EIOPA
EUROPEAN INSURANCE
AND OCCUPATIONAL PENSIONS AUTHORITY

# Video Address

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## PRIVATE PENSION SAVINGS IN A LOW INTEREST RATE ENVIRONMENT - FROM GUARANTEES TO PROTECTION

Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

**Finanstilsynet Conference: "Pensions when the guarantees disappear"**

**9 March 2017**

Ladies and Gentlemen,

First of all, my sincere apology for not being able to join today’s conference in person. An ad hoc commitment at the European Parliament requires today my personal presence. However, I am very grateful for the opportunity to address you via video.

I would like to thank the organisers, the Danish Financial Supervisory Authority, in particular its Chairman of the Governing Board, Henrik Ramlau-Hansen, its Director General, Jesper Berg, and Jan Parner, Deputy Director General and Member of EIOPA’s Board of Supervisors for inviting me and to congratulate them for the organisation of this very interesting conference with such a topical theme “Pensions when the guarantees disappear”.

Let me start my address by referring to **EIOPA´s approach towards the regulatory framework of private pension savings** in the European Union.

Private pension systems differ quite a lot in the European Union with different levels of maturity and relevance of 2$^{nd}$ pillar occupational pensions and 3$^{rd}$ pillar personal pensions. This has been heavily influenced by the developments in the 1$^{st}$ pillar social security systems, the different political choices on the social and labour laws and the evolutions of the regulatory environment.

EIOPA´s approach towards the regulatory framework of private pension savings has been focused on the achievement of three main objectives: enhanced sustainability, strong governance and full transparency. We believe that only by ensuring these three objectives, complementary private pension savings can contribute to the macro objective of providing adequate, safe and sustainable pensions to European Union citizens.

The journey to accomplish these objectives has been a very challenging one and we have reached different levels of consistency in the two sectors.

On the insurance sector, the implementation of Solvency II was a major step forward for policyholder protection. The structure of the new regime with the definition of risk-based capital requirements, an innovative system of governance and new reporting and public disclosure obligations provides a sound basis to achieve the three mentioned objectives.

With Solvency II the cost of providing long term guarantees becomes much more explicit through the use of market consistent valuation of assets and liabilities and the calculation of risk-based capital requirements. Nevertheless, a number of adjustments were introduced in Solvency II to deal with the potential short term volatility induced in own funds. EIOPA is monitoring the effects of the implementation of the long term guarantee measures on the insurance market and on consumers and published a first report at the end of 2016. Further annual reports are going to be published contributing to the review of the regime in 2021. Furthermore, the implementation of the new Insurance Distribution Directive will enhance transparency and the governance of products.

On the Occupational pensions sector, the IORP II Directive focused mainly on governance and transparency requirements, maintaining the high level principles of the solvency framework of the previous Directive. Consequently, the valuation methods used are country specific. So, not surprisingly, when in the context of the 2015 pension funds stress test EIOPA used market-consistent valuation methods, the conclusion was that, on average, national regimes value pension liabilities 20% lower than the correspondent market value.

In this context, EIOPA issued in April 2016 an Opinion recommending the adoption in the European pension funds regulation of a common framework for risk assessment and transparency. This common framework is based on a market-consistent balance sheet and on a standardised risk assessment built on common, pre-defined stress scenarios. Transparency would be increased by the public disclosure of the main outcomes accompanied by appropriate explanation.

EIOPA’s recommendations would trigger a dialogue on the long-term sustainability of occupational pension promises and encourage timely adjustments, contributing to the protection of pension scheme members and beneficiaries and to a fair distribution of shortfalls between generations. We encourage national regulators and supervisors to use this common framework in their implementation of IORP II.

Let me now move to my second point on **the PEPP and the challenges of non-guaranteed products**.

While the private pension systems differ significantly in the European Union, there are tendencies and challenges that are common. One of these realities is the move from guaranteed to non-guaranteed benefits. In the insurance sector we have witnessed a move from long-term guaranteed products to unit linked contracts and in the occupational pensions sector, a move from defined benefit to defined contribution plans.

These movements, that started a number of years ago, were accelerated by the increase in the cost of providing long term interest rate guarantees consequence of the persistent low interest rate environment and the increase in longevity.

In Denmark, not only the new business is written as non-guaranteed but also the stock is being transferred from guaranteed products to low or no guarantees through re-selection of saving schemes. With some nuances, this is a reality that is present in a number of Member States.

Within a context where hard guarantees are more and more a legacy issue, I would like to mention two important areas of work:

- First, the creation of a **Pan-European Personal Pension Product, the PEPP**, a safe, transparent and cost-effective personal savings product;

- Second, the **review of the consumer protection framework applicable to non-guaranteed private savings** products.

On the PEPP:

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 and 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.

EIOPA considers the development of a pan-European Personal Pension Product as a top priority. In order to allow a 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.

I strongly believe that the PEPP should allow 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, applying lifecycle strategies and 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.

Provided that by design these collective Profit Sharing Products avoid the exposure to short term market volatility, we should explore to what extent the regulatory treatment in Solvency II could be aligned to the risks effectively incurred, resulting possibly in lower capital requirements than fully guaranteed products.

Finally, on the need to **review the consumer protection framework applicable to non-guaranteed private savings** products:

It is of the utmost importance that consumer protection is placed at the centre of the pension savings products development. This is particularly relevant for non-guaranteed products where financial risks are entirely borne by consumers. It is a basic question of maintaining trust and confidence. In this sense, the questions raised by the Danish FSA in its recent discussion paper are quite pertinent.

Let me mention some examples of further work in this area:

- Develop guidance regarding the expectation from supervisors on the application of the Prudent Person Principle in the context of non-guaranteed products;
- Analyse if the long-term characteristics of pension savings products is sufficiently captured within the information on costs, risks and performance included in the PRIIP's KIID;
- Adapt the market conduct supervisory practices to the new information available to consumers and the new requirements imposed on the providers.

Overall, as in the context of the PEPP, I would favour an evolution towards the definition of basic characteristics of non-guaranteed pension savings products, and the development of specific adequate risk management practices, governance and information requirements.

Ladies and Gentlemen,

Regulatory and supervisory frameworks need to adapt to the challenging market situation. Risk transfer to policyholders and pension plan members requires additional attention to governance, risk management, transparency and selling practices.

Denmark has been on the forefront of the discussions and actions to deal with the provision of long term sustainable private pension savings. You were among the first to apply the market consistent valuation of assets and liabilities and risk capital requirements, both in insurance and in occupational pensions. And you were also early responding to the low interest rate environment. I very much welcome such approach of actively tackling the challenges stemming from the macro-environment. They definitely don’t disappear if we ignore them.

Today’s discussion on the regulatory and supervisory framework for non-guaranteed private pension savings is an essential one for consumer protection and the provision of adequate, safe and sustainable pensions for citizens. I very much welcome the initiative of the Danish FSA and I am hugely interested in the conclusions of this debate. Denmark can again lead the way to a robust and sustainable private pension system. Europe should learn from you.

Thank you for your attention.