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CEIOPS response to European Commission Green Paper - "Towards adequate, sustainable and safe European pension systems"

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1. Introduction

1.1 The Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) is the Level 3 Committee for the insurance and occupational pensions sectors under the so called "Lamfalussy Process". CEIOPS is composed of high level representatives from the insurance and occupational pensions supervisory authorities of the European Union Member States. The authorities of the other Member States of the European Economic Area (Norway, Iceland and Liechtenstein) and the European Commission participate in CEIOPS' activities as observers. CEIOPS is involved in both Level 2 and 3 Lamfalussy activities by:

- providing advice to the European Commission on drafting of implementation measures for framework directives and regulations on insurance and occupational pensions; and
- issuing supervisory standards, recommendations and guidelines to enhance convergent and effective application of the regulations and to facilitate cooperation between national supervisors

1.2 The CEIOPS response to the Green Paper is limited to those issues within the competence of CEIOPS which are not political in nature. However, although it is not for CEIOPS to propose solutions for all problems identified in the Green Paper, as supervisors we can present our technical assessment and practical experience of the situation and we stand ready to help the EC from a technical perspective. Based on the expertise of its Members¹ and on work undertaken in recent years and on current projects, CEIOPS can identify difficulties encountered in practice and potential areas for improvement and can provide further help. Because of the complexity of pensions and the wide range of different approaches throughout the EU/EEA, it is important that CEIOPS be involved in the development of any detailed proposals.

1.3 The approach adopted in the remaining sections of this document is as follows:

Part 2 sets out an overview of the most important themes.

Part 3 comments on a number of statements in the text of the Green Paper.

Part 4 addresses each of the fourteen questions in the Green Paper. This has been undertaken as follows:

- We have provided answers to those questions that fall within CEIOPS competence and where agreement is possible;
- Where there are divergent views, we have set out the range of views; and
- We have identified those areas within its competence where CEIOPS can contribute to further work.

¹ References in this document to the Members of CEIOPS are deemed to include both the (EU) members and the (EEA) observers of CEIOPS

2. Overview

CEIOPS welcomes the Green Paper as an important event for European pensions, and fully shares the objectives of the paper of providing greater security, efficiency and adequacy in retirement provision. The Green Paper is a comprehensive analysis of the challenges facing European pensions and deals with all relevant issues. CEIOPS especially welcomes the fact that the approach adopted integrates economic, social and financial market issues and thereby acknowledges the complexity of pensions. We also recognise the importance of the issues of adequacy, sustainability and demographic change which are raised in the Green Paper, and the need for a multi-tiered and integrated response.

This response from CEIOPS addresses specific issues identified in the Green Paper. However, subject to the specific comments in section 3 below, it is important to state that CEIOPS accepts and endorses the analysis of pensions set out in the Green Paper, insofar as it deals with matters within its competence.

Funded pensions (i.e. backed by a fund of assets) represent a considerable proportion of the wealth of citizens of Member States, and therefore the importance of this sector, the expectations of members and beneficiaries, as well as the economic impacts must be recognised. However, pensions also have a social aspect, which should be respected. CEIOPS notes and welcomes that the Green Paper does not question the prerogatives of Member States in pensions and that it does not propose a one-size-fits-all pension system design. CEIOPS' view is that this is one of the most important statements in the Green Paper, and must be borne in mind when considering all issues.

It is CEIOPS' view that any future development of pensions as a result of this Green Paper must take account of a number of factors:

Diversity and complexity

Pensions are more diverse and complex than many types of financial services because of the different patterns of provision among Member States, the social and employment aspects and the different supervisory structures. Pension policy development must take full account of this complexity.

Governance

Private pension provision and pension institutions take many forms. However, in all cases, the success of the provision in achieving its objectives depends significantly on the governance standards of the institutions. This governance must be at the heart of future development of IORP regulation.

CEIOPS involvement

CEIOPS and its Members represent a source of considerable expertise and information about pension matters, and will be responsible for overseeing the implementation and ongoing application of any future IORP framework. It is important therefore that CEIOPS be involved in the development of this framework to ensure that the result can achieve its objectives as efficiently as possible.

There are no simple answers to the questions posed in the Green Paper. This paper is a significant challenge for all involved in European pensions. CEIOPS looks forward to working with the Commission on the follow-up to the Green Paper including the intended review of the IORP Directive and stands ready to undertake any work needed in this area.

3. Comments on texts in the Green Paper

- 3.1 Extract from section 1, page 2: *"Member States are responsible for pension provision: this Green Paper does not question Member States' prerogatives in pensions or the role of social partners and it does not suggest that there is one 'ideal' one-size-fits-all pension system design."*

CEIOPS' view is that this is one of the most important statements in the Green Paper, and must be borne in mind when considering all issues.

- 3.2 Extract from section 3.3.1, page 11: *"Barriers are in many cases the result of regulatory differences and legal uncertainties, such as an unclear definition of cross-border activity, a lack of harmonisation of prudential regulation and complex interaction between EU regulation and national law."*

CEIOPS endorses the view that there are significant barriers to cross-border activity: its recently published "2010 Report on Market Developments"² showed that by June 2010, there were only 78 IORPs located within the EEA notified to operate cross-border, and that not all of these institutions necessarily have any cross-border activity.

The most significant barriers to this activity are:

- Uncertainty about the legal steps necessary to set up and operate a cross-border IORP;
- Differences among Member States in the definition of what constitutes cross-border activity;
- Uncertainty about the extent and effect of social and labour law as it applies to pensions among Member States; and
- Taxation issues, including uncertainty about the tax treatment and/or the approval process for contributions to cross-border IORPs.

It should be noted that the last two factors are the prerogatives of Member States.

The CEIOPS report of April 2008 "Initial review of key aspects of the implementation of the IORP Directive"³ found that differences in prudential regulation do not seem to be as great a barrier to cross-border activity at the present time.

Some of these issues are considered further below in the response to question 5.

- 3.3 Extract from section 3.4.1, and from bullet (3), page 13: *"As pension provision moves from single to multi-tiered systems and from simple to complex pension packages, the fragmented and incomplete character of the present European framework may no longer be sufficient."*

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² https://www.ceiops.eu/fileadmin/tx_dam/files/publications/reports/CEIOPS-IORP-Market-Developments-Report-2010.pdf

³ https://www.ceiops.eu/fileadmin/tx_dam/files/publications/submissionstotheec/ReportIORPdirective.pdf

(3) *There are unclear boundaries between: social security schemes and private schemes; occupational and individual schemes; and voluntary and mandatory schemes.*"

CEIOPS recognises that there could be some unclear boundaries, especially from an EU rather than national perspective. However, this position should be seen in a context where all Member States are aiming to ensure a consistent end result i.e. adequate protection of benefits rather than an identical supervisory framework.

3.4 Extract from section 3.4.1, bullet (4), page 13: *"It is not always clear what differentiates general saving from pensions. This raises the question whether the label 'pension' should not be restricted to a product that has certain features such as security and rules restricting access including a payout design which incorporates a regular stream of payments in retirement."*

CEIOPS' view is that it would be helpful to have a definition that distinguished pensions from other savings products. However, the consequences of any potential change to labels or terminology must be thoroughly considered and must not unsettle current practice, or risk causing unanticipated consequences. It would be important that the introduction of a 'restricted' definition of pensions would be done in pursuit of stated objectives, and there must be a strategy for those forms of retirement saving excluded by a restricted definition. A simple restriction on the definition of pensions might lead to a situation where some existing pensions would be left outside the EU regulatory framework.

CEIOPS disagrees with the suggestion in the Green Paper that security be one of the criteria for the definition of 'pension'. CEIOPS is of the view that security should be the result of the identification of a product as a 'pension'. Any other approach could lead to the result that less secure products could never be pensions, which would open possibilities for arbitrage.

3.5 Extract from section 3.4.1, page 14: *"International policy discussions raise the question whether current EU regulation is able to cope with the shift towards DC schemes. A reassessment of the IORP Directive may be required in areas such as governance, risk management, safekeeping of assets, investment rules and disclosure. In addition, the current EU framework does not address the accumulation phase. This includes (i) plan design to mitigate short-term volatility in returns and (ii) investment choice and default investment options."*

In general, defined benefit and defined contribution IORPs use the same general EU supervisory framework as set out in the IORP Directive, for instance as regards safekeeping of assets investment and disclosure. There are only a few differences between DB and DC in the Directive, for instance in article 11 (4) (c).

Many fundamental issues are common to both types of pension such as safekeeping of assets, and management competence, but there are clearly some issues specific to DC that could be addressed. The important difference between DB and DC is who bears the risks. CEIOPS agrees that it should be investigated and discussed whether there should be further differentiation in the framework, and is currently undertaking a project which examines the specific risks borne by DC members of IORPs.

3.6 Extract from section 3.4.2, page 14: *"These solvency rules are currently the same as those that apply to life assurance undertakings."*

It is important to point out that firstly this statement in the Green Paper only applies to the regulatory own fund provisions covered by Article 17 of the IORP Directive, and furthermore that these rules are based on Solvency I, not on the Solvency II Directive which is being introduced.

The technical provisions requirements for IORPs which are defined in principle in articles 15 and 16 of the IORP Directive are not the same as for life insurance, and are not identical among Member States. The issue of technical provisions and related matters is dealt with further below in the detailed answer to question 10.

3.7 Extract from section 3.4.2, page 15: *"The suitability of Solvency II for pension funds needs to be considered in a rigorous impact assessment, examining notably the influence on price and availability of pension products."*

There are different views among CEIOPS Members about the suitability of Solvency II for IORPs. Examples of views include, inter alia, the full application of Solvency II rules to IORPs and the development of an independent solvency regime for IORPs. This matter is discussed further below in the detailed answer to question 10.

CEIOPS recognises the importance of thorough impact assessments of any proposed solvency regime, despite the challenges they present.

The Commission and Member States may wish to pursue a broad examination, which will go beyond a limited assessment of financial impact. This might include, where relevant, the effect on competition if opting-out is not permitted, and the effect on participation rates where participation is wholly voluntary.

The impact assessments may present specific issues including:

- Small IORPs may not be in a position to handle the cost or complexity of detailed impact assessments. There are significant numbers of small IORPs throughout the EEA; and
- If a proposed regime is more technical than what is currently in place, there may be significant challenges of technical resources.

4 Questions of the Green Paper

- (1) *How can the EU support Member States' efforts to strengthen the adequacy of pension systems? Should the EU seek to define better what an adequate retirement income might entail?*

CEIOPS has no comment to make on this question. However, CEIOPS would be well placed to assist the Commission in gathering data on the current situation within CEIOPS Members' areas of competence.

- (2) *Is the existing pension framework at the EU level sufficient to ensure sustainable public finances?*

CEIOPS has no comment to make on this question.

- (3) *How can higher effective retirement ages best be achieved and how could increases in pensionable ages contribute? Should automatic adjustment mechanisms related to demographic changes be introduced in pension systems in order to balance the time spent in work and in retirement? What role could the EU level play in this regard?*

CEIOPS has no comment to make on this question.

- (4) *How can the implementation of the Europe 2020 strategy be used to promote longer employment, its benefits to business and to address age discrimination in the labour market?*

CEIOPS has no comment to make on this question.

- (5) *In which way should the IORP Directive be amended to improve the conditions for cross-border activity?*

CEIOPS has no comment to make on the question of what steps should be taken, if any. However, CEIOPS work to date has identified a number of barriers to the development of cross-border IORP activity, not all of which fall under the IORP Directive. These are as follows:

- Different definitions of the various concepts related to cross-border activity;
- Diversity in the extent and content of social and labour law provisions relevant to the field of occupational pensions. The extent and content of social and labour law is specifically reserved to Member States; and
- Diversity among the tax regimes relevant to the field of occupational pensions – this again is a Member State prerogative.

- (6) *What should be the scope of schemes covered by EU level action on removing obstacles for mobility?*

CEIOPS has no comment to make on this question.

However, CEIOPS and its Members offer their technical expertise within the limits of their competence and abilities on the matters covered by this question. Given

the complexity of any likely activity, it is important that this expertise be incorporated in the process.

- (7) *Should the EU look again at the issue of transfers or would minimum standards on acquisition and preservation plus a tracking service for all types of pension rights be a better solution?*

CEIOPS has no comment to make on this question.

Nevertheless, CEIOPS and its Members offer their technical expertise within the limits of their competence and abilities on the matters covered by this question. As is the situation for question 6, it is important that this expertise be incorporated in the process.

- (8) *Does current EU legislation need reviewing to ensure a consistent regulation and supervision of funded (i.e. backed by a fund of assets) pension schemes and products? If so, which elements?*

The remit of CEIOPS Members in their home states with regard to pensions is to apply national supervisory regulations. The matter of consistent regulation of pensions is therefore broader than the CEIOPS Members' remit and so outside the scope of a CEIOPS response.

However, it is important that CEIOPS participate in any such work especially as CEIOPS has already undertaken work in this area.

Especially important are what are known as pillar 1-*bis* systems. Between 1997 and 2007 most CEE⁴ countries implemented pension reforms resulting in establishment of multi-tiered pension systems where certain proportion of mandatory pension contributions (up to 50%) from the 1st pillar (Pay As You Go) have been channelled to the DC schemes managed by privately owned professional asset management institutions. These schemes are fully funded, their managers are governed by the national prudential and social security laws and they are subject to the national prudential supervision. At the EU level some of them are placed under the Social Security Coordination Regulation⁵. Most of the CEIOPS Members from the CEE region supervise not only IORPs but also these newly established schemes. In case the European Commission identifies any issues relevant to the supervision of these schemes we encourage the Commission to present them to CEIOPS, being the only platform that brings together EEA pension supervisors.

- (9) *How could European regulation or a code of good practice help Member States achieve a better balance for pension savers and pension providers between risks, security and affordability?*

This is primarily a political matter, and therefore outside the scope of a CEIOPS response.

However, CEIOPS believes that discussion of this matter would be useful and should be encouraged. As for many other issues raised in the Green Paper, it is

⁴ Central and Eastern Europe.

⁵ http://europa.eu/legislation_summaries/employment_and_social_policy/social_protection/c10516_en.htm .

important that CEIOPS participate in any such work: the project on DC risks already referred to is relevant in this matter.

(10) What should an equivalent solvency regime for pension funds look like?

The response to this question is limited to IORPs.

- (a) In April 2008, CEIOPS published the results of the "Survey on fully funded technical provisions and security mechanisms in the European occupational pension sector"⁶. This report should be referred to for a fuller consideration of the issues raised by this question.
- (b) It is an important aspect of the IORP Directive that it differentiates between local and cross-border business in applying fully funding obligations.
- (c) The 2008 report identified four principles which should underpin a IORPs supervisory framework. These are:
 - 1. A forward-looking risk-based approach;
 - 2. Market consistency for solvency purposes;
 - 3. Transparency; and
 - 4. Proportionality.
- (d) The principles of Solvency II could be used as a starting point for a solvency regime for IORPs. However, any common regime must take account of the specific nature of IORPs.
- (e) Consideration of an equivalent solvency regime for IORPs must take account of all of the factors that contribute to the solvency of occupational pension provision and the security provided to members and beneficiaries. Many of these factors are specific to IORPs.

The technical provisions obligation imposed on an IORP according to Article 2(1) of the IORP Directive is central to the security of pension benefits. This security is enhanced by whichever of the following apply in a Member State:

- Risk buffers (including regulatory own funds)
- Sponsor support (which may be limited)
- Guarantee schemes and/or other security mechanisms
- Conditional benefit promises
- Controls on contribution/premium calculations
- Use of subordinated loans and/or

⁶ https://www.ceiops.eu/fileadmin/tx_dam/files/publications/submissionstotheec/ReportonFundSecMech.pdf

- Risk management obligations and investment rules

The above factors are not listed in any order of importance: not all of them apply in all Member States, and their significance can vary from state to state and from case to case.

In addition to these factors, some Member States permit or require as a last resort mechanism a reduction in future unconditional indexation and/or adjustment of accrued benefits in certain circumstances.

A further influence on the security of benefits is the response required in case of a trigger event, for example a breach of funding requirements. For instance, the length of the recovery period has an impact on member and beneficiary security.

An important difference between a number of the factors above and the solvency regime for insurance undertakings is that only some of these factors are capitalised, i.e. they provide security in advance of anticipated events. However others represent responses that occur or are required after a trigger event.

- (f) At the moment, CEIOPS Members do not have a common level of member and beneficiary security. They also do not share a single approach to achieving security.

As regards the minimum common level of protection an equivalent solvency regime should achieve, it will need political agreement to be reached first. Member States may then achieve equivalent levels of security for IORPs through differing mixes of the elements of a solvency regime identified in (e) above

- (g) Any solvency regime obligations must take account of those aspects which may be covered by social and labour law and therefore reserved to the Member States concerned. A number of the factors set out in (e) above may be included in the social and labour laws of some Member States.
- (i) Although not formally a security mechanism or an element of a formal solvency regime, the governance of an IORP is clearly an important aspect of maintaining solvency. Any consideration of a common solvency regime should therefore take account of this matter, perhaps as a separate sequenced task.
- (j) The development of a common solvency regime will be an enormously complex task. CEIOPS has developed an extensive knowledge and expertise in the diversity of the existent IORPs regimes across the EU, including the IORPs' solvency regime. Thus, CEIOPS is able and willing to contribute decisively to this discussion but a realistic amount of time should be allowed.
- (k) CEIOPS recognises the importance of impact studies when considering any change to the solvency regime. However, these studies must be structured to allow sufficient time, and must take account of the resources of participating institutions and of national supervisors. See also section 3.7.

(11) Should the protection provided by EU legislation in the case of the insolvency of pension sponsoring employers be enhanced and if so how?

CEIOPS has no comment to make on whether protection on employer insolvency should be enhanced. However, it should be noted that the level of employer support for IORPs differs widely among Member States, and this will have a significant effect on any consideration of this matter.

(12) Is there a case for modernising the current minimum information disclosure requirements for pension products (e.g. in terms of comparability, standardisation and clarity)?

Any decision about imposing common standards is a matter for agreement among Member States and not for CEIOPS.

The information that must be provided to members and beneficiaries is usually covered by social and labour law. Standardisation of such requirements would have to take account of the reserved rights of Member States under this provision.

It should be noted that there is no common definition of 'pension product' and that such a term is not the same as an IORP. An important part of any decision on this matter will be the extent to which common obligations will apply.

CEIOPS can and should participate in any information gathering and in the details of any work that informs or follows a decision on this matter. CEIOPS is already engaged in work on pensions which shadows the work being undertaken on PRIIPS, and the CEIOPS work is not limited to IORPs in this field.

Financial literacy and member information are inextricably connected. The coordination of financial literacy and education initiatives will be one of the tasks of EIOPA, which will replace CEIOPS in January 2011.

(13) Should the EU develop a common approach for default options about participation and investment choice?

CEIOPS has no comment to make on this question as the design and implementation of a common approach are prerogatives of national governments.

However, there would be value in CEIOPS undertaking further work on the matter (perhaps through codes of practice and/or Level 3 guidance).

(14) Should the policy coordination framework at EU level be strengthened? If so, which elements need strengthening in order to improve the design and implementation of pension policy through an integrated approach? Would the creation of a platform for monitoring all aspects of pension policy in an integrated manner be part of the way forward?

Policy coordination is a matter for political agreement. However, it seems clear that within its competence, EIOPA, as successor to CEIOPS, could and should fill an important role in monitoring and coordination were such a platform developed.