoil increased monitoring took place in a number of Member States. Stress tests, including...
providing guidance on parameters and scenarios for undertaking-specific stress tests, were also one of recommended actions for the future European Insurance and Occupational Pensions Authority (EIOPA). In addition, further research into the implications of the current low interest was suggested.

Several Member states reported that regulatory intervention was required due to undertakings not meeting solvency requirements. There was also increased monitoring of solvency levels where there was a risk of breaching minimum required capital requirements. One Member highlighted that in particular a number of smaller insurers were not able to meet minimum solvency margins and corrective actions had to be taken including the transfer of portfolios, capital raising and a change of management.

In the life sector the aggregate solvency ratio increased last year, reaching a level of 290 percent at the end of 2009 (compared to 253 percent at the end of 2008). In the life business the solvency ratio was especially high in BG and SE.

In the non-life sector the corresponding figure was 341 percent (299 percent at end 2008). The solvency ratio was above 600 percent in three reporting Member States and below 200 percent in eight other Member States.

*Defined as available solvency margin divided by required solvency margin. Total refers to unweighted average, based on sum of available solvency margin and sum of required solvency margin across countries.
Source: CEIOPS

**INVESTMENTS**

CEIOPS monitors the current asset allocation of European insurance companies closely.

The insurance sector exhibits a diversified sovereign bond portfolio across EEA countries, Japan, Switzerland and the United States, which accounts for roughly a quarter of total assets. By nature, the common currency allows for some search for yield within the Euro area, that was visible in some investment patterns with considerable holdings in cross-border sovereign
debt, issued at “average plus” yields by the end of 2009. On the other hand, non-Euro area investment-grade exposures tend to be more home biased.

The exposure towards the banking sector amounts to some fifth of total assets. About one third of this lies with secured (collateralised) bonds, which predominantly still carry a AAA rating, while bank subordinate debt and equity account for some 4% of total assets. The overall real estate exposure accounts for some 15% of total assets (including mortgage loans and covered bonds, which account for more than half of this figure).

In general, while de-risking of portfolios in the aftermath of the crises appears to continue, the overall asset allocation has not changed substantially in most Member States. In AT the exposures to structured products, property and equity assets were reduced. It was also highlighted that diversification is being monitored through regular surveys (ES).

**Figure 20: Asset allocation* for 2009**

* Investments for the benefit of policyholders who bear the investment risk are excluded. “Fixed income” covers debt securities and other fixed income securities, loans guaranteed by mortgages and other loans. “Equity” covers shares and other variable-yield securities, participating interests, investments in affiliated enterprises and participations in investment pools. Data also includes composite insurance undertakings, but excludes reinsurance undertakings.

Source: CEIOPS
DEVELOPMENTS IN 2010 AND OUTLOOK

**Low interest rate environment**

The majority of Member states stressed the risks associated with the current low interest rate environment. This is an issue for both life and non-life insurers.

- For life insurers who have embedded minimum guarantees in their life products there is a risk of negative interest margins, i.e. the bond yields being lower than the minimum guarantees. The increased appetite for unit-linked products in some Member states have enabled some insurers to switch to less capital intensive products thus alleviating some of the concerns.
- Where life insurers are required to value liabilities on a market-consistent basis lower investment returns will increase liabilities thus negatively impacting capitalisation.
- For non-life insurers, who predominantly invest in bonds, lower investment returns mean that it will be more difficult to compensate underwriting losses with investment gains.
- Reinvestment risks and a potential search for higher yields by investing in riskier assets were also highlighted by some Members.
- Two Members stressed that it is either difficult for insurers to match the duration of bonds with the duration of liabilities or there is a general duration mismatch.

**Sovereign and credit risk**

Exposure to sovereign risk was identified as a potential risk by a number of Member states and exposures are being monitored. In relation to credit risk it was also mentioned that investment guidelines very often limit the exposure to one asset class or one issuer.

Credit risk is not of major concern for most Member states as investment guidelines and the monitoring of asset portfolios limit the ability of regulated firms to incur significant risks. UK drew attention to a potential widening of credit spreads for corporate bonds, which may be harmful in particular for life insurers with annuity portfolios as this could cause a fall in asset values.

In terms of the credit risk to reinsurers, one Member stated that in life business there is a significant dependence on a few providers. Otherwise, concentration risk was not identified or mentioned as a major risk by most Member states.

**Changes in regulation**

Several Members emphasised that prior to the introduction of Solvency II no regulatory changes are planned. Three Members (FR, PT, UK) reported either forthcoming or implemented organisational changes in the supervision of insurance companies.

DE highlighted that due to a strong growth in traditional single life premiums there was risk of customer detriment and new rules were introduced to respond to this.
SUPERVISORY RISK ASSESSMENT FOR THE INSURANCE SECTOR

CEIOPS Members and Observers have been asked to assess risks and challenges, out of a list of 42 items, according to the probability of a materialisation and the impact on the national insurance market. Based on the responses from 26 Member States\(^3\), the following risks and challenges are classified as the most imminent, ranked by the product of the scores for probability and potential impact (see Table 1).

Interest rate risk (especially the low yield environment), regulatory & reporting changes (preparations for Solvency II) and the economic cycle\(^4\) are the risks with highest overall ranking. While the second item is reported as having only a medium impact, the interest rate risk is expected to have a more significant impact. Substantial impacts are also expected if higher lapse rates or a renewed increase in sovereign risks should materialise.

Table 1: Classification of most imminent risks for the insurance sector

<table>
<thead>
<tr>
<th>INSURANCE (based on 26 replies)</th>
<th>Average probability of risk</th>
<th>Average impact of risk</th>
<th>Development over the last 12 months</th>
<th>Expected development over the next 12 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>ranking based on (probability times impact)</td>
<td>1 = low 2 = medium-low 3 = medium-high 4 = high</td>
<td>1 = low 2 = medium-low 3 = medium-high 4 = high</td>
<td>-2 = cons. decrease -2 = cons. decrease</td>
<td>-2 = cons. decrease -2 = cons. decrease</td>
</tr>
<tr>
<td>Interest rate risk</td>
<td>2.7</td>
<td>3.0</td>
<td>0.8</td>
<td>0.2</td>
</tr>
<tr>
<td>Regulatory &amp; reporting changes</td>
<td>2.9</td>
<td>2.6</td>
<td>0.3</td>
<td>0.8</td>
</tr>
<tr>
<td>Economic cycle</td>
<td>2.5</td>
<td>2.7</td>
<td>0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>Lapse risk</td>
<td>2.3</td>
<td>2.6</td>
<td>0.4</td>
<td>0.0</td>
</tr>
<tr>
<td>Equity risk</td>
<td>2.4</td>
<td>2.4</td>
<td>0.1</td>
<td>0.2</td>
</tr>
<tr>
<td>Tax and pension reforms</td>
<td>2.5</td>
<td>2.2</td>
<td>0.4</td>
<td>0.6</td>
</tr>
<tr>
<td>Premium risk</td>
<td>2.2</td>
<td>2.5</td>
<td>0.3</td>
<td>-0.1</td>
</tr>
<tr>
<td>Sovereign risk</td>
<td>2.1</td>
<td>2.6</td>
<td>0.8</td>
<td>0.0</td>
</tr>
<tr>
<td>Competition</td>
<td>2.2</td>
<td>2.3</td>
<td>0.4</td>
<td>0.1</td>
</tr>
<tr>
<td>Credit risk</td>
<td>2.2</td>
<td>2.3</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Natural catastrophes</td>
<td>2.0</td>
<td>2.4</td>
<td>0.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Consumer confidence</td>
<td>2.0</td>
<td>2.3</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td>Reserve risk</td>
<td>1.8</td>
<td>2.5</td>
<td>0.0</td>
<td>-0.1</td>
</tr>
<tr>
<td>Longevity risk</td>
<td>2.0</td>
<td>2.1</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Claims inflation</td>
<td>2.0</td>
<td>2.1</td>
<td>0.0</td>
<td>0.1</td>
</tr>
</tbody>
</table>

Source: CEIOPS

Over the last twelve months (see Table 2) virtually all the fifteen risks mentioned above have increased. The highest increases are reported with regard to sovereign risk, interest rate risk and natural catastrophes. On the contrary, credit risk (in the corporate sector), reserve risk and claims inflation are considered to be basically unchanged as compared to 12 months ago.

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\(^3\) AT, BE, BG, CY, CZ, DE, DK, EE, ES, FI, FR, HU, IE, IS, IT, LT, LV, NL, NO, PL, PT, SE, SI, SK, UK.

\(^4\) “economic cycle” covers various challenges such as the decline in written business, asset-side risks and the potential rise of fraudulent claims.
Table 2: Development in risks for the insurance sector over the last 12 months

<table>
<thead>
<tr>
<th>INSURANCE (based on 26 replies)</th>
<th>Development over the last 12 months</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-2 = cons. decrease +2 = cons. increase</td>
</tr>
<tr>
<td>Sovereign risk</td>
<td>0.8</td>
</tr>
<tr>
<td>Interest rate risk</td>
<td>0.6</td>
</tr>
<tr>
<td>Natural catastrophes</td>
<td>0.5</td>
</tr>
<tr>
<td>Tax and pension reforms</td>
<td>0.4</td>
</tr>
<tr>
<td>Lapse risk</td>
<td>0.4</td>
</tr>
<tr>
<td>Competition</td>
<td>0.4</td>
</tr>
<tr>
<td>Regulatory &amp; reporting changes</td>
<td>0.3</td>
</tr>
<tr>
<td>Premium risk</td>
<td>0.3</td>
</tr>
<tr>
<td>Consumer confidence</td>
<td>0.2</td>
</tr>
<tr>
<td>Economic cycle</td>
<td>0.1</td>
</tr>
<tr>
<td>Equity risk</td>
<td>0.1</td>
</tr>
<tr>
<td>Longevity risk</td>
<td>0.1</td>
</tr>
<tr>
<td>Credit risk</td>
<td>0.0</td>
</tr>
<tr>
<td>Reserve risk</td>
<td>0.0</td>
</tr>
<tr>
<td>Claims inflation</td>
<td>0.0</td>
</tr>
</tbody>
</table>

Source: CEIOPS

... for the next months

For the next twelve months (see Table 3), only some risks are expected to increase significantly, especially regulatory & reporting changes as well as tax & pension reforms and the risks of another downturn in the economic cycle. Regarding premium risk and reserve risk, some relaxations are expected.

Table 3: Expected risks for the insurance sector over the next 12 months

<table>
<thead>
<tr>
<th>INSURANCE (based on 26 replies)</th>
<th>Expected development over the next 12 months</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-2 = cons. decrease +2 = cons. increase</td>
</tr>
<tr>
<td>Regulatory &amp; reporting changes</td>
<td>0.8</td>
</tr>
<tr>
<td>Tax and pension reforms</td>
<td>0.6</td>
</tr>
<tr>
<td>Economic cycle</td>
<td>0.3</td>
</tr>
<tr>
<td>Equity risk</td>
<td>0.2</td>
</tr>
<tr>
<td>Interest rate risk</td>
<td>0.2</td>
</tr>
<tr>
<td>Claims inflation</td>
<td>0.1</td>
</tr>
<tr>
<td>Consumer confidence</td>
<td>0.1</td>
</tr>
<tr>
<td>Longevity risk</td>
<td>0.1</td>
</tr>
<tr>
<td>Competition</td>
<td>0.1</td>
</tr>
<tr>
<td>Lapse risk</td>
<td>0.0</td>
</tr>
<tr>
<td>Sovereign risk</td>
<td>0.0</td>
</tr>
<tr>
<td>Credit risk</td>
<td>0.0</td>
</tr>
<tr>
<td>Natural catastrophes</td>
<td>0.0</td>
</tr>
<tr>
<td>Premium risk</td>
<td>-0.1</td>
</tr>
<tr>
<td>Reserve risk</td>
<td>-0.1</td>
</tr>
</tbody>
</table>

Source: CEIOPS
4. DEVELOPMENTS IN THE EUROPEAN REINSURANCE SECTOR

Data sources

The following analysis of developments in the European reinsurance sector in 2010 is based on publicly available market research as well as the reporting of key financial figures for the largest European reinsurers provided by CEIOPS Members.

2010 showed, up to now, to be a difficult business year for the reinsurance industry after suffering the highest level of insured losses in a decade in the first half of 2010. The costliest events already occurred in the first three months, including the earthquake in Chile, Windstorm "Xynthia" in Europe and several severe catastrophe events in the US and Australia striking the reinsurers’ catastrophe budgets long before the onset of the hurricane season.  

Since the renewal in January 2010 the reduction of the rates has accelerated, despite the heavy losses sustained, with the renewals for US catastrophe business reportedly down by 12% on average. In Asia and Europe the downward trend was less striking; the decline appeared to be 5% and 2.5%, respectively, moving rates towards the levels seen in 2008.

Overall, according to data from Munich Re, the first six months in 2010 saw 440 events, the second highest figure for this period since 2000, causing economic losses of USD 70bn. The insured losses reached USD 22bn and were comparatively low in relation to the economic losses, but they already exceeded the total for 2009, were more than twice of the first half year average since 2000 and even topped the figures for 2008, when the previous record for half year losses was set.

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8 See Munich Re press release 7 July 2010.
SIGNIFICANT LOSSES IN 2010

Figure 21: Non-US catastrophe losses by region

The costliest weather related event occurred in Europe, when windstorm “Xynthia” hit Spain, France and Central Europe. “Xynthia” caused overall losses of USD 4.5bn and insured losses reached USD 3.4bn. Later in the year the Deepwater Horizon oil rig explosion caused a massive oil spill across the north-central Gulf of Mexico. The oil spill is expected to cause one of the largest environmental damages in history. Experts have estimated insured losses from the oil rig explosion up to USD 6.0bn. The economic losses exceed this figure by far.

By contrast the devastating earthquake that hit Haiti in January 2010, killing more than 220,000 people and causing an economic loss of about USD 8 bn, only resulted in insured loses of USD 150mn due to the extremely low insurance penetration.

### Table 4: Largest losses 2010

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
<th>Region</th>
<th>Economic Loss USD bn</th>
<th>Insured Loss USD bn</th>
</tr>
</thead>
<tbody>
<tr>
<td>27.02.2010</td>
<td>Earthquake Chile</td>
<td>Latin America</td>
<td>30.0</td>
<td>8.0</td>
</tr>
<tr>
<td>20.04.2010</td>
<td>Explosion Deepwater Horizon</td>
<td>USA</td>
<td>up to 35.0</td>
<td>up to 6.0</td>
</tr>
<tr>
<td>27.-28.02.2010</td>
<td>Winter Storm Xynthia</td>
<td>Europe</td>
<td>4.5</td>
<td>3.4</td>
</tr>
<tr>
<td>12.-16.05.2010</td>
<td>Severe Storm, Hail</td>
<td>USA</td>
<td>2.5</td>
<td>1.1</td>
</tr>
<tr>
<td>15.06.2010</td>
<td>Flash floods</td>
<td>France</td>
<td>1.5</td>
<td>1.1</td>
</tr>
<tr>
<td>08.-13.01.2010</td>
<td>Winter Damage</td>
<td>Europe</td>
<td>1.7</td>
<td>1.0</td>
</tr>
<tr>
<td>15.-24.05.2010</td>
<td>Floods</td>
<td>Europe</td>
<td>3.5</td>
<td>0.3</td>
</tr>
<tr>
<td>02.-12.06.2010</td>
<td>Floods</td>
<td>Europe</td>
<td>3.5</td>
<td>0.3</td>
</tr>
<tr>
<td>12.-26.01.2010</td>
<td>Earthquake Haiti</td>
<td>Caribbean</td>
<td>8.0</td>
<td>0.3</td>
</tr>
<tr>
<td>July – September 2010</td>
<td>Floods</td>
<td>Pakistan</td>
<td>15.0</td>
<td>n.a.</td>
</tr>
<tr>
<td>04.09.2010</td>
<td>Earthquake</td>
<td>New Zealand</td>
<td>1.5(^{12})</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

The heavy monsoonal rains in Pakistan caused flash floods and landslides. So far more than 1,700 people were killed by this event.\(^{13}\) At this time, there are no insured loss estimates available for this event. The economic losses are expected to be hundreds of millions of USD.

Despite the fact, that there is a growth of insurance penetration outside Europe and the US, there still is a low level of insurance in those regions. As a result the overall estimated economic losses resulting from natural catastrophes in 2010 exceed the insured losses several times.

**MARKET TRENDS**

Due to uneconomic rates and an investment environment that provides an alternative between record low yielding or high-risk assets the prospect of profitable organic growth seem limited. With reinsurers companies generally well capitalised, for many of them taking over a company seems an interesting alternative to entering new geographies and segments with no outlook of

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being profitable in a hard reinsurance market. Therefore, it is expected that Mergers & Acquistion (M&A) become again increasingly more interesting, after M&A activities had seriously been hit by the financial crisis 2008.

Figure 22: M&A activity

Investments portfolios were crushed along with significant drops of the GDPs. This raised the pressure on the already soft reinsurance markets and led to time values of reinsurance companies still far below their value before the crisis started.

The market for catastrophe bonds rebounded in 2009. With no new bonds being issued at the end of 2008 due to the impact of the financial crisis, the market rallied again. The volume of new bonds issued or bonds replaced came to about USD 3.5bn in 2009. The second quarter 2010 was the most active second quarter on record regarding the issue of catastrophe bonds. Eight transactions were completed with a volume of USD 2.1bn coming into the market.

In recent years the number of reinsurers located in other parts of the world, that are moving to Europe to establish their business has risen. Regulatory changes in Europe related to the Solvency II Directive and taxation-related issues in the US tax legislation have increased the attractiveness of a number of European countries, especially Ireland, Switzerland, the Netherlands and Luxemburg. The significant shift toward Europe results in accounting for about 60% of the global net reinsurance premiums.

\[\text{14 See AON Benfield Reinsurance Market Outlook September 2010, page 10.}\]
\[\text{15 See AON Benfield Reinsurance Market Outlook September 2010, page 10.}\]
\[\text{16 See Guy Carpenter World Catastrophe Reinsurance Market 2010, page 3.}\]
So far five of the six largest and longest standing global reinsurers are based in Europe. The European “Big Five” - Munich Re, Swiss Re, Hannover Re, Lloyd’s and SCOR - are still dominating the global reinsurance market. As regards the regional distribution within the European Union, major reinsurers have their headquarters domiciled in DE, CH, FR, UK and Luxemburg.

The Reinsurance Directive has made it easier to move reinsurance business portfolios within the European Union. This option is occasionally used for portfolios which are intended to be put into run-off. Increased activities in the run-off sector might be observed in the upcoming years, as companies might seek to unlock capital in preparation for Solvency II requirements.

DEVELOPMENTS IN 2010

In 2010 many reinsurers managed to restore their balance sheets to a level above the highs seen in 2007, now reaching peak levels. The reinsurers were not only able to replenish the 18% erosion in capital reported in 2008, which was equivalent to USD 54bn for the top 40 reinsurance groups, but furthermore managed to increase capital by USD 63bn during 2009.

Guy Carpenter believes the reinsurance sector was overcapitalised by about USD 20bn or 12% at the beginning of 2010. Although this figure fell back to about 8% in June, there is still abundant capacity, but demand is suppressed, so pressure on rates remained high and continued to drive down prices. On the other hand, global reinsurance rates fell by 6% on average through the 2010 renewal season. One major reason for this decline is the excess capital.

The excess capital was also used to absorb the heavy losses experienced in the first quarter of 2010. Due to the fact of still having abundant capital available, many reinsurers announced share buyback programs or special dividends.\(^{23}\)

OUTLOOK 2011

At the end of the second quarter the US National Oceanic and Atmosphere Administration has predicted an active hurricane season for the Atlantic based on warm ocean temperatures like in 2005. But the predicted heavy hurricane losses failed to appear. Therefore, for example, Munich Re raised its profits forecast substantially after benefiting from the mild hurricane season and better returns of its investments.\(^{24}\)

The rising profits will probably have a negative impact on the rates expected for 2011. Reinsurers will be able to maintain or even increase capacity. For Europe, a stable capacity with rates that could decrease by 5% to 10% is expected.\(^{25}\) The US will probably even experience higher capacity by 10% on average, while the rates are likely to go down by 5% to 15% and in exceptional cases by 20%.

The trigger to precipitate a turnaround would be one market changing event in the region of a USD 50bn loss or multiple losses in the USD 20bn to USD 30bn range.\(^{26}\) This would decrease capacity, significantly harden the rates and therefore stabilise the market. So far the low catastrophe loss activity since the first two quarters kept it well below the stressed level to trigger a hard market.

As the profit margins are eroding there remains further pressure from the low interest rates to achieve rate adequacy. Reinsurers

\(^{22}\) See Guy Carpenter World Catastrophe Reinsurance Market 2010, page 9.


\(^{24}\) See Financial Times 10 November 2010, page 16.

\(^{25}\) See AON Benfield Reinsurance Market Outlook September 2010, page 33.

are focused on high quality investments with short durations that are highly liquid. During the financial crisis investors were seeking safe havens for their money, so they invested into high quality government bonds and the yield of those government bonds began to decline. In early-October 2010 the current yield for 10-year German government bonds reached some 2.2%, coming down from about 4.7% in July 2008. In 2010 high quality government bonds yields have drifted downwards and the low yields remain a concern for reinsurers as low investment returns put pressure on underwriting results.

In 2011, the still existing excess of capital will likely continue to depress rates, as reinsurance capacity will exceed demand. The weak pricing combined with the upcoming regulatory changes provides a difficult environment for reinsurers in the near future.

COMPANY SPECIFIC INFORMATION

Most of the reinsurers have been able to strengthen their business. As a result, the tendency of the net reinsurance premiums written was increasing.

Figure 25: Net Reinsurance premiums written

![Net Reinsurance Premiums Written (EURm)](image)

Figure 26 presents the (net) combined ratio\(^{27}\) for 2005 until 2009 and shows mainly a declining (net) combined ratio evidencing higher profitability.

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\(^{27}\) Net combined ratio expressed as sum of net expenses, net claims and net increase in technical provisions as percentage of net written premiums.
Premium income increased by 6.6% for the first nine months year on year and reached EUR 17.6bn, compared to EUR 16.5bn for the same period in 2009. The reinsurance business was marked by heavy burden from major losses, especially in the first quarter. Of the originally projected 6.5% for natural catastrophe losses, the first three quarters already went beyond this forecast with around 8%. Therefore the combined ratio reached 102.1% (2009: 96.3%) of net earned premiums for January to September, with only 93.8% incurring in the third quarter. Although Munich Re managed to achieve an investment income of EUR 2.8bn, the operating results fell to EUR 2.5bn due to the heavy losses. However, reinsurance contributed EUR 1.7bn to the group’s overall profit.

Swiss Re announced the payback of the convertible perpetual capital instrument provided by Berkshire Hathaway as at 3 November 2010. Swiss Re will account the approximately USD 1bn pre tax in the fourth quarter. So far the operating result for the first three quarters is reported to improve to USD 2.3bn, resulting in a net income of USD 1.8bn, although the premium income diminished by 9.3% to USD 15.3bn. Property & Casualty contributed (unconsolidated) USD 1.8bn to the operating profit. Mainly the well below average natural catastrophe activity in the third quarter resulted in a combined ratio of 95.6%. Life & Health managed to realise an (unconsolidated) operating profit of USD 506mn. Asset management significantly enhanced the result to (unconsolidated) USD 3.3bn based among other things on lower impairments.

28 See Munich Re press release, 9 November 2010, Munich Re raises profit guidance for 2010.
29 See Swiss Re news release, 4 November 2010.
31 See Swiss Re, Third quarter 2010 report, page 57.
A strong demand for non-life and life/health reinsurance led to a growth of gross written premiums of 11.5% and reached EUR 8.6bn in the first nine months. Based on a satisfactory loss development, especially in the third quarter, **Hannover Re** had a combined ratio of 99% in the non-life reinsurance. Although the major loss burden is still higher than the expected level, Hannover Re achieved an operating result of EUR 862mn and an after tax profit of EUR 582mn, including an additional income derived from a tax effect. Property & Casualty contributed EUR 438mn to the groups’ net income. Life/health business totalled EUR 170mn. Investment income increased to EUR 872mn due to further rise in ordinary income and lower write-downs. Based on the favourable business development and the positive tax effect Hannover Re raises its net profit expectation for 2010 from EUR 600mn to more than EUR 700mn.

**SCOR**

SCOR’s total premium income grew to EUR 5.0bn in the first three quarters 2010. In the Property & Casualty business the combined ratio was 99.9%. For the first nine months SCOR reached a net income of EUR 267mn, which is close to the level achieved in the same period 2009 and despite the heavy losses of the first quarter 2010.

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33 See SCOR press release 5 November 2010.
5. DEVELOPMENTS IN THE EUROPEAN PENSION FUNDS MARKET

This section highlights the main developments that occurred in the European occupational pension fund sector, based on feedback provided by CEIOPS Members. Not all EU countries are covered, in some of them IORPs (i.e. occupational pension funds falling under the scope of the EU IORP Directive) are (still) non-existent or are just starting to be established (CZ, HU, MT). In DK, FI, FR and SE the main part of occupational retirement provision is treated as a line of insurance business, and is therefore not covered in all parts of this section.

In addition to the usual data, reporting and analysis timelines for pensions, which for this year's report looks at 2008, CEIOPS has supplemented this information with additional data for 2009. This data was collected where possible on a best effort basis from supervisors for a preliminary view of 2009 taking into account that full figures are not yet available. Data collected for 2009 has provided CEIOPS with an approximate view of the financial position of occupational pension funds at the end of 2009. It should therefore not be read as a definitive summary of the current conditions but more as an indicator of the situation.

RECENT DEVELOPMENTS – MAJOR POLICY REFORMS

Some countries have seen structural changes and developments in 2008 and 2009 relating to the laws governing occupational pension funds. While changes are specific to individual countries there are common trends and aims within the policy developments.

Developments aimed at increasing membership are reported in six countries. BG has seen the establishment of its first IORP in 2008 with eight occupational pension schemes now already in place, while in BE industry-wide schemes have grown further. In FI a new legislation has been set up for allowing defined contribution (DC) pension schemes. The UK has plans to introduce a requirement for auto-enrolment for all employees into schemes meeting a certain criteria from 2012 aimed at tackling low provision and take up in membership. In IE a similar reform has been recently announced by the Government. DE reported a change in pension rights in case of divorce, allowing divorced persons to be eligible for becoming new members of IORPs.

Changes in the field of supervisory reporting systems have been seen in ES and with NO implementing a new electronic system for reporting. In BE the risk-based approach has been reinforced while in PT major attention has been devoted to the risk management and internal control systems of IORPs.

New accounting rules have been introduced in BE. For DE accounting changes will come into effect in 2011.
The **flexibilities** built into the funding approach for IORPs has been reported as important in NL, PT and the UK allowing IORPs to set appropriate recovery plans to repair deficits in defined benefit (DB) schemes. ES has allowed members in a situation of long-term unemployment to recover their vested rights.

There have also been developments in **disclosure** with SK reporting measures aimed at increasing financial awareness and HU changing its approach of communication to members. IT has reinforced information requirements, introducing the obligation to provide estimates of the pension annuities that can be reasonably expected.

**Changes and developments by country**

A country-per-country summary of structural changes and developments in 2008 and 2009 follows:

In **BE**, following the regulatory change that introduced in 2007 a new principle-based prudential framework, from 2008 new accounting rules are applicable for the calculation of technical provisions which have to be prudent and take into account the risk profile of the pension plan. This leads, in general, to higher levels of technical provisions. Specific accounting rules have also been introduced to report ring-fencing cases and off-balance derivatives. As part of the governance framework, IORPs had to create internal audit and compliance functions to improve risk management. During 2008 the supervisory risk-scoring model has been reviewed to introduce an even more sophisticated asset-liability management approach.

From the middle of 2008 the first IORP has started to operate in **BG**; as of end September 2009 there are eight occupational schemes managed under that IORP. The introduction of a multifund system and the improvement of the payout phase in the Bulgarian supplementary pension system have been under discussion in 2009.

**DE** has reformed the pension right adjustment on divorce. According to this reform almost all pension rights acquired during the marriage must be adjusted in the existing system. This means that all IORPs must accept divorced persons as new members. For the financial year 2010 (reports in 2011), new accounting rules will come into effect.

**ES** has changed the regulation allowing people in a situation of long-term unemployment to recover their vested rights removing the obligation of being at least one year in that situation. During 2009 the supervisor approved new statistical and accounting models where the portfolio information has been developed, so that supervisors get information about every asset that belongs to pension plan portfolios. Besides, the periodicity of surveys has been increased.
FI has introduced new legislation allowing the establishment of DC pension schemes which is now fully in force but no pension funds providing DC pensions have yet been created.

In IE, the government introduced the option for DC members retiring between December 2008 and December 2010 to defer the purchase of a retirement annuity. The Government has recently announced a reform of whole pension system to increase the coverage of the private pensions and to strengthen the sustainability of public pensions. The reform will require the auto-enrolment of all employee aged 22 or over from 2014, along with matching contributions from the employer, the introduction of a new single pension scheme for all employees and the increase of the state retirement age to 68 by 2028.

In IT, as further step of the reform implemented in 2007, standards of communication are under revision to reinforce the transparency and the comparability of information given to members. In this perspective, the supervisory authority is currently reviewing the statement of the personal balance to be annually sent to members. Furthermore, pension funds are required, from March 2010, to provide individual projections on the benefits that participants may expect to receive at retirement. The projections have to be calculated using a standardized methodology according to which expected future returns are set as a function of the “strategic” asset allocation of the plan chosen by the participant (a risk premium for equities is set prudentially at 2 per cent). Ways to communicate long-term risk are currently being explored.

As a consequence of the financial crisis, in NL, the supervisor (in consultation with the competent Ministry) has decided to grant additional flexibility, extending the recovery period allowed for funds to return to the minimal required coverage levels. However, such flexibility is made conditional on the existence of a realistic recovery plan. During the summer of 2010, the government has decided that a number of pension funds will have to bring planned recovery measures forward. As a result, a number of funds may implement benefit cuts starting as of January 2010. The entire regulatory framework for pension funds is currently under revision from both political and technical level.

In NO the new Insurance Act, which came into force in July 2006, became effective from 2008. Pension funds are subject to a new price and earnings structure, requirements for a division of assets between owners and customers, and new rules on profit distribution. The new rules are designed to promote effective operation and a clearer distribution of risk and return between customers and owners. A new electronic reporting regime for pension funds was established in 2008.
At the beginning of 2008, in **PT**, the Government created a new voluntary 3rd pillar capitalized pension vehicle, run by the Social Security investment body, as a measure to improve pension savings. In 2009, a new regulation regarding new requirements on the risk management and internal controls systems for IORPs was put in force, which is going to be in full effect at the end of 2010.

In **RO** stricter investment limits on risky assets set out in primary legislation have been detailed as well as in secondary legislation issued by the regulator. These changes are aimed at ensuring diversification or restricted investments in illiquid and high risk financial instruments.

In 2009 **SI** started preparations for the modernization of the existing pension system. With the adoption of new legislation (to be implemented in early 2015) the State intends to respond to demographic changes in Slovenia and to overcome some drawbacks of existing legislation. The overall objectives of modernizing the pension system are to increase the working population by raising the age of retirement, to maintain the solidarity of the pension system, to increase awareness of the expected pension benefit and establishing the principle of dependence between the funds paid in the scheme and pension payments from the scheme.

**SK** has introduced a new legislation that requires Pension Fund Management Companies to provide, starting from 2009, more detailed information to members about fund management and performance.

In response to the crisis and fall in the markets in 2008 and early 2009 the Pensions Regulator in the **UK** focussed on helping trustees of DB schemes to understand the impacts on their schemes and sponsors and to ensure that appropriate plans are in place to repair any deficits. A series of free workshops were held enabling trustees and advisors to engage directly with the regulator. The regulator through these workshops and a public statement issued in June 2009, reaffirmed its approach to how trustees are expected to set prudent technical provisions and appropriate recovery plans to eliminate deficits as quickly as the sponsor can reasonably afford taking full account of the strength of the underlying covenant. While technical provisions must remain prudent there is flexibility in setting a recovery plan to repair a deficit to meet the funding objective however any risk margin contained in the assumptions used must take account of the extent to which the employer can support them.

Towards the end of the year the regulator also launched a campaign aimed at encouraging good governance and administration and better management of pension scheme risks. A statement published alongside results of the 2009 pension scheme governance survey outlines the regulator’s key focus
areas. Included within this campaign and aimed at focusing greater attention on risks facing pension scheme members, the Pensions Regulator also published revised internal controls guidance for consultation.

STRUCTURAL DEVELOPMENTS - ASSETS AND CONTRIBUTIONS

Accumulated assets

The total size of assets as a percent of GDP gives a good indication of the relative wealth accumulated by the pension fund sector (see Figure 27). The size of pension funds is to a large extent related to their time of enactment and labour market coverage. Countries such as the UK and NL with a relatively long history of occupational pension provision see total assets representing a high asset to GDP ratio. These two countries together make up the vast majority of the overall assets invested in occupational pension funds across Europe.

Where traditional public sector pensions, other similar national arrangements and group life insurance contracts play a dominant role in the retirement system, the size of the occupational pension fund sector is relatively small. This is especially the case for continental European countries. However, we see some of these countries are putting in place reforms to increase occupational pension provision resulting in increased membership and coverage of IORPs which is especially important with the growing pressures on pay as you go public systems.

Figure 27: Penetration rate of occupational pension funds (Total assets as % of GDP)*

* Data for the UK relates to DB schemes only. For LU, LV, RO and BG the assets to GDP is less than 1 percent.

Source: CEIOPS

Contributions received

The main source of funding for pension schemes results from the contributions payable by both sponsors and members. Figure 14 shows the total estimated contributions for 2006 to 2008 with the main concentration again being in DE, NL and the UK.
However Figure 28 shows the difference in gross contributions payable between 2006-2007 and 2007-2008. As can be seen, for countries with more mature markets there is a smaller difference year-on-year (unless a significant reform or event has taken place) as both employers and members aim to spread the cost of retirement provision over a medium to long term period. However, younger and developing markets have seen a marked increase over the last few years as membership grows and the market matures. This is especially true in RO where a significant increase took place in 2008 as membership grew and members also chose to contribute more into their schemes. The significant increase seen in PT was a result of the fall in asset value due to the economic downturn which resulted in DB IORPs being required to increase contributions to keep funding ratios at adequate levels.

Figure 28: Total gross contributions received*

Source: CEIOPS

* For UK, data also depend on the variation in the exchange rate. Movements in DE are due to a one time effect shift from a few large industrial companies to IORP schemes.
Figure 29: Growth in gross contributions received (% change – local currency)*

% change in total gross contributions receivable

Source: CEIOPS

* Movements in DE are due to shifts from a few large industrial companies to IORP schemes, that means due to a one time effect.

**Defined Benefit vs. Defined Contribution schemes**

There is a wide spectrum in the coverage of Defined Contribution (DC) or Defined Benefit (DB) provision. In DE only DB schemes are permitted. In some other countries (BE, FI, NL, NO, PT, UK) DB is not mandatory but still makes up the majority of the contributions being paid by sponsors. However, in some of these countries there is a reported shift away from ‘traditional DB provision’ as sponsors are increasingly choosing to replace ‘traditional DB plans’ and share a number of the risks with members or to set up DC plans instead. In the Member States where occupational pensions are at an early stage of development or are even at the beginning of their life, DC is also the scheme design of choice.

This trend will help reducing the vulnerability of sponsors and the pension fund sector as a whole to the funding risks traditionally related to DB plans. On the other hand the shift to DC plans transfers a number of risks to individual members, often requiring them to make difficult decisions such as investment choices and making information to members and financial education crucial issues, especially if there is an absence of sensible default options. Overall, there is a residual risk that unless suitable DC plans are in place, this movement might result in smaller retirement income than that provided by DB plans.

Figure 30 shows that, considering aggregated data at EU level, a large proportion of contributions are being paid into DB schemes. Due to the increasing shift towards DC substantial increases in contributions into new DC plans can be expected in future years.
Figure 30: Allocation of gross contribution receivable (2008)

![Allocation of gross contributions receivable](image)

Source: CEIOPS

**IORPs and Members**

The number of IORPs in the EU is stable. However, in some countries a consolidation process is underway (ES, IE, IT, NL). In particular, the number of Dutch pension funds has been declining steadily since 1997 as many employers and employees have chosen to liquidate their pension fund and transfer the provision of the plan to another pension fund to save costs of provision.

Also in FI the number of pension funds is declining and the liabilities are transferred to insurance companies. Also the number of members is declining due to the fact that there is no new entry into the schemes.

In DE, as consequence of new accounting rules to be introduced in 2011, it is expected that new "Pensionsfonds" will be established. Some companies may choose to shift their book reserves schemes to “Pensionsfonds” because of lower administrative costs in managing these obligations. If this trend will manifest remains to be seen.

During 2009, in RO there were 4 new voluntary pension funds which started activity, managed by international asset managers.

Membership rates have continued to grow slowly in 2008 and 2009. However, some countries expect that the increase in unemployment will also have an impact on the trend in membership. In AT at the end of 2009, a significant increase in membership rate has been seen when civil servants switched to the pension fund regime. In BE membership grew rapidly in 2007 and 2008 mainly as a result of the introduction of industry-wide pension schemes: +54 percent in 2007 and a further 39 percent in 2008, mainly for the blue collar workers.

**Cross-border activity**

The IORP Directive\(^\text{34}\) (due for implementation by 23 September 2005) provided for the first time an EU wide legal framework for IORPs wishing to operate cross-border. CEIOPS has since monitored the scale of this activity and published in June 2010.

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\(^{34}\) Directive 2003/41/EC is on the Activities and Supervision of Institutions for Occupational Retirement Provision
an update\textsuperscript{35} showing the growth in the number of cross-border IORPs, as formally notified to Member States during the course of a 12 month period from June 2009 until June 2010.

It should be noted that Member States have adopted different approaches to how they identify a cross-border arrangement, and so caution should be exercised in making comparisons of activity between Member States.

The findings show that from June 2009 until June 2010 a total of 7 new cross-border IORPs have been reported. However, the results also show the cessation of cross border activity by 5 IORPs during the reporting period. As at the end of June 2010 a total of 78 IORPs have gone through the required notifications to operate cross border. This is spread across 7 Home Member States (AT, BE, DE, IE, LI, LU and UK). Activity is mainly concentrated in two Home States, the UK having 37 and IE having 25. However, greater diversity is seen in the Host Member States with 22 Member States acting as Host to cross-border IORPs.

\textit{Asset allocation}

Figures 31 and 32 show the aggregate asset allocations across countries for 2006, 2007 and 2008. The figures have been split into two graphs with Figure 31 showing the countries where DB is the main scheme design and Figure 32 for mainly DC countries.

In the majority of the countries offering DB schemes there is a significant part of the investment portfolio dedicated to equities which, while the value and return on equities has suffered during the downturn, remains a preferred choice of assets by most countries. This likely owes to the long term nature of the liabilities in respect of pension schemes and, based on long term empirical evidence, the ability for equities to demonstrate the potential to offer a higher return than bonds. Also the payment of dividends from equities held provides an ongoing source of income to the fund. In some countries equities are seen as a higher risk investment and IORPs have therefore limited exposure to these assets. This has helped in minimising the immediate effects of the downturn in the equity market.

In countries where the pension promise is linked to a guaranteed return on the contributions rather than a final or average salary, we see a greater investment in debt securities and guaranteed return investments with limited equity exposure. This is due to the underlying guarantee provided to the member and the need to reduce volatility in order to provide a greater degree of certainty over the asset returns year on year in order to meet this promise.

\textsuperscript{35} CEIOPS 2010 Report on Market Developments

Occupational pension funds invested approximately about 14% of total assets in sovereign debt of EEA countries (plus Japan, Switzerland and the United States), 9% of their assets in banks (through bonds, equity and other instruments like loans or deposits) and about 7% of their assets in real estate (via mortgage loans, covered bonds and indirect investments).

**Figure 31: Allocation of assets for mainly DB countries (2006-2008)**

![Asset Allocation (DB countries)](image)

Source: CEIOPS (where available/possible investments in UCITS are allocated according to the underlying assets).

**Figure 32: Allocation of assets for mainly DC countries (2006-2008)**

![Asset Allocation (DC countries)](image)

Source: CEIOPS (where available/possible investments in UCITS are allocated according to the underlying assets).

**Main effects on IORPs**

The role played by IORPs in the recent financial crisis is different to that of other areas of financial services. IORPs do not have the same issues in respect to liquidity and the threat of a ‘run on the bank’ in the same way as that of the banking sector. The nature of an IORP, in that they are designed to provide retirement benefits in the future for members, make it a long...
term undertaking requiring decision making to focus on the long-term interests of scheme members. Focusing on a single year’s return can give a misleading picture of the ability of pension funds to deliver adequate pensions in old age. IORPs also have in many countries a number of security mechanisms available to them in the event of under-funding.

The impact on IORPs is therefore not comparable to the banking sector due to these differing business models, differing liability durations and differing exposures to customer behaviour. Member States either did not experience the closure of any IORP/scheme; or when it happened, the number of closures or wind ups for different reasons has not been exceptional with respect to the previous years.

The turmoil has however hit IORPs primarily in their role as investors and for DC schemes members’ confidence.

Sharp drops in the equity markets seen in 2008 put their investment portfolios under severe strain. However, significant positive returns in 2009 have mitigated this to some extent. Only a few countries reported small positive or zero returns in 2008 due to the relatively high share of debt securities (FI, DE, RO, BG).

Figure 33 gives an estimate of the rate of return on assets for all schemes from 2006-2008 and Figures 20 and 21 show estimates for DB and DC schemes separately. Again, please note that 2009 data is preliminary and often based on partial samples of national pension markets while the 2006-2008 data is based on a more complete sample.

**Figure 33: Rate of return on assets for all schemes (2006-2008)**

Source: CEIOPS
In 2008, the return of the assets declined, in comparison with 2006 and 2007. Some exceptions have been seen e.g. in countries where systems are at an early stage of development. However, calculation methodologies used for return on assets are not yet harmonized across countries. As a consequence, figures across countries are only partially comparable.

Several countries reported that IORPs reacted to the crisis by shifting the asset allocation towards debt securities, and in particular, towards government bonds either to reduce risky assets or as consequence of the variation of asset price. In 2009, the general exposure to equity markets has been higher with respect to the previous year. However, the trend in the asset allocation is not clear because the major exposure of IORPs to equity investments could be due to the change in the value of assets, as consequence of the substantial recovery of related financial markets, or to the deliberate modification of the asset allocation. In some cases the increase of relative holdings in
stocks has been less than the recovery of markets indices would suggest, implying that pension funds decided to not fully rebalance the allocation with respect to a benchmark/defined “strategic” asset allocation.

**Average funding levels**

As would be expected the financial turmoil reduced the funding levels for DB schemes in 2007 and 2008 across Europe.

In some countries funding dipped below 100 percent which is allowed for a limited time by the IORP Directive as long as a concrete and realisable recovery plan is in place. In practice, Member States use different methods and assumptions to determine their technical provisions. This results in significant variations in the size of technical provisions across countries for comparable defined benefit commitments. For example differences exist around establishment of assumptions (best estimates, levels of prudence) which can have a significant effect on the liabilities and so also on the funding level. Countries also differ markedly in their approaches to inflation protection which often needs to be taken into account in the calculations and can affect the size of the liabilities significantly.

There is also in some countries an interaction between the different elements that make up the pension frameworks across Member States. For example, emphasis on prudent valuation principles, which results in extra reserves, reduces the need for additional security mechanisms. This is also true vice versa where the existence of security mechanisms other than up front capital requirements to the IORP reduces the need for a higher funding level. Overall security or solvency cannot therefore be understood by viewing this figure in isolation without a full appreciation of all the elements involved including the security mechanisms available.

Data for 2009 is however very limited at this time, and the figures shown have been provided on a best effort basis or using estimates where available and should be taken to be an indicative view of the situation at the end of 2009.

2009 has seen an upturn in the markets which as a result has seen pension funds reporting significant positive returns. This in turn has had a positive effect on the funding positions of IORPs, although in most countries not yet back to the levels seen in 2007. Also, for countries where IORPs are not funded to the full level required by the national law, deficit contributions are being paid by sponsors aimed at bringing IORPs up to the required level in their national jurisdiction.

As a consequence, new recovery plans presented in some Member States to supervisory authorities for a longer recovery period have been accepted. A lot of recovery plans consisted of amending the financing plan in general leading to a higher level of contributions to be paid in 2009 and sometimes changing the risk profile of the assets. In NO, as many pension funds chose to keep a high exposure to equities, they needed to raise additional
capital in 2008 and the beginning of 2009. In some cases the measures taken implied a reduction of benefits for pension participants (AT, NL) or the removal of the indexation of benefits for some time (NL). In the UK trustees were reminded that flexibility in the recovery plan process and make-up exists, including making use of contingent assets or agreements for contributions to increase in the future as sponsors recover and cash flow problems are eased.

**Figure 36: Funding levels for DB schemes (2006-2009)**

![Diagram showing average cover ratio for DB schemes from 2006 to 2009, with data points for AT, BE, DE, ES, FI, IE, LU, NL, NO, PT, SE, UK. The y-axis represents the percentage of funding levels, ranging from 0% to 180%, and the x-axis lists the countries. The sources are 2006, 2007, 2008, and 2009.]

Source: CEIOPS

### THE REACTION OF SUPERVISORS TO THE DOWNTURN AND LESSONS LEARNED

In light of the downturn, the responses of supervisors have focused on the flexibility within their frameworks and the different security mechanism available.

Due to the severity of the crisis, some countries introduced additional measures such as increasing the length of recovery plans (NL) or being more amenable in their structure given the economic environment (UK). In several countries, the measures introduced during the crisis have been in force throughout 2009 but the frequency of additional reporting declined noticeably.

In reaction to the turmoil, supervisors enhanced additional reporting requirements, either for all IORPs or using a sample. For example the requirements to submit reports (e.g. assets and actuarial reports, investments and technical provisions data), in addition to the usual reporting deadlines or with an increased frequency and/or detail. Increasing reporting requirements have been less in DC systems where the frequency and range of the information collected are generally already seen as sufficient.

Ad hoc surveys have been carried out to determine the exposure of IORPs investment portfolios to “toxic assets” and in all cases this has not been reported as material.
### Additional stress tests

In case of DB schemes or DC schemes with guarantees (provided by IORPs), some supervisory authorities carried out additional stress tests according to different scenarios to assess the systemic robustness of the IORP sector or the solvency conditions of an individual IORP. As a consequence, in some countries, IORPs have been required to submit a reorganization/recovery plan, to increase the frequency of calculations, to change the asset allocation, to increase additional contributions to be paid by the employers (BE, NO), to eliminate the indexation of benefits for some time (NL) or to increase its risk-bearing capability (NO).

### Individual contacts and meetings

Some supervisory authorities (DE, BG) set up an internal task force to monitor the evolution of the crisis and to evaluate supervisory measures. A closer monitoring of riskier IORPs has been performed and individual contact and meetings with selected IORPs, especially with large defined benefit pension funds, have been organised, also on regular basis in several countries (BE, IE, IT, LU, NO, PT, ES, UK).

### Communication with industry

Improving the communication with the industry has been considered an essential tool to react to the crisis and to promote key message through the industry. Different initiatives have also been carried out to enhance the communication with IORPs to explain supervisory measures taken (BE), to encourage IORPs through public statements and workshops to monitor closely the impacts on individual schemes and use the flexibility available in the regulatory framework (UK) or to properly assess the exposure of their portfolios with respect to the different risk factors and to improve portfolio diversification (IT).

### .... and with members

In the context of DC schemes, supervisors informed members (also through IORPs) that they may elect for a more active role in reviewing their pension fund in the light of their current circumstances to decide whether they need to make any changes to the fund in which they invest, their level of contributions or their target retirement date (UK) or they may defer the conversion of their individual accounts into benefits when they retire (IE, IT). Supervisory authorities strengthened their communication strategy emphasising the long-term perspective of pension performance mainly in case of weak returns.

During the crisis supervisors commenced or increased the exchange of information with other supervisory authorities responsible for financial stability or for direct or indirect regulation/supervision of IORPs.

### SUPERVISORY RISK ASSESSMENT FOR THE OCCUPATIONAL PENSIONS SECTOR
CEIOPS Members and Observers have been asked to assess risks and challenges, out of a list of 27 items, according to the probability of a materialisation and the impact on the national occupational pension funds market. Based on the responses from 19 Member States\(^\text{36}\), the following risks and challenges are classified as the most imminent, ranked by the product of the scores for probability and potential impact (see Table 5).

Equity risk, interest rate risk (especially the low yield environment), and tax and pension reforms are the risks with the highest overall ranking. The potential impact on the pension fund sector is considered to be significant if one of these risks should materialise.

**Table 5: Classification of most imminent risks for the occupational pension fund sector**

<table>
<thead>
<tr>
<th>PENSION FUNDS (based on 19 replies)</th>
<th>Average probability of risk</th>
<th>Average impact of risk</th>
<th>Development over the last 12 months</th>
<th>Expected development over the next 12 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>ranking based on (probability times impact)</td>
<td>1 = low</td>
<td>2 = medium-low</td>
<td>3 = medium-high</td>
<td>4 = high</td>
</tr>
<tr>
<td>Equity risk</td>
<td>2.6</td>
<td>2.9</td>
<td>-0.1</td>
<td>-0.1</td>
</tr>
<tr>
<td>Interest rate risk</td>
<td>2.4</td>
<td>3.1</td>
<td>0.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Tax and pension reforms</td>
<td>2.5</td>
<td>2.7</td>
<td>0.8</td>
<td>0.6</td>
</tr>
<tr>
<td>Economic cycle</td>
<td>2.4</td>
<td>2.6</td>
<td>0.1</td>
<td>0.2</td>
</tr>
<tr>
<td>Credit risk</td>
<td>2.3</td>
<td>2.2</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td>Regulatory &amp; reporting changes</td>
<td>2.3</td>
<td>2.2</td>
<td>0.3</td>
<td>0.5</td>
</tr>
<tr>
<td>Sovereign risk</td>
<td>2.0</td>
<td>2.1</td>
<td>0.7</td>
<td>0.0</td>
</tr>
<tr>
<td>IT risk</td>
<td>1.7</td>
<td>2.4</td>
<td>0.2</td>
<td>0.0</td>
</tr>
<tr>
<td>Longevity risk</td>
<td>2.1</td>
<td>2.0</td>
<td>0.0</td>
<td>-0.1</td>
</tr>
<tr>
<td>Consumer confidence</td>
<td>2.1</td>
<td>2.0</td>
<td>0.0</td>
<td>-0.1</td>
</tr>
</tbody>
</table>

Source: CEIOPS

Over the last twelve months (see Table 6) virtually all the ten risks mentioned above have increased. The highest increases are reported with regard to tax and pension reforms, sovereign risk and interest rate risk, mirroring the assessment by insurance supervisors. On the contrary, equity risk is considered to be slightly lower than 12 months ago.

**Table 6: Development in risks for the occupational pension fund sector over the last 12 months**

36 AT, BE, BG, DE, ES, FI, IT, LI, LU, LV, NL, NO, PL, PT, RO, SE, SI, SK, UK.
For the next twelve months (see Table 7), only some risks are expected to increase significantly, especially regulatory & reporting changes as well as tax and pension reforms given the fiscal consolidation in all European countries. Regarding equity risk, longevity risk and consumer confidence some relaxations are expected.

Table 7: Expected risks for the occupational pension fund sector over the next 12 months

<table>
<thead>
<tr>
<th>PENSION FUNDS (based on 19 replies)</th>
<th>Expected development over the next 12 months</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-2 = cons. decrease</td>
</tr>
<tr>
<td></td>
<td>+2 = cons. increase</td>
</tr>
<tr>
<td>Tax and pension reforms</td>
<td>0.8</td>
</tr>
<tr>
<td>Sovereign risk</td>
<td>0.7</td>
</tr>
<tr>
<td>Interest rate risk</td>
<td>0.5</td>
</tr>
<tr>
<td>Regulatory &amp; reporting changes</td>
<td>0.3</td>
</tr>
<tr>
<td>Credit risk</td>
<td>0.2</td>
</tr>
<tr>
<td>IT risk</td>
<td>0.2</td>
</tr>
<tr>
<td>Economic cycle</td>
<td>0.1</td>
</tr>
<tr>
<td>Longevity risk</td>
<td>0.0</td>
</tr>
<tr>
<td>Consumer confidence</td>
<td>0.0</td>
</tr>
<tr>
<td>Equity risk</td>
<td>-0.1</td>
</tr>
</tbody>
</table>

Source: CEIOPS

Main risks…

Equity volatility is expected to remain high and as such is highlighted as a significant risk for pension funds as investment in equities remains relatively substantial. However, IORPs have not been encouraged to move away from equities at a time when they are low valued, indeed some countries have seen an increase in investment in equities in 2009, to enable IORPs to benefit from the relatively high returns that equity could provide (with respect to debt securities investments) in the medium-long term perspective.

Low interest rates figures are also ranked high on the list of risks identified. A sustained period of low interest rates will put pressure on pension funds which offer a guarantee related to investment return as fixed interest assets are a key element in achieving this.
There may also be an impact on the valuation of liabilities in some countries to the extent to which the returns on fixed interest assets are used to value liabilities. Credit risk is also of concern both in the asset holdings and to the extent that an IORP is reliant on a solvent sponsor for ongoing support.

The crisis did not have a systemic impact on the EU private pension system, however, it hit pension funds primarily in their role as institutional investors and had a significant impact on consumer confidence, still to be restored. The current regulatory and supervisory regime is seen by many as being flexible enough to face the effects of the crisis. Several supervisors are working in close contact with government and other authorities to monitor the impact of the crisis on pension funds and to evaluate whether possible changes in the legislation or regulation framework are needed in order to mitigate the pro-cyclical effect of solvency requirements and to improve the risk management of pension funds. In DC systems, increasing attention is paid to financial education and to communication to members in order to strengthen the awareness of the risk involved in financial market investments and on the proper investment horizon of investment for retirement. Also, discussions are started around how to better share risks between IORPs/employers/members and to improve design of default options.
## ANNEX 1: COUNTRY ABBREVIATIONS

<table>
<thead>
<tr>
<th>Code</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>AT</td>
<td>Austria</td>
</tr>
<tr>
<td>BE</td>
<td>Belgium</td>
</tr>
<tr>
<td>BG</td>
<td>Bulgaria</td>
</tr>
<tr>
<td>CY</td>
<td>Cyprus</td>
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<tr>
<td>CZ</td>
<td>Czech Republic</td>
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<tr>
<td>DE</td>
<td>Germany</td>
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<tr>
<td>DK</td>
<td>Denmark</td>
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<tr>
<td>EE</td>
<td>Estonia</td>
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<tr>
<td>ES</td>
<td>Spain</td>
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<tr>
<td>FI</td>
<td>Finland</td>
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<tr>
<td>FR</td>
<td>France</td>
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<tr>
<td>GR</td>
<td>Greece</td>
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<tr>
<td>HU</td>
<td>Hungary</td>
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<tr>
<td>IE</td>
<td>Ireland</td>
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<tr>
<td>IS</td>
<td>Iceland</td>
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<tr>
<td>IT</td>
<td>Italy</td>
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<tr>
<td>LI</td>
<td>Liechtenstein</td>
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<tr>
<td>LT</td>
<td>Lithuania</td>
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<tr>
<td>LU</td>
<td>Luxembourg</td>
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<tr>
<td>LV</td>
<td>Latvia</td>
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<tr>
<td>MT</td>
<td>Malta</td>
</tr>
<tr>
<td>NL</td>
<td>Netherlands</td>
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<tr>
<td>NO</td>
<td>Norway</td>
</tr>
<tr>
<td>PL</td>
<td>Poland</td>
</tr>
<tr>
<td>PT</td>
<td>Portugal</td>
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<td>RO</td>
<td>Romania</td>
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<tr>
<td>SE</td>
<td>Sweden</td>
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<td>SI</td>
<td>Slovenia</td>
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<tr>
<td>SK</td>
<td>Slovakia</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
</tbody>
</table>
ANNEX 2: SCOPE OF CEIOPS’ PENSION FUND DATA

The current scope of analysis on the financial conditions and financial stability of the pension fund sector is based on data provided by national competent authorities to EuroStat according to the data definitions prescribed in the Methodological Manual for Pension fund Statistics. The business statistics on pension funds are developed in the frame of Council Regulation n° 58/97 concerning structural business statistics. This regulation is the main legal reference for the collection, compilation and transmission of EU structural business statistics in the various sectors, including the occupational pension funds sector.

The coverage of the business statistics on pension schemes is generally limited to Pillar II schemes that are linked to a professional occupation. Such schemes usually operate on a funded basis. Moreover, they frequently provide cover for biometric risks (mortality, invalidity and longevity). Occupational schemes are organised either as autonomous pension funds or trusts, non-autonomous pension funds (or book reserve mechanisms) or group life insurance contracts, depending on institutional and traditional differences between Member States.

Autonomous pension funds or trusts are established separately from any sponsoring undertaking or trade. They receive the contributions, invest them and pay retirement benefits. Non-autonomous pension funds mainly refer to the book reserve system. The employer undertakes to pay benefits to his employees and makes provision for commitments on the liabilities side of his balance sheet. In the case of group life insurance contract, the contributions are paid to a life insurance undertaking which invests the contributions and pays the benefits. These schemes are excluded from the pension business statistics as they are already covered by the insurance services statistics.

Likewise, Pillar I compulsory social security schemes and Pillar III individual retirement savings are excluded from the scope as these are not covered by the business statistics on pension schemes. It should be noted that not all Member States of the EEA operate occupational pension provisions. Data availability varies substantially among the various Member States, which hampers a thorough analysis and comparison of the pension market developments between Member States.

Austria:
Data includes all occupational pension contributions to Pension Undertakings covered by the Austrian "Pensionskassen Act". The Pillar II provisions are not compulsory. Contributions cover about 18 percent of the working population.

Belgium:
Pension fund statistics relate to institutions for occupational retirement provisions, i.e. occupational pension funds and so called "pensioenkassen" for the self-employed.

Bulgaria:

37 Methodological manual for pension funds statistics ([ISPFS_Oct01_doc14_PF_Manual.pdf](http://example.com)).
Pension fund statistics relate to institutions for occupational retirement provisions.

**Czech Republic:**
The Czech private pension funds are not occupational based in nature. The beneficiaries can enter in a contract with the pension fund directly regardless of their occupational status.

**Denmark:**
The pensions fund sector in Denmark is very limited. This sector has the size of 1/50 or 2 pct. of the Pillar II sector (the entire occupationally pensions sector) in Denmark. The number of active (working) members in all pension funds in DK is about 7000 persons and the total amount of assets is approximated € 5 billion. Consequently Finanstilsynet in Denmark do not, for the pension fund sector, regularly report to CEIOPS.

**Finland:**
Statistics do not include Finnish statutory pension schemes operated by individual undertakings/foundations/funds. Statistics only relate to occupational pension funds by Directive 2003/41/EC.

**Germany:**
The pension funds statistics relate to institutions for occupational retirement provision that fall under the scope of the IORP Directive, i.e. Pensionskassen and Pensionsfonds. Beside these two types of implementing occupational pensions there exist three further types, namely Direktzusage (book reserves), Unterstützungskassen (support funds) and Direktversicherung (direct insurance) that do not fall under the scope of the IORP Directive and are therefore not considered.

**Hungary**
The data shown for 2008 for Hungary has been based on the mandatory DC private pension funds. These pension schemes are autonomous, DC and operate on a funded basis. Based on the World Bank’s classifications, mandatory pension funds belong to the 2nd pillar.

**Italy:**
Data cover autonomous pension funds instituted both as independent legal entities (contractual pension funds) and as pools of segregated assets (open pension funds) set and managed by financial intermediaries. The data does not include book reserve schemes.

**Latvia**
Pension fund statistics relate to private pension funds and cover both occupational and individual pensions.

**Luxembourg:**
There are 2 supervisory authorities in Luxembourg:
The CSSF is the competent authority for pension funds governed by the law of 13 July 2005 relating to institutions for occupational retirement provision in
the form of SEPCAVs and ASSEPs and the Commissariat aux Assurances is the competent authority for insurance products as well as pension funds governed by the Grand Ducal Regulation of 30 August 2000.

Pension fund statistics cover pension funds governed by the law of 13 July 2005 relating to institutions for occupational retirement provision in the form of pension savings undertakings with variable capital (SEPCAVs) and pension savings associations (ASSEPs).

**Netherlands:**
Pension fund statistics relate to all Pillar II institutions for occupational retirement provisions.

**Norway:**
Pension fund statistics relate to institutions for occupational pensions (so-called "pensjonskasser"), and cover both private and municipal pension funds.

**Poland**
Occupational pension schemes operated in Poland cover:
1. occupational pension fund
2. agreements with life insurance undertakings
3. agreements with investment fund undertakings
4. foreign management undertakings

All information included in the pension funds statistics relates only to occupational pension funds. The activity of the occupational pension funds in Poland is based on similar regulations as the open investment funds.

**Portugal:**
Data include all occupational pension schemes including substitutive funds from the banking and telecommunications sectors established through collective agreements. No figures regarding technical provisions are provided due to the distinctive legal framework under which Portuguese pension funds operate.

**Romania:**
The statistics refer to the voluntary pensions, regulated by the Law no. 204/2006 regarding the voluntary pensions, as amended and modified (according to the IORP Directive provisions).

**Slovakia:**
Recent pension system reforms have introduced mandatory funded occupational pensions as of January 2005.

**Slovenia:**
Data includes all contributions to pension undertakings, mutual pension funds and contributions collected by insurance undertakings from pension contracts.
Spain:
All the data relates only to occupational pension funds (by Directive 2003/41/EC) which account for about 40 percent of the total pension fund sector. In addition, there are also individual and associated pension funds operated in Spain.

Sweden:
The Swedish pension fund statistics refers to a special form of "friendly societies" and accounts for less than 10 percent of the overall non-state related occupational pensions. The remaining occupational pensions are almost entirely covered by life insurance undertakings.

UK
The entry for the UK relates schemes covered by the Institutions for Occupational Retirement Provision Directive. Both defined benefit and defined contribution schemes exist in the UK. 2008 date has been based on an estimated aggregate position and the results of a small sample of UK schemes.