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## **KEYNOTE ADDRESS**

### **PENSIONS IN EUROPE: CURRENT CHALLENGES AND FUTURE PROSPECTS**



***Occupational Pensions between European Union Rules and National Solutions***  
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Ladies and Gentlemen,

First of all, thank you very much for the invitation to speak at today's conference addressing a hugely important topic which concerns all of us – **pensions**.

Pensions should allow us to enjoy a well-deserved retirement after an active employment. Planning for retirement raises questions such as “will I save enough for a decent life afterwards”, “will my living standards fall” or “will the inflation wipe out my savings?” In the turbulent economic environment of the past few years, these questions are extremely relevant and well-placed.

Europe faces **severe concerns about sustainable and adequate pensions** which forces employees, employers and governments to re-examine their retirement strategies. National pensions systems are challenged by **demographic** and **labour market** changes, as well as **pressure on national budgets**. The population in the European Union is ageing due to a combination of increasing longevity and low birth rates. National pensions systems more and more rely on supplementary private pensions. However, traditional employment-based pensions systems are not **necessarily prepared to support the changing environment** of the labour market and **cannot cater for unemployed, entrepreneurs or mobile workers**. According to World Bank data in some Member States, less than one half of the working age population are active members of mandated pension schemes<sup>1</sup>. Traditional patterns where the resources to pensioners were transferred from workers can therefore not be the only solution anymore.

It's clear that in order to address these pertinent problems, we need **occupational and personal pension schemes to fill in this gap**.

Going forward, we encounter some further challenges. There are **very divergent pensions systems** in Europe, **diverging importance of Pillar I, II and III, different types of pension arrangements and personal pension products**. In a number of Member States there are **no or very few occupational pensions**. In Austria for example, only one quarter of employers offer an occupational pension to circa 23 % of the working population.

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<sup>1</sup> World Bank: World Bank Dataset, Active Coverage, 3Q2014

In the Member States where the Institutions for Occupational Retirement Provision (IORPs) are present, they experience a **challenging economic environment**, including falling asset values and bond yields in an extremely low interest rate environment. Pension liabilities have significantly outgrown related assets.

**These are some of the challenges for Europe to respond and to act promptly in the coming months and years.**

In my intervention today, I will outline what Europe has done so far, what is EIOPA's work in relation to pensions and what are the future steps and divided my speech into three parts:

- First, I will talk about the **challenges and benefits of the IORP II**, a new Directive that came into force in January this year
- Second, I will continue with **EIOPA's work on private pensions and the PEPP, a pan-European Personal Pension Product**
- Third, I will conclude with **EIOPA's initiative relating to the 2<sup>nd</sup> regime for Defined Contribution Occupational Pensions Schemes**

### **To my first point: Challenges and benefits of the IORP II**

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

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

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

- **Streamlining** the **authorisation of cross-border IORPs and transfers**
- **Promoting consistency and supervisory convergence** in key areas, such as **transparency**, including information to members and beneficiaries, **governance requirements** and **risk management**

EIOPA believes that there should be **an efficient Single Market for private pensions to the benefit of European citizens**. Currently 80 active cross-border IORPs in Europe seem to speak a different language. One of the crucial tasks of EIOPA will be to take a more active role in **supporting the authorisation and setting up of cross-border IORPs**. EIOPA welcomes the **express right to mediate in more complicated cases**.

Further, EIOPA has been **promoting more transparency in the pensions sector** and will **further research good practices at national level to support relevant national implementations and consistency of information to empower national and European pensions tracking services**. In terms of information regarding the pension promises, **clear transparency about cost and charges, performance and pension projections is of paramount importance**. Transparency about the IORP itself, in line with the ideas developed in **EIOPA's Opinion a Common Framework for Risk Assessment and Transparency for IORPs**, is equally important.

Concerning the defined benefit pension schemes, which unfortunately become more and more a legacy issue, EIOPA believes that there is a need to build appropriate incentives for a proper dialogue between employers and employees on their long-term sustainability. However, this important dialogue should be based on valuations and risk assessments that reflect economic reality: Without that we will not contribute to a better risk management, will fail to reflect the true risks that the different stakeholders are running and will help to preserve schemes that are clearly unsustainable, postponing the taking up of measures in due time. The inevitable consequences in the short to medium term will be a sudden lowering in the value of pensions for the members and beneficiaries, higher concentration of costs for employers and ultimately intergenerational conflicts.

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

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

- (2) **Enabling IORPs** via good governance and risk management, **to invest in the best interest of members and beneficiaries.** Promoting sustainable investments, considering factors like environmental or social impacts of those investments, is natural to the business of providing retirement income.
- (3) **Being transparent:** This is about **comparable and relevant information to current and future members and beneficiaries,** but also about **relevant data to be submitted to supervisors and regulators.** Much more **analysis on the macro- and micro-impact of pension funds on financial markets and financial stability** is needed.

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

### **Let me now turn to my second point: EIOPA's work on private pensions and PEPP, a pan-European Personal Pension Product**

In response to the European Commission's Call for Advice and following a thorough due process, EIOPA issued its advice on how to develop a European Union Single Market **for personal pension products** – in light of the European Commission's initiative of implementing a Capital Markets Union.

In the area of long-term retirement savings, it is evident that the European Union internal market is far from delivering its full potential. There is a huge fragmentation of products available to consumers, from low-performing deposits, to very often too complex and costly life insurance and mutual funds, many of them not truly retirement saving products. Also consumer protection rules are very different in the various European Union Member States. This fragmentation is a serious obstacle to cross-border business, increases the costs, reduces the average returns for savers and ultimately undermines consumer confidence in private pension provision.

**Consumers' awareness of the imminent need of additional pension savings has to be raised. Trust in personal pension products and their providers' needs to be built to promote further savings.** EIOPA is convinced that personal pension savings will only deliver on the promise of enabling adequate replacement rates in the future, if those **products are fair and savings are safe** - in the sense of **trustworthiness -, cost-effective and transparent**, as well as **sufficiently flexible to cater for a European labour market.**

In particular, cost-efficiency can be increased by taking advantage of the economies of scale allowed by the cross-border provision of services in the European Union internal market.

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

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

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

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

The PEPP should have a **long-term perspective in its investment policy** to better reflect the long-term nature of retirement savings. This is particularly

welcomed from a macro-perspective because long-term investors are needed to provide stable funding to the European Union economy. In order to allow this long-term investment horizon, the **PEPP should envisage minimum holding periods to mitigate the surrender risk. Sustainable investment in illiquid assets should match liabilities with a correspondent illiquid profile.**

**Furthermore, a key element for the success of the PEPP is the tax regime applicable. We believe that the PEPP should have the same tax advantages than the national personal pension products.**

EIOPA stands ready to further work on PEPP, namely in the design of „product pilots“. We intend to explore pure **individual Defined Contribution Schemes** but also **collective Profit Sharing Products**.

While pure individual Defined Contribution Schemes can be designed to adjust investment risk throughout the live of the contract, thus reducing risk for members, the development of collective Profit Sharing Products could allow the **pooling of investments** with the smoothing of returns across members of the pool, so that all members benefit from **average long-term returns** of the fund and are **protected from extremely negative outcomes** in stressed market situations.

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

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

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

***Turning to my third and last point: The 2<sup>nd</sup> regime for Defined Contribution Occupational Pensions Schemes***

Whilst the PEPP is designed as a personal product, I believe that some of its learnings can benefit occupational pensions, too.

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

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

**Conclusion**

Ladies and Gentlemen, there are number of challenges ahead of us. But there is also a bright side and some solutions are already on the horizon.

We all need to be aware of the **imminent need of additional pension savings**. It is of utmost importance that **retirement savings are based on truly long-term strategies, and that products offered to European citizens are fair and cost-effective**.

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

**We also believe that a pan-European Personal Pension Product** has the potential to become the most tangible outcome for the European citizens. It will help in the provision of adequate retirement savings. And with the PEPP we could see the benefits of building a true single capital market.

Thank you for your attention.