Position Paper

CEA response to the EC Green Paper - Towards adequate, sustainable and safe European pension systems

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Summary

Against the background of the financial crisis and demographic ageing, the CEA acknowledges that in some Member States (MS) further pension reforms can be necessary. Pensions are a cornerstone of the European economy. Our future competitiveness, our standard of living, our ability to evolve and grow, depend in great part on our ability to build up effective, affordable and sustainable pension systems as they represent a big part of the public finances in all MS.

The CEA supports the European Commission's (EC) vision that there is no one-size-fits-all design for pension reforms and that MS should be responsible for their individual design. As a result, the CEA calls on the EC to ensure that its policy work in this field does not derail pension reforms underway in individual MS. However, the EU has a role to play in monitoring pension systems' sustainability and assessing the adequate level of pension savings. This is an area perfectly suited for the open method of coordination

The CEA believes that insurers can play an important role in this debate. Insurance companies have unique expertise in offering and efficiently administering sustainable pension systems and developing innovative insurance solutions. Due to the actuarial expertise that was built up over the last two centuries, life insurers provide sustainable retirement benefits. Life insurance products can provide the same benefits as public pensions by the provision of annuities, survivor benefits and long term pension savings. Against this background, life insurers are well-positioned to ease the burden on public pension schemes by providing funded pensions.

In the past, longevity risk has exceeded demographers' expectations and life insurers have a long track record tackling this. Since they are subject to strict supervision and regulation, including comprehensive solvency requirements, they offer high levels of pension protection for their customers.

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Responses by the CEA to questions put by the European Commission

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

A key aspect to strengthen adequacy is improving pension savings. Several assessments have concluded that European society will have a budgetary deficit which would require a huge increase in households' pension savings to reverse. It is necessary to build up a social culture of pension savings and use tools, necessary to promote these practises. In this context:

a. MS should develop politically stable legal frameworks allowing well-targeted fiscal incentives to promote adequate funded pension savings with a long-term perspective through work-based and supplementary pension systems in all MS without access restrictions. Furthermore, it is important that MS inform consumers of these tax advantages available to support their long-term pension goals.
b. Currently, information about pension systems' economic importance and composition which is available at EU level is insufficiently comparable. Therefore, the CEA encourages the EC to launch an assessment in this field. A possible outcome could be the following:
    i. An improved common statistical framework which enables full and efficient cross-country comparability across MS through a converging methodology.
    ii. A common taxonomy defining the characteristics of the PAYG and private sector products.
    iii. Following (i) and (ii), the EC could support MS to assess their current pension systems and set non-binding goals, whose results would be fully disclosed, within a fixed timeframe based on the gathered data. This could enable national policy-makers, regulators, industry and citizens to assess the performance of the current system and take necessary action.
c. The CEA welcomes EU initiatives that encourage MS to include financial education (including pension issues) as a compulsory component in school education. Furthermore, the EC should support each MS to update every citizen on a regular basis about the accrued pension entitlements for the public, occupational and supplementary pension systems.

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

The CEA would like to point out possible workstreams that would allow the EU to achieve its non-binding goals towards more sustainable pension systems. These workstreams are based on the security which should be the main element in every welfare system:

a. In the case of Pay-As-You-Go (PAYG) welfare systems, security means being able to measure, monitor and, correct the level of long-term financial sustainability while different national calculations exist. For that purpose, the EC together with the Member States should develop a common, harmonised assessment methodology to measure the long-term sustainability position of each national pension system that would be aspirational and non-binding for all states and whose results would be fully disclosed. Already existing calculations should be made more comparable by introducing a common methodology. It should be considered how use of these calculations can be made in the context of the Stability and Growth Pact (SGP). These goals should inspire MS to react. The EC would have an important warning function in case of a deficit but should not decide on specific measures to be taken.
b. Adequate design of funded pensions contributes to the sustainability of both public finances and funded systems.
c. Within the Open Method of Coordination (OMC) the EU should invite MS to assess their respective adequate balance between funded systems and unfunded pension provision.

(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?*

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(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 labor market?*

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(5) *In which way should the Directive on Institutions for Occupational Retirement Provision be amended to improve the conditions for cross-border activity?*

The EC argues in the Green Paper that the IORP directive has not removed significant obstacles for cross-border activity. These obstacles prevent the realization of efficiency gains arising from economies of scale and competition, thereby raising the costs of pensions and restricting consumer choice.

Harmonizing solvency II-type principles applying to IORPs will strengthen the single market for pensions. In the context of the IORP Directive, the EC rightly describes a lack of harmonisation of prudential regulation as a barrier to cross-border activity. Such harmonisation would address regulatory gaps and avoid regulatory arbitrage. This is because it allows for a combination of national social and labour law (which cannot be chosen) with the most permissive supervisory regime of the 27 Member States. The overall level of security for employers and employees can only decline as a result.

In addition to the very important IORP review, it would be useful to reduce other obstacles for cross-border activity between MS. A common language would also facilitate transparency and comparability between different pensions.

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

The CEA supports the elimination of all obstacles to the freedom of movement across and within MS. The CEA recognises that the creation of a general framework removing obstacles for mobility might have a positive impact on worker mobility.

However, the attempt to accomplish this objective should not hamper the further development of occupational and supplementary pension provision, ultimately leading to less social protection.

According to the CEA, previous proposals risked to be counterproductive, since they might have led to a significant increase in the cost of occupational plans, thereby endangering the democratisation of occupational pension plans (which is vital in an ageing society). In addition, various provisions were unclear and inapplicable in practise, and are thus a source of legal insecurity.

In order to achieve a more workable solution, the CEA urges policymakers and all stakeholders to take into account these concerns. The CEA is available for any additional explanations or assistance required in order to achieve an outcome which broadens and deepens occupational pension provision throughout the EU.

(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?*

The CEA is supportive of the idea to improve the freedom of movement across and within Member States.

Regarding transferability, there are certain technical and legal issues that should be taken into account:

- Pension entitlements which were acquired cannot directly be transferred, only their capitalized values can be transferred.
- A retrospective approach would in some countries result in inadequate capital requirements as the transferability of assets has not been included in the solvency requirements. This is the case where national transferability is not possible.
- Implementing the right to transfer would result in a short-term investment strategy of the pension provider where there are guarantees. , resulting in a lower return on the assets.
- Given that retirement benefits are so closely linked to national social security and labour legislation (which changes frequently), it may not be practicable to reach an EU framework for this.

Therefore, the CEA suggest the EC encourage MS to look for solutions allowing transfers within their national competence but looking at European cross-border transferability in the medium term.

Beyond transferability, a tracking service for all pension rights can be very helpful. This is because a tracking service is a very important tool for individuals to help them keeping an overview of the retirement benefits they have acquired, both through social security legislation and through individual or work-based pensions. However, the CEA is concerned that in reality this will be very hard to implement. The CEA however welcomes any domestic measures taken by the national governments to inform citizens on a timely and regular basis about their pension benefits once they start working. Accordingly, the CEA suggest the EC encourage MS to share best practice about their experience in this field.

Finally, any initiative at EU level should take into account what already exists at national level.

(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?

In the presence of the current regulatory patchwork the impact of strict Solvency II principles, notably for guaranteed products, in one sector will be undermined by the possibility of regulatory arbitrage. Solvency II applies ris-based valuation and regulatory capital requirements, while the IORP Directive still follows a non-risk based approach. We can see no reason why Solvency II principles should be appropriate for only one significant segment of the industry (insurers providing pension products) but not for IORPs. Since detailed work is required to plan and manage the transition while maintaining stability, the EC has to launch an immediate project including an impact assessment for the application of Solvency II principles to IORP's.

The staff working document accompanying the Green Paper shows the regulatory patchwork that currently exists at European level with respect to the provision of benefits. Consequently, capital backing pension schemes and products providing retirement benefits may have a completely different value depending on the type of provider:

- Life insurance companies are obliged to reserve funds depending on solvency requirements currently reviewed under a more risk-based approach.
- The IORPs are subject to capital requirements that are not risk based.
- Asset managers offer products including capital guarantees cross border without any capital requirements.

As a consequence the security level of products including capital guarantees will decline. The principle "same risk, same rules" should be fully respected to create a level playing field between life insurers, IORPs and mutual funds offering guaranteed benefits (see also recitals 12 and 30 IORP Directive).

The CEA believes that the same principles should apply to pension funds and to insurers. The Solvency II principles are appropriate for pension funds provided the economically significant differences between pension products or schemes are taken into consideration.

(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?

The primary objective of solvency rules is to create more security by financial service providers. In order to create a level playing field for all pension providers, a solvency regime based on the "same risks, same rules" principles should be a first priority on the European agenda.

With respect to pension products including capital guarantees a trade-off between security and affordability exists at first glance only. If pension liabilities are not fully funded, costs will arise at a later point of time. The only question which remains to be answered is who will pay these costs. In case of insolvency of the pension provider the employer has to make additional contributions, and in case of clauses which allow for the reduction of accrued pension rights, the beneficiary has to accept benefit cuts. In the event of the employer's insolvency, Solvency II is a benchmark; the costs of the promise will be socialised and transferred to the tax payers in the event of a bail-out. Then the burden would be imposed on future generations of employees, who will carry the main responsibility of demographic change. In any case, the definition and decision on the balance between risk and security should be taken in the national context.

The CEA believes in order to achieve a better balance for pension savers and providers that MS share best practice. The CEA believes that the OMC is the right means to share these best practises. This approach would allow MS to adopt pension reforms appropriate to the situation they are faced with and would reflect that a one-size-fit all solution would not work.

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

The EC rightly calls the risk-based Solvency II approach applying to life insurance companies an adequate starting point for creating an equivalent solvency regime for pensions. Consistency of supervisory regimes for different providers is to be ensured by applying the "same risks – same rules – same capital" principle. Of course, this also implies that distinctive characteristics of pension funds when relevant from a supervisory point of view should be adequately taken into account. The CEA believes that an equivalent risk-based approach for IORP pension funds should be built on the level of risk they represent since firm solvency principles increase supervision and confidence in the financial markets.

The CEA believes that the long-term nature of pension commitments means that an appropriately rigorous regime should be applied consistently to providers of pensions, be they insurers or IORPs. In the case of capital guarantees, this should also apply to mutual funds offering guaranteed benefits. However, consideration needs to be given to the most appropriate way to apply these principles. The Solvency II principles are appropriate for pension funds provided the economically significant differences between pension products or schemes are taken into consideration.

The CEIOPS report "Fully funded, technical provisions and security mechanisms" of 2008 provides ample evidence of the existence of differences regarding how technical provisions of IORPs are calculated. These inconsistencies should be removed.

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

It is clearly important to ensure that employees relying on the pension promise of their employer for their retirement income are appropriately protected against the employer's insolvency. An exchange of best practice and agreement of targets through the open method of co-ordination could be supportive. We would not like to see national systems that work well having to be adjusted in response to EU legislation adopting a new way of guarding against the insolvency of the employer simply because there are problems in individual Member States. The outsourcing of liabilities in this context to an external provider protects beneficiaries from the insolvencies from the employer. As these external providers are subject to strict solvency principles, they are to reasonable extent protected against insolvency

The CEA is currently waiting for the results of the study (ESOFAC), issued in 2009 and the gathering of information to provide a position on this question. The CEA however suggests that the level of protection should be clearly informed to the stakeholders.

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

The information provided to policy holders and beneficiaries should reflect the characteristics of the pension products they are affiliated with. For long-term pension products such as occupational pensions it is particularly necessary to clarify the kind of guarantees and long term commitments the pension provider is offering as well as an indication of the quality of the solvency regime they are under. We propose to take the solvency II directive as an inspiration for introducing information disclosure requirements for IORPS that are up to date.

We agree that the current approach has led to different national approaches. In individual MS, the information disclosure requirements can vary between pension funds and pensions provided by insurers, and they can even be set by different regulators.

The EC could usefully seek to establish the approaches used across all Member States in practice.
In general, the contractual information should clearly reflect the characteristics of pension products which the EC has stressed: safety and guarantees, rules reflecting access and long-term commitments.

The CEA sees an important role for the EC in establishing a common pension language across the EU. Many terms used no longer reflect the reality on the ground. For example, the terminology of three Pillars is no longer appropriate in this environment. We believe it would be extremely valuable if the Commission could establish a common, clear vocabulary for the variety of pension provision and pension products, public, work-based and private, which is understood across all Member States. This is also a necessary prerequisite for enhancing the policy co-ordination framework at EU level, a goal which the CEA supports.

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

The CEA believes that default options about participation choice should be left to MS. Some jurisdictions have adopted automatic enrolment for their pension reforms, which is in effect soft compulsion because employees will be automatically enrolled and then have to opt out if they do not wish to benefit from the pension scheme. But what is appropriate will differ from MS to MS depending on a number of variables, including cultural factors and employment relations.

The CEA also strongly feels that a common EU approach for default options about investment choice could have very detrimental unintended consequences. This would restrict the space for market creativity at national level. It is recognised by all sides that prescriptive regulation in this field could restrict innovation and therefore harm the interests of pension scheme members. This must be true all the more for attempts regulating this through EU legislation.

Furthermore, the insurance industry is an initiator of a number of initiatives aimed at improving citizens' financial literacy. The Commission can add real value by organising and coordinating best practice and information exchange between EU member states on effective financial literacy initiatives. The CEA supports the EC's request to MS including financial education as a compulsory component in school education curricula and sufficient attention should be given to pensions issues. As a useful next step and stocktaking exercise, the CEA would welcome the inclusion of a financial/ pension literacy module in the next OECD programme for international student assessment (PISA) test. National governments should be furthermore encouraged providing an understandable and accurate statement to each citizen on the value of the state pension benefits they can expect. Life insurers can work with MS governments to draw consumers' attention to the fact that they need to save (more) for retirement and that they are responsible for financing that retirement.

(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?

Insurers are significant pension providers and should be adequately represented in the Occupational Pensions Stakeholder Group of the European Insurance and Occupational Pensions Authority (EIOPA). An effective and formal mechanism to ensure insurance participation in the Occupational Pension Stakeholder Group must be put in place. This would be coherent with the integrated approach that the Commission presents in its Green paper on pensions. For instance, life insurers' assets contain 95% of asset market for funded pensions in France and 80% in Belgium. Furthermore insurance providers have unique expertise in providing, efficiently administering and reinsuring sustainable pension solutions and are the perfect complement assuring adequate retirement benefits. Therefore the CEA believes that life insurers can play an important role and provide the necessary key contributions and knowledge in the stakeholder group.

The CEA also supports the EC monitoring all aspects of pension policy in the M S. This would be a real step forward and allow best practice and other information to be shared through the OMC and a coherent view of the legislative framework and its practical application in all MS to be developed. At the same time, it would leave enough room to MS for the concrete design and implementation. This approach should be fully used. It is important that such work complements, rather than duplicates, work undertaken by other bodies such as the OECD. The CEA also believes that the OECD provides a basis but should be more convergent.

The CEA also supports the EC seeking to agree targets with Member States on key indicators, such as a sensible equilibrium between PAYG and funded pensions, or on adequate retirement income. However, such targets would need to be non-binding on Member States and be set for the medium to long term, given the considerable variations in living standards between Member States.