



EAPSPI – AEIRSP – EVVÖD

EAPSPI – European Association of
Public Sector Pension Institutions

AEIRSP – Association européenne des
institutions de retraite du secteur public

EVVÖD – Europäischer Verband der
Versorgungseinrichtungen des
Öffentlichen Dienstes

RESPONSE TO THE CONSULTATION DOCUMENT OF THE EUROPEAN COMMISSION

**CONSULTATION ON THE HARMONISATION OF SOLVENCY RULES APPLICABLE TO
INSTITUTIONS FOR OCCUPATIONAL RETIREMENT PROVISION (IORPs) COVERED BY
ARTICLE 17 OF THE IORP DIRECTIVE AND IORPs OPERATING ON A CROSS-BORDER
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1. EAPSPI, the European Association of Public Sector Pension Institutions, represents 23 pension institutions out of 13 EU-Member States, Norway and Switzerland. Some of EAPSPI's members are financed on a PAYG basis and therefore fall outside the scope of the IORP Directive. For all funded pension institutions that are members of EAPSPI, this consultation is of paramount importance since it will have a significant impact on the further discussion about future supervisory rules at EU-level.
2. EAPSPI would like to point out that this consultation would have been better based on a broader view allowing the Commission to get a complete overview of the various solvency rules of IORPs as well as different security mechanisms in Member States. Instead, the scope of this consultation is focused on pension schemes in some selected countries.
3. EAPSPI is of the opinion that there is a fundamental difference between IORPs and insurance undertakings in terms of pension products and of steering instruments. Therefore, EAPSPI believes that IORPs, i.e. institutions of the second pillar, should be treated differently to insurance undertakings of the third pillar since workplace (or occupational) pension provisions are fundamentally different to individual insurance contracts.
4. The IORP Directive already provides common minimum standards and its implementation was only achieved in 2007 in EU Member States. Therefore, further legislative measures to modify these rules are premature. A further harmonization of solvency rules for funded schemes on a European level is therefore not necessary at the moment.
5. With respect to the demographic evolution in Europe, EAPSPI is of the opinion that IORPs will be able to help solving future problems of the state-run first pillar schemes and that the IORP Directive will help to promote this development.
6. EAPSPI would like to mention that cross-border activities have had insufficient time to develop significantly since the implementation of the IORP Directive. Even if cross-border activities are expected to increase within the next years, EAPSPI does not believe that they will develop significantly among public sector pension schemes.
7. EAPSPI comes to the conclusion that, beyond the scope of this consultation, there are further common principles that are applicable both to funded IORPs (as far as funding and security mechanisms are concerned) and to unfunded IORPs (as far as security mechanisms are concerned). These shared common principles can be outlined as follows:

- The main target of IORPs is the protection of the interests of the beneficiaries with regard to their pension commitment.
- In order to avoid any market distortions it is evident that in terms of funding and/or security mechanisms, the same rules should be applicable for pension products that are the same and delivered by insurance undertakings and by IORPs. This, however, requires the products to be truly comparable.
- In most countries, individual pension arrangements delivered by insurance undertakings are entirely different to pension products delivered by IORPs.
- The interests of the beneficiaries can also be ensured by other mechanisms than supervisory rules that are currently under discussion in the debate on Solvency II. In particular, labour law provides a large degree of protection in many Member States. For this reason, labour law, and particularly collective labour law, may be called “consumer protection law in the field of occupational pensions”.

A. IORPS SUBJECT TO ARTICLE 17 OF THE IORP DIRECTIVE

This section focuses on IORPs that are subject to Article 17 of the IORP Directive. These IORPs underwrite liabilities to cover against biometric risks, or provide guarantees of a given investment performance or a given level of benefits. They are therefore required to have regulatory own funds, i.e. "additional assets above the technical provisions to serve as a buffer". For these regulatory own funds, Article 17(2) of the IORP Directive refers to the Solvency I regime in the recast Life Directive. As the recast Life Directive will cease to exist after the adoption of Solvency II, the **main question for IORPs subject to Article 17 is whether and to what extent the Solvency I regime should be replaced by solvency rules similar or equivalent to the Solvency II rules.**

This main question is dealt with by looking first, in general terms, at the objectives and principles of the solvency rules and then, more specifically, at the rules relating to regulatory own funds and funding.

(i) Objectives and Principles

1. Solvency rules for IORPs subject to Article 17 should aim at guaranteeing a high degree of security for future pensioners, at a reasonable cost for the sponsoring undertakings, in the context of sustainable pension systems that are decided by the Member States.

QUESTION

Do you agree, or do you consider that the overall objective of solvency rules for these IORPs should be different?

ANSWER

EAPSPI agrees to this overall objective but at the same time it should be clear that this objective is not only an issue for Article 17 IORPs. The IORP Directive itself also does not restrict this objective to IORPs subject to Article 17. EAPSPI is therefore of the opinion that this consultation would have been better based on a broader basis allowing the Commission to get a complete overview of the various solvency rules of IORPs as well as the different security mechanisms in the Member States. The current consultation only focuses on IORPs covered by Article 17 of the IORP Directive and on IORPs operating on a cross-border basis. In view of the European landscape of supplementary pension schemes, only few pension schemes really comply with Article 17 of the IORP Directive in the sense that they are financial institutions that alone bear the risk of the commitments. In this context, EAPSPI does not share the point of view of the Commission that these IORPs are therefore similar to insurance undertakings. In response to question n° 4. a), EAPSPI points out fundamental differences between IORPs and insurance undertakings.

EAPSPI has noticed that the scope of this consultation is focused on pension schemes in some selected countries, notably in the Netherlands which represents a major part of all assets in the European pension sector (675 billion €). On the other hand, the consultation leaves out pension schemes of other European countries where the second pillar is also of paramount importance. Therefore, the consultation is mostly relevant for the Dutch FTK-system that has recently proven its financial sustainability in the Dutch national context due to the fact that the FTK-system is fully in line with the requirements of the IORP Directive. Furthermore it has already anticipated some rules of the new Solvency II regime in its regulatory framework.

2. Beneficiaries and sponsors seek to secure occupational pensions that maintain standards of living after retirement. Pension schemes, in particular those that provide life-long income such as annuities, are subject to risks related to future mortality rates, financial returns on assets, future inflation, future participation and contribution rates, which affect the overall solvency position of IORPs subject to Article 17. The CEIOPS survey shows that there are wide differences between Member States in their approach to these and other risks.

QUESTION A)

Do you believe that prevailing solvency rules for IORPs subject to Article 17 provide adequate protection relative to the objective of safeguarding pension beneficiaries' claims at reasonable cost for the sponsoring undertakings?

ANSWER

EAPSPI is of the opinion that both EU and national legislation have achieved a good balance between the objectives of an adequate protection and of reasonable costs with the current rules in the IORP Directive and the possibilities for national Member States to introduce deviating requirements to take into consideration the particularities of the respective pension systems. Against this background, EAPSPI shares the point of view of the Commission that any evaluation of the IORP Directive at present is premature and that it is too early to suggest any modification of this directive at the moment. According to the conclusion of the Commission in its consultation document (p. 2), the IORP Directive was fully implemented across the EU only in 2007. In this context it is also important to notice that the CEIOPS report has not revealed any serious solvency problems of IORPs due to the regulations in the IORP Directive.

QUESTION B)

Have there been shortcomings or flaws identified in the prevailing solvency rules for IORPs subject to Article 17? If yes, please specify. What could constitute the main challenges lying ahead?

ANSWER

EAPSPI has not identified any shortcomings in the prevailing solvency rules for IORPs. This conclusion is in accordance with the findings of CEIOPS in their document MARKT/2512/08 of June 2008:

“In conclusion, the report finds that, though there is considerable diversity in the way some key aspects of the IORP Directive have been interpreted and implemented, there is little evidence of major issues arising from these differences. Given this, and given the limited experience of the Directive in some areas, the report finds no reason at this stage for legislative changes to the Directive.”

QUESTION C)

Which solvency rules could be viewed as proactively dealing with different risks and improving risk management techniques?

ANSWER

EAPSPI is of the opinion that in general terms the existing rules are sufficient. With a view to any proactive risk management techniques, legislation – both at EU and at national level – should not disturb the financial balance of second pillar pension institutions as a whole. As far as additional financial requirements are concerned, EAPSPI thus does not see any need for revised supervisory rules for those reasons given in answer to question n°4. a).

As far as revised management techniques are concerned, one could think about the introduction of a risk-management system to detect all potential sources of risk (financial, operational or related to governance) that takes into consideration the principle of proportionality as well as the social and labour law that applies to the concerned pension institution. In practice, such a revised risk-management system has recently been introduced for IORPs in the German Insurance Supervision Act (VAG). This system, called MaRisk (§ 64a VAG), corresponds to the second pillar of the Solvency II regime.

QUESTION D)

To what extent do compulsory versus voluntary membership in pension schemes have a different impact on the overall outcome of solvency rules and in which case(s) are problems likely to arise in the future?

ANSWER

In general terms, EAPSPI is concerned about this question since in the public sector, compulsory membership in occupational pension schemes is quite widespread in Europe, like for example in the public sector of the Netherlands, Sweden and Germany.

In many public sector pension systems throughout the European Union, employees are automatically covered by a supplementary pension system once they have joined the public sector since their affiliation is foreseen in collective agreements. In this case, they do not have any possibility of opting-out. Mandatory participation in the second pillar involves more risk sharing in the so called industry-wide pension funds, e.g. in the Netherlands. The fact that there is practically no possibility of opting-out either for employers or for employees, gives IORPs the possibility to share the risks of investment, inflation and longevity between employers and employees and even share the risks with future generations.

Furthermore, IORPs are governed by the respective employers and employees of the company or the industry-wide sector. Thus, they have several steering instruments, such as adjusting contributions and/or liabilities if necessary. IORPs often have the possibility to do so in case of financial shortfall, especially if the IORP is based on a collective agreement. According to German jurisprudence, for example, social partners are entitled to reduce the level of benefits to a larger extent than company based pension promises when setting up a pension scheme since the interests of the insured persons are deemed to be sufficiently protected through the participation of the trade unions in this case.

An individual pension plan in the third pillar, however, naturally cannot be mandatory since this would be contradictory to the notion of "individual" that necessarily implies the individual person's own choice. Therefore, insurance undertakings do not have these steering instruments, because the amount of premiums to be paid and the amount of pension to be built up in the scheme are contractually fixed. Insurance undertakings sell guaranteed

individual pensions and they have to be able to stand up for their cast-iron guarantees. Individual pension contracts often have a fairly short policy period (on average roughly 10 years in the Netherlands) due to the fact that frequently, insured persons have the opportunity to cancel the contract and to retrieve the premiums or to receive a lump sum once they have reached the contractual retirement age. IORPs, however, benefit from a longer period of participation of employers and employees in the schemes that amounts to approximately 20 years or even longer. Therefore it is obvious that in the case of insurance undertakings the degree of certainty has to be higher and the recovery period shorter.

QUESTION E)

To what extent do the solvency rules prevailing today in the different Member States need to differ for single-employer or multi-employer IORPs subject to Article 17?

ANSWER

EAPSPI does not see any need to distinguish between single-employer and multi-employer IORPs. Moreover, EAPSPI is of the opinion that such a differentiation, as far as solvency rules are concerned, is only necessary between insurance undertakings and IORPs. The question of whether an IORP has one or several employers does not necessarily have any effect on its size and on its effectiveness. An IORP can, for instance, cover 100,000 persons. From the point of view of the protection of beneficiaries, there are no fundamental differences if these 100,000 persons are insured by 10 or by 100 (or even more) employers. The only important criterion is the extent of the employer's responsibility.

3. The CEIOPS survey outlines four common overarching principles, as part of emerging best practices underpinning the supervisory framework which may be relevant to this consultation on IORPs subject to Article 17. First, a forward-looking risk-based approach to pension supervision, that weighs the potential risks faced by an IORP, as well as risk mitigants, and tailors the scope and intensity of supervision to this appraisal. Second, the principle of market-consistency in the valuation of an IORP's assets and liabilities for supervisory purposes. Third, the principle of transparency, which implies that an IORP is open on how its financial position is determined and that reserves (or shortages), as well as prudence embedded in technical provisions and adjustment instruments, are made explicit to the supervisor. Fourth, the principle of proportionality, implying that supervisory requirements are applied in a manner proportionate to the nature, complexity and scale of the IORP's inherent risks.

QUESTION A)

Do you agree with these principles and which principles do you consider particularly relevant or not relevant to underpin the supervisory framework for IORPs subject to Article 17?

ANSWER

EAPSPI endorses all four principles in general. However, the fourth principle of proportionality should be listed at the top of the list in order to underline that it is not financial supervision and solvency rules which are the objectives, but that they are merely means to ensure adequate pensions for affordable costs.

QUESTION B)

Are there any other overarching principles that you consider relevant for IORPs subject to Article 17?

ANSWER

In view of the answer above, EAPSPI does not see any further principles to be taken into consideration.

QUESTION C)

Do you see a case for a different supervisory approach for IORPs subject to Article 17 depending on their size or complexity?

ANSWER

The principle of proportionality already takes into consideration the differences of these entities as to their size and the complexity of the pension plans they manage. It is therefore of paramount interest for pension institutions of the public sector since it allows social partners to define pension plans and IORPs according to their needs.

Both in the public and in the private sector, IORPs are of different sizes. In the public sector in Germany, for instance, there are IORPs that cover roughly 2 million employees whereas smaller entities only have around 20,000 participants.

Apart from the size, the complexity of the pension plan is also an important element that is taken into consideration by the principle of proportionality. In our opinion, a higher complexity is frequently associated with higher financial uncertainty whereas simple pension plans are often easier to be monitored and supervised.

QUESTION D)

To what extent do you consider that the supervisory frameworks existing today for IORPs subject to Article 17 already meet the principles emerging out of international best practice, as described in the CEIOPS survey?

ANSWER

In most European Member States, the supervisory rules for IORPs are already in accordance with the principles described in the CEIOPS report. Not only in the Netherlands, as laid down in the FTK-principles, but also in the UK, Germany, Denmark, Sweden and other countries. In general terms the CEIOPS report came to the conclusion that every country has chosen its own way to ascertain an adequate protection and – apart from a few exceptions – there are almost no Member States with insufficient protection. Furthermore, in the context of the

Robins case (C-278/05), the Commission has found out that in most European countries the protection mechanisms are sufficient and that, therefore, no supplementary insolvency protection is necessary.

(ii) Regulatory own funds and funding rules

4. In cases where the IORP itself, and not the sponsoring undertaking, underwrites the liability to cover against biometric risk, or guarantees a given investment performance or a given level of benefits, the IORP is required to hold additional assets in the form of regulatory own funds according to the rules currently prevailing for life assurance undertakings (Solvency I). As from 2012, it is expected that new solvency rules will apply to life insurance undertakings (Solvency II). This would mean that from a solvency perspective, different rules will apply to IORPs subject to Article 17 and life insurance undertakings offering similar products.

QUESTION A)

Do you anticipate competitive distortions emanating from the application of different solvency regimes between insurance companies and IORPs subject to Article 17? Please specify.

ANSWER

In the opinion of EAPSPI, competitive distortions do stem from the application of different solvency regimes between insurance companies and IORPs. Indeed, competitive distortions would exist if the same solvency regime were applied to both insurance companies and IORPs because there are fundamental differences between them in terms of pension product and in terms of steering instruments. These differences can be explained as follows:

The most obvious difference between IORPs and insurance companies is that the latter sell pension products in which demographic and financial risks are underwritten by the institution itself. Therefore they guarantee pensions only themselves, without having any sponsor behind. Consequently, the insurance industry has to minimize the shortfall risk to protect the interests of their beneficiaries. The best way to ascertain this protection is to cover their liabilities with financial instruments that correspond to the way a risk is run (i.e. long-term bonds). The alternative is a high solvency ratio, in case of a downturn of the financial markets. Both alternatives provide sufficient protection of their beneficiaries and their guaranteed individual pensions.

Considering this main feature of insurance products of the third pillar as exposed above, EAPSPI concludes that IORPs in general terms, including those of Art. 17 of the IORP Directive, are different from insurance companies.

The major differences can be described as follows:

- IORPs run pension plans, in which the risks are shared collectively by employers and employees who are not only competent for the design of the pension plan but who also exercise a permanent supervision of the pension plan through their control in the Board of Directors or similar institutions of the pension scheme. Thus, the employees and the beneficiaries are able to exercise a direct control on the policy of the pension institution, therefore assuring their influence in the design of the pension scheme.
- Usually, IORPs only cover groups of employees of one or several employers whereas insurance companies are “open” to everyone.
- In some jurisdictions a plan sponsor backs the pension commitments, like for instance in Germany, where the employer assumes a kind of “final guarantee” towards his employees and retirees even if the pension plan is executed by an external entity (cp. § 1 (1) 3 of the Occupational Pension Act – *Betriebsrentengesetz*). In the case of the German public sector pension institutions, the situation is even more favourable for employees and beneficiaries. Employers are obliged to pay additional contributions if ever the pension institution faces serious financial problems. Hence, a supplementary protection is achieved since the concerned employee or beneficiary is not obliged to contact his employer for fulfilment of the pension promise, but the pension institution as the “service provider” has got a direct claim against the employer.
- In other countries, contributions and liabilities may be adjusted if necessary. In the public sector, such adjustments have been undertaken in the Netherlands as well as in Germany in order to ensure the long-term sustainability of the pension scheme. In the cases under consideration, employers and employees have recently agreed on transforming the final pay system into an average income system. In the Netherlands, employers and employees decided some years ago not fully to index pensions according to wage growth in order to improve the financial situation of the IORPs. In Germany, the social partners agreed on a fundamental reform of the public sector pension scheme in 2001 in order to ensure the long-term sustainability of this scheme. In this context, the former top-up scheme, that was supposed to bridge the gap between the benefits of the first pillar scheme and the pension level of a civil servant,

has been abolished and replaced by a “points-based system” according to which the later benefits are calculated on the basis of the current income.¹

- Some IORPs even have the possibility to share the risks not only collectively between employers and employees but also with future generations. This so-called intergenerational solidarity (or risk sharing) can be best organized by means of the mandatory structure of most IORPs, as for instance in the Netherlands with industry-wide mandatory IORPs and in Germany in the public sector pension schemes that cover almost the total number of 5 million public sector employees. Economic research shows that intergenerational risk sharing cannot be organized in the free market, i.e. by insurance undertakings.²
- Mostly, IORPs are non-profit institutions, whereas insurance undertakings have to make profits for their shareholders. IORPs distribute their profit only to the beneficiaries whereas insurance undertakings have to take care of the shareholders’ interests. Thus, to a certain extent, IORPs bear a closer resemblance to first pillar public pension schemes rather than to insurance undertakings.
- IORPs are able to make long-term investments because of the relatively long duration of their liabilities.
- Finally, IORPs usually have a good reputation among employers, employees and beneficiaries who feel that IORPs provide better pensions for lower costs.³ A recent study has revealed that in view of the current crisis on the financial markets, 75% of the Germans consider occupational pension as safe. Yet, only 50% have confidence in the first pillar and 55% in the state-subsidised third pillar “Riester-Rente”.⁴

In view of these differences with the insurance products, IORPs have got the ability to use various steering instruments to ensure an adequate solvency margin to fulfil their commitments. Because of this difference, there should be different supervisory rules for both of them.

¹ Further details of this reform are given in EAPSPI’s information letter European Pension Bulletin (EPB) n° 12 of April 2002; downloadable at www.eapspi.eu / EPB

² Steenbeek / van der Lecq (editors), “Costs and benefits of collective pension systems”, Springer Verlag, September 2007

³ German periodical „Finanztest“, special edition “Spezial Altersversorgung” of November 2008, p. 92/93

⁴ Study of the German polling institute IPSOS; <http://knowledgecenter.ipsos.de/docdetail.aspx?c=1042&sid=67F6B1C4-CC4A-4636-A948-1860CB7A00B1&did=adf6b246-8056-48a6-a203-dcd87ac5e0d2>; see the summary in IPE-news of 6 November 2008

Therefore, EAPSPI believes that the application of the new Solvency II regime to IORPs would lead to market distortions since different institutions would be subject to the same supervisory regime instead of taking into consideration the differences between the second and the third pillar. It would mean that supplementary pension schemes would become unnecessarily expensive and thus provide inferior pensions in comparison to the level IORPs deliver under the current supervisory rules. Employers who are not willing to spend additional resources on a supplementary solvency margin could close already existing pension schemes or switch from DB to DC schemes as has already been the case in the UK.⁵

Any additional and more severe solvency requirements would force IORPs to increase assets up to more than 60% of the technical provisions or sell up a corresponding part of their assets invested in equities.⁶ An example of a pension scheme based on a career average and a conservative investment strategy of only 11% of equities and 80% of bonds has revealed a funding gap of 30%.⁷ Therefore, a recent study of Allianz Global Investors of May 2008 has revealed that notably DB schemes would face considerably higher costs and a negative impact on the sponsors' willingness to maintain DB schemes.⁸ On a macroeconomic level, the shift from equities to bonds would threaten financial stability and economic growth. From EAPSPI's point of view, this does not seem to be in line with the Lisbon Agenda and with national policies based on this Agenda.

Especially in view of the current financial crisis, EAPSPI questions the "mark-to-market" evaluation of the Solvency II regime as an adequate tool for measuring pension liabilities. The current crisis has revealed the deficits of this method that should therefore not be applied to the commitments of IORPs; especially since their investment strategy differs largely from institutional investors, for whom this approach was developed.

An introduction of the Solvency II regime would furthermore not be in line with the Commission's Better Regulation approach that is mentioned in the introductory part of this consultation (p. 4). The insurance industry have had the opportunity to analyse the impact of the Solvency II regime for a couple of years through the QIS-studies. Up to now, such a formalized procedure has not been applied to IORPs.

⁵ See Hillman "Quelling the pension storm", study issued by the UK-think-tank Policy Exchange, downloadable at <http://www.policyexchange.org.uk/Publications.aspx?id=525>; summary in IPE-news of 5 March 2008

⁶ Study of Allianz Global Investors AG: "Evaluating the impact of Risk Based Funding Requirements on Pension Funds", downloadable at www.oecd.org/dataoecd/22/61/40764487.pdf

⁷ See IPE-news 30 October 2008: "Crisis "confirms" Solvency II not for pensions"

⁸ See above, footnote n° 6

At European level, the European Commission obviously intends to harmonize the regulatory framework for IORPs to a certain extent, especially to avoid the possibility of supervisory arbitrage. Since Article 17 of the IORP Directive is linked to Art. 27 and 28 of the Directive 2002/83/EC (Life Assurance Directive), the conclusion could be drawn that in general terms, a new framework for IORPs ought to be in line with the principles of market valuation and risk based supervision as for banks (in Basel II) and for insurance undertakings (the future Solvency II regime). However, due to the fundamental differences between the second and the third pillars, a different approach in the field of supervision is necessary.

QUESTION B)

Do you have any evidence of such competitive distortions (as mentioned in the previous sub-question) existing already?

ANSWER

Even if the CEIOPS report does not provide any evidence of such competitive distortions, EAPSPI wishes to highlight two evolutions in the recent past that might happen again if IORPs were faced to an excessively severe solvency regime. Due to more severe legal conditions for the second pillar, along with changes in accounting standards, particularly reporting of pension commitments, UK-employers have mostly switched from DB to DC schemes. This trend has caused a decrease of the average benefit-level in the second pillar. This evolution is nowadays a serious challenge for the UK pension policy as a whole that has to look for ways to improve the average level of old-age income.⁹ A further example of such a distortion comes from Germany. In 2002/2003 pension funds had to sell large parts of their equity holdings due to instructions of the supervisory authorities that later caused a decline of the German stock market index DAX.

QUESTION C)

What would be the likely impact of applying Solvency II (or similar solvency rules) to IORPs subject to Article 17?

⁹ See above, footnote n° 5; UK-study “Quelling the pension storm”

ANSWER

See the answers given to questions a and b.

QUESTION D)

What would be the impact on the future provision of defined benefit schemes and the risk of closing down existing schemes?

ANSWER

As already pointed out above, the main risk would be closing down the current defined benefit schemes for financial reasons, and shifting the risks to individuals by transforming pension plans into DC schemes.

The risks now shared in collective schemes would thus shift to individuals. This would mean a reduction in pension benefits in the second pillar because economies of scale, for example collective risk sharing in investments, will disappear. On the other hand, this shift will not lead to decreasing costs. Against the background of an ageing society this would mean that it will not be possible to achieve adequate pension provision for affordable costs.

In this context, EAPSPI is of the opinion that IORPs are able to help in solving general European problems in the state-run first pillar schemes brought about by an ageing population. This evolution will have considerable effects on the state-run PAYG schemes of the first pillar that are expected to decrease on average in the EU-States by 25% during the coming decades. Some workplace pensions of the second pillar are therefore indispensable to ensure adequate pensions throughout Europe. Consequently, the existing IORP Directive will help to promote this development, especially because it adopts a principle-based approach, which on the one hand sets out a basic set of rules, but on the other hand allows Member States to interpret these principles in the light of the different types of workplace pension provision that exist under social and labour law in the different countries.

QUESTION E)

What would be costs and benefits of this? Please provide quantitative information, where available.

ANSWER

With respect to the answers to questions a) and b), EAPSPI does not see any benefits in introducing Solvency II for IORPs. On the contrary, as already worked out by the above mentioned study of Allianz Global Investors, the costs would sensibly increase which would endanger especially DB-schemes.

QUESTION F)

In case a Solvency II-type regime were to be applied to IORPs subject to Article 17, which elements would need to be adjusted to take account of the specificities of the institutional set-up in which that IORP operates (e.g. recovery plans, additional contributions, flexibility of benefits, etc.)?

ANSWER

EAPSPI is not of the opinion that Solvency II, even with some minor adjustments, would be appropriate for IORPs. There are too many differences between IORPs and insurance companies as shown above. IORPs can work with longer recovery periods than insurance companies; IORPs have several steering instruments that insurance companies do not have.

Therefore, IORPs need to hold substantially lower buffers than insurance companies and can have substantial longer recovery periods in case of dropping below a certain solvency capital requirement or dropping below the minimum capital requirement.

If ever the Solvency II requirements were extended to IORPs, the entire process would have to be revised to take into consideration the specificities of IORPs as described above.

5. The IORP Directive requires IORPs subject to Article 17 to hold assets to fund their technical provisions at all times. In the event of underfunding, the IORP is required to establish a recovery plan.

QUESTION

In case of overfunding can the excess assets be returned to the sponsoring employer or are there restrictions to this (thereby reducing the upside potential for employers)? Does this partly depend on whether occupational pension schemes are closed or open to new members?

ANSWER

As far as public sector pension institutions are concerned, EAPSPI would like to provide an answer on the basis of Dutch legislation. The Dutch FTK-regime foresees several conditions regarding returning excess assets to the sponsoring employer. This can only be done when the IORP has all the necessary buffers, and when all shortfalls of conditional indexation and accrued nominal pension rights over the last ten years are restored. Additionally, employers and employees can make agreements in the contract between the employer and the IORP concerning the destination of excessively high buffers in accordance with the above-mentioned legal restrictions.

B. IORPS OPERATING ON A CROSS-BORDER BASIS

This section focuses on IORPs that engage in cross-border business. These IORPs could be IORPs covered by Article 17 of the IORP Directive as well as other IORPs. **The main question here is to what extent the differences in the solvency regimes for IORPs that operate on a cross-border basis are creating internal market problems.** This main question is dealt with by looking first at the rules relating to technical provisions and then at the solvency rules for IORPs operating on a cross-border basis.

(i) Technical provisions

6. The CEIOPS survey shows that, in practice, Member States use different methods and assumptions to determine their technical provisions, partly reflecting historical and cultural differences. Current practices vary from applying best estimates to including extra safety margins in the underlying assumptions and incorporating prudence in different components of the technical provisions. Discount rates applied to the valuation of the technical provisions for example vary considerably. Moreover the treatment of mortality tables is rather diverse, as mortality rates, elements of prudence or incorporation of a trend component to reflect improvements in life expectancy are differently applied. This diversity can result in significant variations in the size of technical provisions across countries for comparable defined benefit commitments, and hence to differences in the level of liabilities to be funded.

QUESTION A)

To what extent do you consider greater harmonisation within the EU in this field or in individual elements of the valuation of technical provisions possible or necessary for IORPs operating on a cross-border basis?

ANSWER

As stated above, EAPSPI would like to emphasise that cross-border activities have had insufficient time to develop significantly since the implementation of the IORP Directive. Those that have developed are mostly executed by investment undertakings in some countries for defined *contribution* pension schemes. Even if cross-border defined *benefit* schemes are developed one day, the main driver for cross-border activities will probably be

more favourable fiscal and supervisory regulations in other Member States. However, EAPSPI expects this development to face the reluctance of certain stakeholders, especially trade unions that might oppose the idea of exporting pension plans. Since public sector pension schemes are frequently negotiated by the social partners (e.g. in the Netherlands, Sweden, Germany), EAPSPI does not believe that cross-border activities will develop significantly in this sector.

With respect to the question of the Commission, EAPSPI thinks that some harmonization in the field of valuation of the technical provisions could be useful, but only for IORPs which operate on a cross-border basis. Otherwise, EAPSPI supports the principle that each IORP should establish its technical provisions according to its domestic rules.

Whenever IORPs operate on a cross-border basis, harmonized technical provisions seem to be useful since this should help to achieve the objectives of the IORP Directive, i.e. ensuring that technical provisions are sufficient to maintain the payments of pensions to beneficiaries and that technical provisions are adequate to cover the liabilities of future accrued pension rights. Up to now the question remains open as to whether common standards on this issue can be reached in the future at European level. On the other hand, from the perspective of creating an internal market for IORPs in Europe, less prudential accounting of technical provisions might imply a more cost-efficient pension at a first glance. However, this also means an inferior quality of this pension product because it is less certain that the IORP allocates prudential technical provisions in order to provide a later pension to the beneficiaries that corresponds to the pension promise.

The opposite approach is not always useful either. If supervision is too strict, it may lead to raising the price level of a pension scheme and employers could decide to close schemes since they are no longer able to afford them.

QUESTION B)

Should prudential requirements be considered separately from Social and Labour Law (SLL)? If yes, how could prudential requirements and SLL be distinguished?

ANSWER

Both requirements are meant to protect the interests of beneficiaries of the pension scheme. For an IORP operating cross-border, clear competences are essential.

However, to ensure that individual beneficiaries of pension schemes will not become victims of supervisory arbitrage, it would be useful to develop some general guidelines at European level, e.g. security measures to ensure that an IORP can cover its liabilities. Because of the principle of subsidiarity, it is up to the individual Member States to decide how to provide such security measures. This could be done by using a financial buffer, other guarantees or the obligation of the employer to provide supplementary resources if necessary to cover the liabilities.

7. The CEIOPS survey shows that in practice, Member States differ markedly in their approaches to inflation protection of the benefits promised. In some Member States they are conditional, in which case inflation risk is left with the beneficiaries, while in others they are unconditional.

QUESTION A)

How should differences in indexation promises (i.e. in nominal, conditionally indexed and real terms) be taken into account or included in a solvency framework for IORPs operating on a cross-border basis?

ANSWER

In several Member States, the so-called indexation rule or target is part of the pension scheme promise between employers and employees. Prudential requirement should only evaluate whether the indexation rule communicated to beneficiaries can be fulfilled by the IORP.

If prudential requirements would require that unconditional indexation is the only option to be taken into consideration (as is the case in the Solvency II regime) this would mean that the costs of pension schemes would rise to such an extent that these pension schemes would have to reduce their benefit level. Therefore, for instance, UK employers and employees are currently very interested in the Dutch system of conditional indexation, since the UK system only provides for unconditional indexation.

QUESTION B)

Do you foresee any difficulties arising from differences in the specific nature of pension promises in case of cross-border activity?

ANSWER

EAPSPI is of the opinion that in the future, for the sake of an efficient internal market, the content of a second pillar pension plan should continue to be defined jointly by employers and employees in accordance with national social and labour law of the respective Member State.

(ii) Solvency rules

8. The IORP Directive has created opportunities for the provision of cross-border pension services, as a first step towards an internal market for occupational pensions. Take-up so far has been rather slow, as full implementation of the Directive was achieved only in 2007. More time is therefore needed for the full effects of the Directive to unfold.

QUESTION A)

To what extent are the differences in solvency rules for IORPs operating on a cross-border basis acting as an obstacle towards cross border activity of occupational pensions?

ANSWER

As stated above (see answer to question 6. a)), EAPSPI is of the opinion that cross-border activities of DB schemes will not develop significantly as far as public sector pension schemes are concerned. Consequently, differences in solvency rules for IORPs cannot be an obstacle.

QUESTION B)

Do you think that there may be other, and potentially more important, reasons beyond the scope of prudential regulation that complicate the conduct of cross-border activity? Please specify.

ANSWER

EAPSPI does not see any further reasons as explained in the answer to question 6. a), b) and 8. a).

9. The IORP Directive lays down only minimum solvency requirements for IORPs. The CEIOPS survey suggests that material variations in regulatory requirements may spur regulatory arbitrage by IORPs operating on a cross-border basis and supervisory competition between Member States.

QUESTION A)

Is there any evidence of i) regulatory arbitrage by IORPs operating on a cross-border basis, and/or ii) supervisory competition between Member States? If so, please give examples.

ANSWER

As far as EAPSPI is aware, the Dutch government examined this issue when the Belgian OFP was introduced. This investigation revealed that there is no regulatory arbitrage between Member States.

QUESTION B)

Do you expect regulatory arbitrage by IORPs operating on a cross-border basis, and/or supervisory competition between Member States to occur in the future, and what evidence do you have to support your belief?

ANSWER

Apart from different regulations in this field, the fiscal treatment of a pension plan is important. Furthermore, employers and employees tend to be in favour of administrating the scheme in one Member State, this mostly being their country of origin.

Much more important for IORPs than being able to be domiciled in another Member State, is the possibility of investing abroad. Article 19 of the IORP Directive represents substantial value in this respect.

QUESTION C)

Do you think that regulatory arbitrage and/or supervisory competition due to differences in the treatment of IORPs operating on a cross-border basis could ultimately be in the interest

of pension beneficiaries or sponsoring undertakings or do you think that this may ultimately be harmful? If so, in what way?

ANSWER

Regulatory arbitrage could be harmful for the interests of the beneficiaries, but EAPSPI does not think that this will happen on a large scale. However, in periods like the current international financial crisis, some Member States may feel tempted to offer IORPs favourable conditions in order to attract them to move to their countries.

QUESTION D)

Do you think that the EU solvency rules for IORPs operating on a cross-border basis should be risk-oriented, and based on a market-consistent valuation of assets and liabilities?

ANSWER

EAPSPI supports this approach and is of the opinion that the current IORP Directive supports these ideas.

QUESTION E)

Do you think that the definition of the right level and method of risk orientation should be determined at EU level or left to individual Member States?

ANSWER

EAPSPI is against any determination of this question at EU-level since general rules for 27 Member States will not work in practice. Because of the fundamental differences in the design of the national pension systems and the corresponding supervisory mechanisms, the right level and method of risk orientation should be left to the individual Member State that will be able to find the adequate adjustment mechanisms, taking into account the specific characteristics of the pension system.

QUESTION F)

Do you think that the solvency requirements should include rules relating to governance and disclosure?

ANSWER

Similar to the question above, EAPSPI is also of the opinion that these issues should not be determined at EU level because of the variety of pension schemes and institutions throughout Europe.

10. The CEIOPS survey shows that the existing solvency regimes for IORPs operating on the cross-border basis are very diverse. This is reflected in different valuation methods for technical provisions and in the variety of security mechanisms. But, this does not necessarily imply substantially different security levels provided to beneficiaries between Member States. In practice, the different security mechanisms are linked to one another and may operate simultaneously. By implication, as different approaches can be used to secure pension benefits, national pension supervision frameworks do not necessarily have to be identical. In practice, there may be several degrees of harmonisation, or harmonisation only of some elements.

QUESTION A)

Do you think that a harmonised solvency regime for IORPs operating on a cross-border basis is desirable? Please outline in broad terms how such a regime would look like.

ANSWER

As mentioned before, harmonized prudential rules at EU-level are not a key issue for IORPs when deciding about their domicile. In practice, fiscal rules are much more important in this respect because they largely determine the price of the pension scheme. Moreover, harmonisation for defined contribution plans is not of any importance in this context. If an IORP wants to go abroad, it can be sure that the same prudential rules are applicable. Therefore, financial supervision is not a problem for cross-border activities anymore.

QUESTION B)

Do you think that in some parts or elements of the solvency regime there is scope for harmonisation? If so, for which parts or elements?

ANSWER

The CEIOPS survey has shown that there are different methods in the Member States to reach the same outcome, i.e. an adequate protection of the beneficiaries. More harmonization will finally result in creating problems in the near future for those pension schemes that are currently already adequate and financially sustainable. More detailed

prudential rules can never take into consideration the specific concepts and particularities of each national pension system.

QUESTION C)

Is there scope to consider separately different types of IORPs operating on a cross-border basis in this harmonisation? Please explain that view.

ANSWER

See the answers to questions 10 a) and 10 b).

QUESTION D)

Do you see any problems relating to a harmonised approach?

ANSWER

See the answers to questions 10 a) and 10 b).

QUESTION E)

Do you think that the current solvency regimes for IORPs operating on a cross-border basis, which are based on minimum harmonisation, provide a more desirable outcome? Please explain that view.

ANSWER

EAPSPI thinks that this approach will work in practice since it is in line with the principle of subsidiarity which is a basic rule in the field of second pillar pensions.

Munich, 27 November 2008

ABOUT EAPSPI

The European Association of Public Sector Pension Institutions (EAPSPI) is a group of 23 public sector pension schemes out of 15 European countries. The members and observers are institutions from the following countries: Austria, Belgium, Denmark, Finland, France, Ireland, Italy, Germany, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and United Kingdom. These institutions cover the special basic schemes for civil servants or the supplementary schemes for public employees. They are responsible for more than 26 million active members in the public sector and pensioners.

The main purpose of EAPSPI is to enable their members to improve the reciprocal knowledge of their institutions and that of the social organisation of their respective countries. Furthermore, the association intends to take part in the construction of a social Europe and, in this context, to study the consequences of the opening up of Europe, particularly regarding free movement. In this context, EAPSPI analyses ways and means of improving services offered to their clients (pensioners, active members or employers). To achieve this purpose, the association mainly intends to promote exchanges of expertise and information, involving also the area of products and services linked to retirement and to position itself as a pension expert, in order to develop relations and interact with European institutions and other international organisations.