SPEECH

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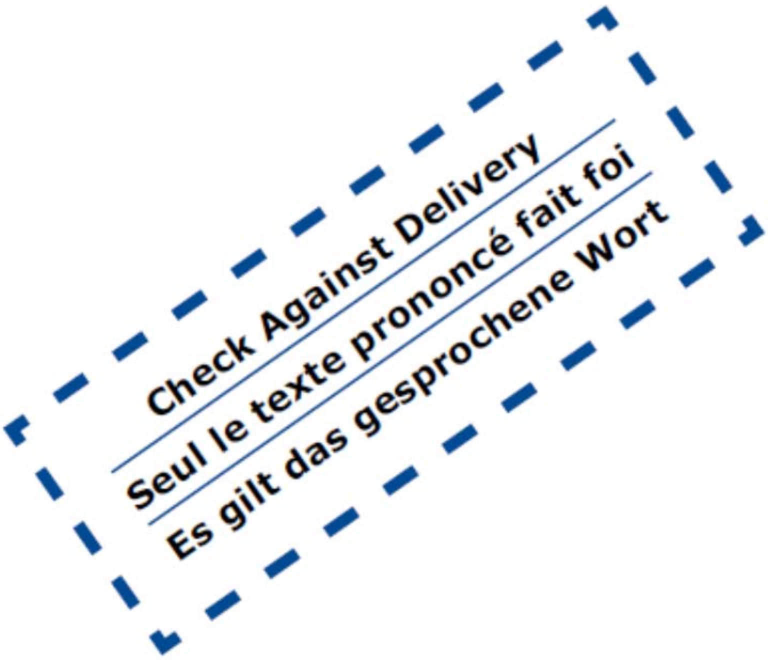
Enhancing occupational pensions: Germany could lead the way



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Ladies and Gentlemen,

Let me start by congratulating Handelsblatt for this initiative and for giving me the opportunity to speak to such an important audience. It is always a pleasure to meet with the German Occupational Pensions representatives.

Today I would like to provide you EIOPA's views on how to enhance occupational pensions and the role that the EU can play in achieving this objective.

Pension systems in the EU are hugely heterogeneous. Some have strong 2nd pillar occupational funds, like Germany, others built-up more 3rd pillar individual solutions and a number has yet to develop strong complementary pension systems beyond the public pay-as-you-go social security regimes.

The shape and nature of the design of pension systems is a member state choice. Nevertheless, The EU regulatory framework should help to foster trust and confidence in complementary pensions, be it 2nd or 3rd pillar.

Why is promoting occupational pensions of such importance? Because employer-sponsored pension schemes should play a major role in enhancing the balance between non-funded and funded schemes. In this way we can ensure that citizens will have a chance to maintain appropriate standards of living in their retirement and an adequate retirement income.

So, creating sustainable and adequate pension systems is one of the major challenges for Europe *and* for Germany in the coming years.

Ladies and gentlemen,

Please join me on a tour through Berlin to discover that there are indeed remarkable linkages between some of the touristic highlights and pensions. We start at the *Fernsehturm*, the best place to get an overview of the **current state of play in European pensions**.

Firstly we witness a fact that is the same all over Europe. Pensions are facing tremendous **challenges to deliver on their promises**. The reasons are obvious. Public pay-as-you-go pension schemes are affected by lower contributions due to higher unemployment. And private funded schemes are affected by the volatility of asset values and by the low interest rate environment.

Members and beneficiaries deserve that promises made to them are fulfilled, at any time. In this context many companies are reinforcing the contributions to their pension funds to reduce underfunding caused by low levels of interest rates, giving further security to their employees.

Secondly we see a **heterogeneous EU pensions' landscape** with a very different role of public, occupational and personal pension vehicles in the 28 Member States.

This reality is not only the result of different cultures and traditions, but also a result of different reform timelines and attitudes.

Thirdly we notice that **pensions are different from other areas**, mostly because of their ‘embeddedness’ in national social and labour law. Differences should be acknowledged.

These are facts, stubborn facts. Faced with the harsh reality, we all need to think about **what we can do to create conditions to deliver adequate, safe and sustainable pensions to EU citizens**.

Demographic ageing, a changing labour market and other trends in the society call for fundamental reforms in pension systems. These reforms should include ways to ensure that members and beneficiaries better understand their own risks.

There is a need to make pension scheme members much more aware of what they are entitled by their pension scheme and the way the scheme deals with financial shocks or increases in life expectancy. At the end it is about knowing who bears the risk? Is it about the sponsor paying ever more contributions or is there a balanced approach where members should expect cuts in benefits in some situations?

This transparency makes members more aware of their pension rights, creates more realistic expectations and allow members to better plan their own future situation.

In some countries, in order to preserve sustainability of pension promises and avoid the negative effects of huge fluctuations in pension contributions (both by employer and employee), financial shocks are absorbed by making gradual adjustments to pension benefits. In collective schemes this also mitigates intergenerational conflicts.

All these changes call for strong governance and full transparency.

In this context, the EU should build **a robust and proportionate regulatory framework, which delivers on three fundamental objectives: strong governance, full transparency and most of all enhanced sustainability**. Let’s take a closer look at these three fundamentals.

At the *Reichstag*, the next stop on our tour, **proper governance and full transparency** are of course key. EIOPA recommends an upgrade in the governance of pension funds, reinforcing the importance of proper risk management and control functions, while applying due proportionality to avoid undue burden and costs to smaller schemes.

On transparency we recommend the development of an information document that should provide standardised, comparable information on contributions, costs and charges, investment options and expected benefits. We cannot hide anymore behind "jargon" and difficulties of providing information.

A month ago we published a report on costs and charges. These are a key issue when considering the value for money or affordability that pension funds deliver. It is important that all costs and charges are disclosed to the parties bearing them. When this is the case those parties are able to assess if they get good value for their money. And disclosure of costs and charges better enables all parties to put pressure on costs. EIOPA will definitely take further steps to address this issue.

Let's continue our tour through Berlin, from the *Reichstag* to the *Museumsinsel*. Here they know **sustainability** the best, hosting works of art that sometimes date back millennia without losing their sustainability or value. On the contrary, I would say.

In pensions we need to do more to **enhance sustainability**, to ensure the protection of members and beneficiaries. We have to make sure that any pension scheme disposes of sufficient assets to fulfil its liabilities within a realistic valuation scenario. Recently we consulted on our further technical work on solvency of pension funds. The next step will be an EIOPA quantitative assessment, which will run from May to July. Subsequently, EIOPA will provide technical advice to the European Commission on EU solvency considerations for pension funds in the first quarter of 2016. We will do so on our own initiative, because the solvency issue is too important to ignore.

The scope of our work is broader than previous work done by EIOPA on solvency. There are indeed various ways to shape a market-consistent and risk-based supervisory framework. The holistic balance sheet can be used to set capital requirements at EU level, but also to establish minimum funding requirements and as a risk management tool to assess the sustainability of pension funds.

I would like to emphasise that using the holistic balance sheet as a risk management tool should have a follow-up.

First of all, the outcomes of assessments should be disclosed to sponsors, members and beneficiaries to raise awareness about the financial situation of the pension fund and, where necessary, stimulate reforms. Secondly, if it was concluded that the pension fund is providing unsustainable pension promises, national supervisory authorities should be empowered to take action to protect members and beneficiaries and ensure overall fairness. A common prudential regime should have built-in flexibility to deal with a wide range of occupational pension schemes in Member States. This may bring comfort to the German pension industry.

It is also essential for me that the holistic balance sheet can be implemented in a proportionate way, and of course without imposing disproportionate costs on pension funds. Another comfort to you.

Pension funds with strong sponsors, and there are many of them in Germany, may establish the value of sponsor support as a ‘balancing item’. In addition, it provides the right incentives by requiring pension funds with weak sponsors to do more detailed assessments.

A common prudential regime with built-in flexibility to deal with a wide range of occupational pension schemes can also contribute to the establishment of pan-European pension funds. An important reason for the current low level of cross-border activity is that national prudential regimes are often tailored to the domestic situation and unable to cope with pension arrangements in other EU countries. I think this would be an incentive for many German companies with their international scope.

Back to our tour. At the *Museumsinsel* we start a relaxing boat tour along the *river Spree*. Relaxation is necessary, because EIOPA is preparing a **pensions stress test**, which will run together with the quantitative assessment.

We are developing a stress test that is appropriate and suitable for pension funds. An important part of the preparatory work was to gain insight in the role of pensions funds in financial stability. To analyse transmission channels of funds to financial markets, EIOPA collected data covering a sample of defined benefit, hybrid and defined contribution schemes in member states with a significant occupational pensions sector. This exercise allowed us to assess pension funds investment behaviour during the past decade, including the financial crisis in 2008.

The stress test will assess the resilience and the behaviour of pension funds in adverse market developments, such as a prolonged low interest environment. It will also incorporate stresses in longevity as one of the major risks in pension funds' overall financial situation.

The pension stress test will cover funds that provide defined benefit and hybrid schemes as well as the ones that finance defined contribution plans.

Pension funds that provide defined benefit or hybrid schemes need to calculate the impact of the stress scenarios on their national balance sheet as well as the holistic balance sheet. Pension funds providing defined contribution plans are asked to evaluate the effect of shocks on future retirement benefits of three representative plan members: one young plan member, one of middle age and one close to retirement.

EIOPA's aim is to achieve a coverage of 50% of the pension fund sector in member states. The validation of the stress test results will take place from end-August to end-September. The report on the pensions stress test will be published at the end of the year.

We will conduct the stress test in parallel with the quantitative assessment on the solvency side in order to avoid the duplication of calculations. This will limit to the extent possible the burden on pension funds and supervisory authorities.

We have also streamlined the quantitative assessment, further reducing the burden on participants. Pension funds will only have to calculate two baseline scenarios compared to 18 scenarios in the 2012 exercise. Moreover, the assessment contains additional simplifications, like the balancing item approach to value sponsor support which I mentioned earlier. What we haven't changed is that pension funds are requested to conduct the calculations on a best effort basis.

I would like to take this opportunity to ask for the participation of the German pension sector on both these exercises. It will help to shape our analysis of impacts and our conclusions and will give good indications on vulnerabilities and risks going forward.

Ladies and gentlemen,

As we all know, pension issues are wide-ranging and certainly not simple, also due to the interaction of national law and EU involvement. However, EIOPA is fully dedicated to a truly European approach to pensions. I hope I've made clear to you what our vision is and what we are doing to make this vision happen. We need your support.

I want to make some remarks on the review of the IORP Directive. Here we see room for improvement.

EIOPA fully supports the European Commission in setting key objectives for the review of the IORP Directive to ensure the soundness of occupational pensions, to better inform pension scheme members and beneficiaries, remove obstacles for cross-border IORPs, and encourage long-term investing by lifting up investment restrictions.

However:

Only if we are able to provide a robust and proportionate EU regulatory framework which delivers on three fundamentals, enhanced sustainability, strong governance and full transparency, we will be capable of regaining the trust and confidence of EU citizens in occupational pension savings.

Only if we are able to provide a robust and proportionate EU regulatory framework we will strengthen citizen’s trust which is needed to further develop occupational pension savings.

Only if we provide a more harmonised supervisory framework we will have a truly cross-border pensions market.

Only if we are able to further develop occupational pension savings, we will be capable of providing adequate retirement provisions to European citizens, enhancing financial stability, and contributing to the EU economy in the best possible way.

In EIOPA’s view the review of the IORP Directive should deliver on these objectives.

We’ll end our tour through Berlin in the *Olympic Stadium*, which reminds us of your national football team, well-deserved world champion. I would like to encourage you to become European champion in occupational pensions. To achieve that, reform is the key word.

The world has changed, pension systems will also unavoidably change. I am confident that Germany will be on the front line in these reforms for the benefit of the German and EU economy and citizens.

Thank you.