

Addendum to the Position Paper of the EIOPA Occupational Pensions Stakeholder Group (OPSG) On the IORP Directive

EIOPA-OPSG-16-04

17 March 2016

The OPSG prepared a Position Paper in June 2015 on the European Commission's proposal for revision to the IORP Directive, which was published in March 2014.

The OPSG expressed its support for the Commission's objectives, particularly in relation to governance and disclosure of information to members and beneficiaries, but the paper also highlighted a number of areas of concern to OPSG, including

- The need for a proper balance between internal market and Member States i.e. subsidiarity
- The need to recognise the role of social partners
- The "fit and proper" requirements should not apply on an individual basis as this could exclude many member trustees
- The retention of some obstacles to cross border activity
- There should not be a one-size-fits-all approach to disclosure of information
- There should not be powers given to the Commission to make Delegated Acts in relation to remuneration policy, risk evaluation and pension benefit statement but these issues should be set out in sufficient detail in the Level 1 text.

The OPSG notes the amendments proposed in the Council negotiating draft agreed in November 2014 and the Parliament proposal as approved by ECON in January. Although it is not practical to produce a detailed position paper on the various alternative proposals, OPSG has considered these in the light of its earlier position paper and this brief paper sets out the OPSG's views on the key issues.

The OPSG is pleased to note that a number of its concerns in relation to the Commission proposal have been addressed by Council, or ECON, or both. In particular

a) Fit and proper requirements

Both Council and ECON propose that those running the IORP should *collectively* be fit i.e. should possess the qualifications and experience necessary to manage the IORP, and should *individually* be proper i.e. of good repute and integrity. OPSG is strongly supportive of this

approach. In addition, Council extends the fit and proper requirements to *outsourced functions*, which OPSG considers appropriate, subject to proportionality. ECON proposes that key function holders should have *professional* qualifications, which OPSG considers appropriate. OPSG considers that these proposals strike a good balance between the need for effective management of the IORP and the inclusion of social partners in its governance.

b) Subsidiarity

This issue is recognised in Recital paragraph (2a) proposed by both bodies which states that this is a minimum harmonisation Directive. ECON emphasises this further in its proposed paragraph (2c):

The Commission and ..EIOPA.. should take account of the various traditions of the Member States in their activities and should act without prejudice to national social and labour law in determining the organisation of institutions for occupational retirement provision.

There are references in the proposals of the two bodies to the Member States and National Competent Authorities to have powers to decide on the detail of the content of the risk evaluation/assessment, the pension benefit statement and investment powers. The OPSG is in favour of such powers being given to Member States where appropriate, subject to compliance with an overall set of high-level principles set out in the Directive.

c) Proportionality

The proposals of the two bodies explicitly refer to the proportionality objective in a number of areas, particularly in the section on governance. A particular example is the proposal that an individual or unit can fill more than one key function (other than internal audit), and may act for both IORP and sponsoring employer if there is no conflict of interests.

d) Delegated Acts

Both bodies have deleted these provisions. OPSG agrees that there should be no competences for the implementation of Delegated Acts within the Directive.

e) Depositary

Both bodies have proposed an amendment which would provide leeway at national level to exempt pure DC schemes from the need to appoint a depositary if they invest in products which are themselves subject to the requirement to have a depositary.

There are a number of areas where the three proposals are substantially aligned although the exact wording will need to be considered carefully.

OPSG has identified four broad areas where agreement will need to be reached:

a) Cross border activity

OPSG agrees that obstacles to cross border activity should be removed, provided the interests of members and beneficiaries are properly protected. The Directive sets out a process involving the IORP, the home state competent authority and the host state competent authority which is designed to ensure that members' interests are protected, both by prudential supervision and social and labour law. This process should be as efficient as possible i.e. each of the bodies involved should have clear responsibilities to be discharged within a reasonable timescale, and should be required to give a reasoned decision if they are unable to do so.

There are three aspects on which OPSG would comment:

a) The OPSG acknowledges that the "fully funded at all times" requirement was initially introduced in the IORP directive to prevent regulatory arbitrage as regards the prudential requirements applied to IORPs in the different Member States. It is, however, a material obstacle to cross border transfers which do not have the objective of regulatory arbitrage and we note the ECON proposal that Article 15(3) be amended to remove the requirement i.e. to have the same option of a recovery period as in a single country IORP "*provided that the interests of members and beneficiaries are fully protected*". OPSG agrees that it is paramount that the interests of members and beneficiaries are fully protected, but suggest that consideration be given to adopting an alternative approach to ensuring this which would make it easier for companies to establish cross border IORPs in line with the objectives of the Directive.

b)

We note that the ECON proposal also includes text in Article 13(1) which appears to contradict their proposal to remove the fully funded requirement in the case of the transfer of part of a scheme:

In the event of a transfer of part of a pension scheme, Member States shall require the transferring and the receiving institution to have sufficient and appropriate assets to cover the technical provisions for the transferred part and the remaining part of the scheme, in accordance with Article 15(1).

The Council proposal has a less prescriptive approach to safeguarding the members' interests, stating that in the case of a partial transfer the home state of the transferring IORP must "*verify the viability of both the transferred and the remaining part of the pension scheme.*" This seems to be a more flexible approach, although it would seem more appropriate for the "viability" of the transferred part to be verified by the home state of the receiving IORP. We do not think that it is necessary to require home state approval of the transfer, which is not currently required under the Directive and would create another hurdle to cross border activity.

c) The requirement (unless disapplied by social and labour law) for approval of a cross-border transfer by members and beneficiaries, or their representatives, as proposed by the Commission in Article 13 is impractical if it means that all members and beneficiaries must give their consent, as this will never be possible in an IORP with many members. The ECON proposal amends this to provide that a majority of members and a majority of beneficiaries, or a majority of their representatives, must approve a transfer, and Recital paragraph 24 notes that "representatives" can be taken to include, for example, trustees in a trust based IORP (e.g. as in UK and Ireland). OPSG considers this to be a better approach as

- The trustees are required to consider the best interests of all of the members and beneficiaries and hence can safeguard members of smaller groups who might be disadvantaged by a majority vote of members

- The trustees can take advice (legal, actuarial etc), and engage on a detailed level with the sponsor, to enable them to evaluate the proposal and if appropriate seek some amendments

It would be preferable if the term "representatives" was defined in the Articles as including trustees or others who have a fiduciary responsibility in relation to the members of the transferring scheme.

- d) ECON propose a new Article 3a entitled "Duty of Care" which gives the competent authorities of the home state of a DB IORP in respect of which it is proposed to make a cross-border transfer, which has been approved by the members and beneficiaries or their representatives, the power to refer the proposal to EIOPA *to assess whether there could be any systemic risk to the EU financial system arising from the transfer and whether the long-term interests of members and beneficiaries are negatively affected if the transfer were to proceed.*

In addition, ECON propose a power under Article 15 to refer to EIOPA any issues on which the competent authorities do not agree.

OPSG considers the proposed Article 3a to be unnecessary as it is difficult to see why a transfer would give rise to systemic risk, and the members' interests are protected by the prudential supervision of the home state of the receiving scheme, which by definition will meet the requirements of the Directive. However, if such a power existed, competent authorities of Member States might feel that they should refer cases to EIOPA to protect their own position, and this would create another obstacle to cross-border activity.

The proposed Article 15 provides a way to resolve differences of interpretation between competent authorities to EIOPA for resolution and OPSG considers this to be beneficial. An alternative approach would be to revise the Budapest Protocol which sets out in detail the procedures to be followed in relation to the establishment of a cross-border IORP.

b) Calculation of technical provisions

Art. 14 of the draft Directive deals with the calculation of the technical provisions of an IORP. According to the proposal of the Commission and the text proposed by the Council, the wording should remain unchanged in comparison to the current IORP Directive. Contrary to this, ECON proposes an amendment in Art. 14 (4), which sets out how IORPs may determine the rate of interest to be used in calculating technical provisions, that would require IORPs who set the discount rate taking into account to the market yields on bonds to determine to maximum rates of interest used in future according to the **current** market yields of high-quality bonds, government bonds etc. The reference to **current** market yields and thus to a **current** market valuation would be inconsistent with the procedures in some Member States where IORPs are obliged to calculate their balance sheet and thus also their level of technical provision via book values.

Although the Directive permits Member States to allow for temporary underfunding combined with a recovery plan, this is not the case in all Member States and hence IORPs have to be fully funded at all times. Any reference to a market valuation of technical provision would lead to a much higher

volatility of the level of technical provisions without giving IORPs time periods to react to such volatilities. For these reasons, the proposal to refer to **current** market yields should not be accepted.

c) Risk assessment/evaluation

This is covered in Article 29 – the Commission proposal provided for a Delegated Act under Article 30 but this has not been supported by Council or ECON, so more detail has to be included in the Directive.

The Commission used the term "risk evaluation" whereas ECON have used "own risk assessment" which reflects the ORSA under Solvency II but without the "solvency" part. OPSG has no view on which term is more appropriate but consider the detail of what should be covered in the evaluation/assessment should be determined by the IORP, subject to the requirements of the national competent authority, which in turn will be required to comply with principles set out in the Directive. The objective should be to enable the IORP to identify, quantify (where possible) and manage the various risks to which they are subject, and to demonstrate how they would deal with adverse conditions e.g. perform their own stress test. This should require a quantitative assessment in relation to some risks, recognising the need for proportionality and cost controls. OPSG agrees that the document should be produced at least every 3 years (or if there is a major change to the risks being taken by the IORP) and should be available on request to members.

d) Disclosure to members and beneficiaries

The Commission proposal has been substantially amended by Council and by ECON, although the general principles are not in dispute – members and beneficiaries should receive timely, clear, concise information which enables them to understand the provisions of the IORP, what (if any) guarantees exist and how they are financed. This may be provided electronically but members have the right to request paper copies. If the information is provided via a website, it is easy to "layer" the information by showing the key features on a single page, and providing additional information which can be readily accessed by "drilling down". OPSG considers that this is a very effective way to provide information to members and should be encouraged.

OPSG agrees that information needs to be provided to members on the risks they bear, on the nature of their pension promise (eg soft vs hard guarantees), on the costs and charges incurred, and (for DC IORPs) investment performance and risk ratings. The detail of how these are presented should be left to IORPs or national competent authorities based on principles in the Directive. OPSG would specifically comment on:

- a) The COMM proposal includes *Article 56 - Information to be given to members during the pre-retirement phase* which Council has deleted. ECON has amended this Article. OPSG agrees that it is important that such members get relevant information to enable them to plan their retirement in good time and that it would not be appropriate to require IORPs to give members advice on the options available, and this is reflected in the ECON text.
- b) The COMM proposal sets out in *Article 48 – Guarantees* how to disclose to members the nature of any guarantee provided by the IORP. This Article is deleted by both bodies but Council refer

to this in Article 47(4) (3c) and ECON in Article 40a (5) (c). However, these references are very limited and OPSG supports the approach taken by COMM in this regard.

- c) The COMM proposal sets out in *Article 50 - Pension projections* but this article has been deleted by Council with replacement text in Article 49(4) and ECON (but projections are referenced in Article 40a(5)). The provision of projections (particularly for a DC IORP) is a complex exercise and requires that reasonable "best estimate" assumptions be made about the future. These are generally based on the mean or median expectation for future returns i.e. the individual has a 50% chance of getting a higher benefit and a 50% chance of getting a lower benefit. ECON also envisages demonstrating "*an extreme but plausible worst case scenario*" for investments. OPSG recognises that members should realise that, depending on the investment strategy adopted, and the nature of any guarantees, they could lose money but are concerned that showing only the potential downside, and not the potential upside, may discourage individuals from saving for retirement at all.
- d) In DC systems the entire risk is taken by the beneficiaries and the impact of costs and charges on annuities can be significant. For DC systems, Member States should require specific detailed cost disclosure rules to ensure transparency for the beneficiaries. DC pension funds should be obliged to report in detail the performance of the investments, the fees and the investment risks on a regular basis. In detail that would be:
- Itemised information of gains or losses (dividend, interest income, development of stock prices and exchange rates, performance on other assets)
 - Results and risk position regarding derivatives
 - Disclosure of the Total Expense Ratio per asset allocation (RTER), including all fees for single investment funds (management fees, compensation for managers, safe custody charges, audit and service fees, trading and transaction fees, broker's commission, stock exchange tax, profit-based compensation, fees for consulting services, expenses for the investment committee).
 - These cost components shall be published as individual components in any case.
 - Implementation of benchmarks independently determined and in line with the market to compare asset categories
 - This information shall also be monitored by an independent authority or auditor.
 - Performance based limitation of management fees could help to reduce the risk of beneficiaries.

OPSG also takes this opportunity to comment on two further aspects of the proposals to amend the Directive

Environmental, social and governance risks (ESG)

The Commission proposal requires that the risk evaluation for pensions includes

a qualitative assessment of new or emerging risks relating to climate change, use of resources and the environment.

ECON have expanded this reference to "*climate change, use of resources and the environment, social risks and risks related to the depreciation of assets due to regulatory change.*" The Recital clarifies that the final reference relates to "stranded assets" e.g. fossil fuel reserves which become unviable. ECON have also explicitly referenced ESG in Articles 20 (Investment rules), 22 (Common principles of governance) 26 (Risk management), 32 (Statement of investment policy principles) and 55 (member disclosures).

Pension funds recognize that with their long-term horizons, Responsible Investment is an important issue and embedded in finding a balance between risk and return on investments. Pension funds' boards and participants alike believe that a good retirement should be enjoyed in a world that is worth living in, for current and future generations to come. Because of their long investment horizon, pension funds (and other long-term investors) need to consider and prepare for scenarios that may seem unlikely in the short run, but with potentially negative consequences in the long run, both for their participants and beneficiaries and their portfolios. They consider it only good risk management to incorporate sustainability factors. Hence ESG criteria ought to be an integral part of the investment beliefs. Social returns are not a substitute for financial returns, but many funds express an ambition to generate social returns without compromising financial returns.

Intergenerational balance

A number of references to intergenerational balance have been included in the ECON draft: this is introduced in their text for Recital 3:

Member States should take into account the objective for all institutions of ensuring the intergenerational balance of occupational pension schemes, by aiming to have an equitable spread of risks and benefits between generations.

There are also specific references to the "intergenerational balance" in Articles 20 (Investment Rules), 29 (Risk assessment) and 60 (Prudential Supervision).

OPSG would point out that intergenerational balance is not applicable in circumstances where each member bears all of his/her own risks, with no guarantees being provided by the IORP or any other party.

The objective of ensuring intergenerational balance is an important topic that has to be discussed. But, due to the existing different pension systems in the different Member States and their interaction with first pillar systems, such discussions always should to be pursued on the national level. If there are intergenerational issues to be resolved with respect to pension schemes in Member States, the national level is the adequate level to deal with such issues and to find sustainable solutions. Therefore, the suggested additions should not be part of the final version of the Articles of the IORP II Directive but could for example be part of the recitals of the Directive.

The primary objective of an IORP is to pay all benefits to members and beneficiaries as they fall due. However, it may be the case that different cohorts of members have different benefit entitlements, due to changes over time in employment terms or in legislative provisions, so that there may not be "an equitable spread of benefits between generations", and the IORP should not have an objective of providing intergenerational balance where this is not intended.

In relation to risk, it is likely that the risks being borne by members who will not receive benefit payments for many years are higher than those being borne by retirees currently in receipt of pension payments, and it would be impractical, and not desirable, to attempt to provide intergenerational balance in this context.

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Adopted by the EIOPA Occupational Pensions Stakeholder Group on 29 March 2016

The Chairperson of the EIOPA Occupational Pensions Stakeholder Group

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