Original Article

Review of the IORP directive

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ABSTRACT The review of the Institutions for Retirement Provision (or Pensions) Directive has the potential to be a defining influence on the future of pension provision in Europe. This article sets out the background to the review and brings readers up to date with recent developments.

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INTRODUCTION

Since the end of 2011, the European Commission's review of the Institutions for Occupational Retirement Provision (IORP) Directive¹ has attracted a great deal of coverage in both specialist pensions and mainstream financial press. Much of this has been on the back of 'doomsday' modelling of the costs of defined benefit liabilities if Solvency II Directive capital requirements were applied to occupational (or supplementary) pensions.

At a public hearing in Brussels on 1 March 2012, DG Market Commissioner, Michel Barnier, dismissed these stories as 'hyperbole' – stating that the Commission has 'not yet put forward any proposals' and that he has never said that pensions would be 'subject to exactly the same rules as those set out under Solvency II'.

Despite this and other implied assurances from the Commission, there remains considerable disquiet about the review – with hard-line opposition from pension fund sponsors, fiduciaries and even member representatives, in many cases

backed by various Ministries from Member States' governments.

Is this concern justified and what might the IORP review mean for supplementary (employment-related) pension provision in Europe?

In this article, I hope to provide readers with background of how we have arrived at where we are, what is and is not currently proposed and what the next key milestones are likely to be. Although I hope to quell some of the more extreme concerns, I think the key phrase is that 'we can be optimistic, but not complacent', that the review will ultimately deliver some sensible proposals. I also think it important not to lose sight of those aspects that comprise much of the review that have been overshadowed – understandably – by the capital adequacy debate.

There are aspects of the review that could be useful in promoting adequate, sustainable and secure pensions. However, what is of paramount importance is to ensure that we achieve the correct balance between these – often competing – aims. Not to do so, for example, by overemphasising the 'security' aspect, risks undermining sponsor support for pensions and thus defeating the adequacy objective.

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BACKGROUND

Our story starts with the 2003 IORP Directive, although that was itself many years in the making.

The purpose of the 2003 IORP Directive was to establish a system of regulation of IORPs (or occupational pension funds) that was common across the European Union – subsequently adopted by European Economic Area (EEA) countries of Norway, Iceland and Liechtenstein. The stated aim was to foster a single market in IORPs and thereby encourage cross-border provision.

The Directive contains an article that required the European Commission to review certain (narrowly defined) elements 4 years after its entry into force – so 23 September 2007. A further provision requires ‘with a view to further harmonisation of the rules regarding the calculation of technical provisions’ the Commission to issue a report every 2 years ‘on the situation concerning the development in cross-border activities’.

A report,² with the wider focus of the implementation of the Directive, from the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), the predecessor to the European Insurance and Occupational Pensions Authority (EIOPA), was published in early 2008.

That report concluded that:

- 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; and
- it would be premature to recommend changes, but to keep matters under review.

At much the same time, CEIOPS published an excellent and detailed survey³ on fully funded, technical provisions and security mechanisms throughout the European occupational pension sector.

Later that year (September), the Commission launched a consultation on the harmonisation of solvency rules for *certain* categories of IORP – those that cover biometric or investment

risks themselves (and so operate similarly to an insurer – also known as Article 17(1) funds) and IORPs that operate across borders within the EEA.

Of course, the global economic crisis also emerged during 2008 leading to the recommendations of the de Larosiere report.⁴ This emboldened the Commission in its ambition for greater consistency in the supervisory regimes of all financial services as well as boosting CEIOPS powers in its revised guise of EIOPA.

In March 2009, the Commission provided a summary of responses to the consultation, but gave no clear indication of likely action. However, the summary suggested an underlying desire in the Commission to extend a Solvency II-based supervisory framework to all IORPs. A public hearing followed in May 2009, which pointed to views polarising between the ‘pensions industry’ – broadly questioning the need for any further harmonisation and opposed to Solvency II being applied to IORPs – and the ‘insurance industry’ being in favour of IORPs being subject to Solvency II, citing the mantra: ‘same risk ... same capital’.

In June 2010, the Commission published its Green Paper ‘Towards adequate, sustainable and safe European Pensions’ and Solvency II was back on the table, but this time for all funded IORPs, not just Article 17 and cross-border plans. The Commission cited the views of stakeholders following the above consultation exercise as necessitating a bespoke ‘solvency regime for pension funds ... that ... avoid[s] pro-cyclical solvency rules’.⁵ The Commission also stated that ‘the Solvency II approach could be a good starting point’ but made it clear that this would need to be ‘subject to adjustments to take account of the nature and duration of the pension promise’.

In part, this was because when the Solvency II Directive was being developed, there were already some who wished to include pension funds within its scope: others were opposed. In the end, a compromise was reached whereby a recital was included that stated: ‘The Commission, assisted by [EIOPA], should develop a proper system of solvency rules

concerning [IORPs], whilst fully reflecting the essential distinctiveness of insurance'. Perhaps, importantly, the recital goes on to state '... and, therefore, should not prejudice the application of this Directive to be imposed upon those institutions'.

In April 2011, the Commission issued a 'Call for Advice' to EIOPA. In that call, the Commission was clear that, in its view, IORPs are financial institutions and therefore the 'Solvency' regime (which covers a lot more than just the Pillar I capital adequacy requirements) for pensions should be 'consistent' with that for insurers.

This point is reinforced in EIOPA's advice, wherein it highlights that it is a single authority with responsibility both for pensions and for insurers. This consistency issue has been taken to a more emotive level, being described as 'ensuring there is a level playing field between insurers and pensions'. In itself, there is little within this statement with which to disagree. However, many consider that there is no common 'playing field' as commitments from insurance undertakings and IORPs differ so greatly. The European Parliament would appear to agree, stating in its report on the Commission's 2010 Green paper that the 'risks in the insurance sector are different from those faced by IORPs'.⁶

As ever, the situation is rather more complex in practice. Many of the 'differences' hold true in general, but can often be found to be rather less clear cut in specific examples.

It was not surprising, given the above, that in the annex⁷ to its call for advice in 2011, the Commission asked EIOPA to consider various of the articles of the Solvency II Directive as the starting point for a harmonised supervisory regime for IORPs – although recognising that these might need to be amended 'to adequately address the specificities of IORPs'.⁸

In February 2012, EIOPA's delivered its advice – following consultation on this with stakeholders and interested parties in the latter part of 2011. That advice has been given in the context of the constraints imposed by the Commission's call and EIOPA states explicitly

that it did not consider whether the Solvency II Directive is an appropriate starting point for the IORP Directive review as that was beyond its remit as it is a political decision. It also reserved the right to revisit its advice in the light of results from the proposed Quantitative Impact Study (QIS).

On 1 March 2012, the Commission hosted another public hearing in the light of EIOPA's advice. At that meeting, in broad terms, the position of the 'pensions industry' was even more vehement than had previously been the case in its opposition to the notion of basing a revised IORP Directive on the Solvency II Directive. Moreover, there was a unified front from sponsors, fiduciaries and employee representatives (in the form of Unions) as well as Government spokesmen from several of the Member States expected to be most significantly affected. It is also fair to suggest that the insurance industry has also moved somewhat with a rather more 'nuanced' stance than merely stating that IORPs should be subject to the same rules as insurers. It should be noted that the effects of certain of the Solvency II requirements on insurers is still being assessed with debates ongoing as to how to ameliorate some of the (unforeseen) consequences that have emerged. It is probably also worth noting that the area spawning most difficulty is that of long-term business – so the area most similar to pensions business.

At the public hearing, there was evidence that the Commission was listening to the objections of the pensions industry. The Director General of the Internal Markets Directorate stated in his closing remarks – 'if we were to apply more rigorous rules to the back book of the pension funds, this would most likely be financially unsustainable. We will therefore have to find a solution on how to deal with the past'. In evidence to the UK Parliament's Work and Pensions Select Committee on 23 April, a Commission official suggested that this could be accommodated via a lengthy transition period of '10, 20 or, maybe even 30 years' to bring the funding of accrued liabilities up to the new solvency level. He also

made it clear that any new requirements would apply to ‘new’ accrual.

Finally, we should not forget that the IORP review is not just about a Solvency II-style risk-based supervisory regime (of which the ‘capital adequacy’ aspect is but one element), but there are also proposals affecting cross-border activity – which has no direct parallel under the Solvency II Directive.

EIOPA’S ADVICE TO THE COMMISSION: 15 FEBRUARY 2012

EIOPA’s advice follows, in the main, the structure set out in the Commission’s call, which asked 23 questions. All bar seven of those addressed how the relevant articles under the Solvency II Directive would need to be amended to cater for pensions. Most of the remaining seven questions that do not start from Solvency II principles relate to cross-border activity, where there is no parallel under Solvency II. A notable exception concerns the provision of information to IORP members, which starts from considering how potential investors in ‘retail’ investment products are informed about the key matters they should consider before investing.

The structure of EIOPA’s response is unsurprising as, in effect, the call for advice restricted EIOPA in this way. EIOPA commented on this restriction to its remit thus:

... many of the questions asked whether specific articles of the Solvency II directive should be amended or removed in respect of their application to IORPs. The broader question of whether these articles were the right place to begin a review of the IORP directive was not asked of EIOPA. Overall, EIOPA notes that the Commission may want to consider some of the wider issues raised by consultation respondents which are outside the scope of EIOPA’s advice.⁹

EIOPA also specified that its advice in relation to the thorny issue of capital adequacy – modelled on ‘Pillar I’ of the Solvency II Directive – is conditional on the outcome of a QIS and that ‘once the QIS is completed, EIOPA will consider

whether to offer further views on those aspects of valuation and capital requirements which are affected by the QIS’.

It should be noted that no QIS is planned in relation to EIOPA’s advice on

- the ‘scope’ of the Directive
- the matters relating to cross-border activity or
- on those areas broadly equating to Pillars II and III of the Solvency II Directive – that is, matters relating to ‘governance and information to supervisors’.

Before we consider those aspects further, let us examine the detail of EIOPA’s advice relating to the capital adequacy requirements.

The holistic balance sheet (HBS)

Much of the commentary about the potential costs of the capital adequacy aspect of the ‘proposals’ is based on extrapolating from Solvency II (QIS 5) valuation assumptions and applying these unadjusted to IORP liabilities. Under the Solvency II Directive, any identified shortfall for insurers has to be corrected in a very short space of time. Determining an IORP’s position against the Solvency II requirements is understandable as it provides a worst-case scenario. Realistically, it is the only benchmark available and the results from rudimentary modelling on this basis in relation to UK provision – both for individual IORPs and an estimate of the aggregate position – produces impracticably large numbers. Defined benefit liabilities are affected to a far greater degree than those relating to defined contributions and the lion’s share of DB liabilities are in the United Kingdom. The Commission has rejected this ‘worst-case scenario’ commentary on the basis that there is, as yet, no proposal. While undoubtedly correct, numbers will influence the shape of those proposals.

A key element of EIOPA’s advice is the HBS. The HBS relies on placing a value on not only the ‘real’ assets (and liabilities) of an IORP, but also on rather more nebulous elements referred to in EIOPA’s advice as ‘security’ mechanisms and ‘benefit adjustment’ mechanisms.

Examples of the former include the value of a sponsor's commitment (its covenant) and national protection schemes – such as the Pension Protection Fund (PPF) in the United Kingdom. Benefit adjustment mechanisms include the ability to reduce 'promised' benefits in times of extreme financial stress. While such adjustment is not possible in the United Kingdom, within other countries – most notably the Netherlands – it is common.

A key attraction of the HBS is that it provides a clear pictorial representation of the 'solvency' position of the IORP. Our representation of the HBS below demonstrates this, although some of the components may require further explanation (Figure 1).

ASSETS

The elements on the left hand (assets) side are fairly self-explanatory. However, while the principle is clear, there is a major challenge in how some of the aforementioned 'security mechanism' aspects should be valued.

One of the main issues with distilling the value of the employer covenant to a single balance sheet number is how to do so on a consistent basis, recognising the many different types of employer (for example, asset rich/cashflow poor and asset poor/cashflow rich) across different sectors and across different jurisdictions. The 'key' information on covenant may well be non-numeric; for example, the ability of an organisation to instantly

divert assets from one jurisdiction to another – possibly where they are then difficult to pursue. There then remain issues as to whether to value a sponsor on a 'going concern' basis versus 'break up' basis, taking account (potentially, at least) of the different insolvency legislation in different Member States. In practice, all of the above are likely to be valid considerations and need somehow to be factored in.

Placing a value on Pension Protection Schemes is also problematic. In the United Kingdom, for example, statute and case law does not allow 'ring-fencing' of assets/liabilities corresponding to the level of PPF compensation, thus it could be difficult to argue that that particular tranche of benefit is 'secure' with any liabilities above that level having to be valued. It is also arguable as to whether the liability side should be reduced or the asset side increased by the PPF 'value'.

LIABILITIES

EIOPA's 'advice' in relation to the liabilities hand side of the balance sheet is perhaps even harder to pin down. There are differing views on how to value the different elements, leading to a great many permutations.

As shown in the diagram, EIOPA's advice refers to three elements on the liability side. The 'best estimate' of liabilities, the risk margin and the Solvency Capital Requirement (SCR).

BEST ESTIMATE

The best estimate of liabilities (based on future cashflows) could be assessed, as is the case in the main under Solvency II, on a near risk-free discount rate and/or another rate – possibly linked to the expected return on assets (in which case the estimate would differ little from the UK technical provisions). Quite what rate is decided upon is likely to affect significantly the 'value' placed on those liabilities.

RISK MARGIN

Various options exist for the calculation of the 'risk margin'. Under Solvency II, this is, broadly speaking, based on the cost of capital that a third party would need to hold to back

Figure 1: Holistic balance sheet.

risks that cannot be hedged if it were to take on the liabilities. EIOPA suggests an alternative of an explicit margin for the risk of adverse deviation from assumptions when assessing the best estimates. Under the current IORP Directive, a degree of ‘prudence’ is included when estimating liabilities. EIOPA suggests that it might be appropriate to express this ‘prudence’ explicitly as a separate ‘risk margin’.

SCR

Arguably, the aspect that could be subject to the greatest debate (with various permutations for its calculation) is the SCR. Apart from whether or not an SCR is appropriate at all for sponsor-backed IORPs, much debate is likely on the confidence level and time horizon used in its calculation. These could both vary from those applicable to insurers under Solvency II – as could the frequency with which it has to be assessed.

Benefit adjustment mechanisms are common features of IORPs in countries such as the Netherlands and these may also be difficult to value – EIOPA considers that it *might* be appropriate that the presence of certain types of such mechanisms could justify a lower confidence level than might otherwise be the case. It might further be argued that the different levels of State pension should influence confidence levels. The argument is that it might be appropriate to have a lower confidence level when calculating an IORP’s SCR in those countries with a high replacement rate from Pillar 1 provision than in those countries where State pension is lower.

THE IMPACT STUDY

Only once the QIS has been undertaken, is it likely that there will be a clearer idea as to how difficult the valuation of these elements might be? Irrespective of the degree of difficulty, such a valuation is still likely to be controversial. Even if ‘answers’ to the above can be divined from the QIS, they are likely to result in a compromise between broad brush (and hence affordable) and detailed (and potentially costly) exercises. At worst, they would simply be a ‘fudge’.

EIOPA’s QIS should provide a lot more data with which to gauge the likely costs of various permutations of the possible bases for valuing liabilities, as well as an indication of how the ‘security’ and ‘benefit adjustment’ mechanisms can be valued. At present, the net capital impact for IORPs is unknown. The results of the different permutations will influence the choice of the regulatory response to any imbalance within the HBS and the length of transition period(s). Understandably, in the absence of these data, EIOPA’s advice makes no mention of what action should be taken. Moreover, the choice of regulatory intervention is a political decision, which needs to be considered within the co-decision procedure for agreement of the revised Directive.

Only once EIOPA’s QIS output is available, can the next stage of the impact assessment – the macro-economic impact (to be carried out by the Economic and Financial Affairs Directorate of the Commission) – be sensibly performed. If there is any possibility of short-term corrective action in the form of a capital injection in response to an imbalance in the HBS, concerns that ought to be addressed in that broader assessment include the possibility that the proposals could result in:

1. Increased pension security for the growing retired generation at the expense of returns to existing investors and of future economically productive investment and hence at the expense of jobs and economic growth.
2. Increased cost for companies raising capital because of reduced demand from pension funds for long-term credit and equity.
3. Reduced competitiveness relative to non-EU countries that have lower levels of pension security.
4. Reduced revenues from corporate taxation (if corporate profits are diverted to pension funds).

Another factor that may need to be considered is the percentage replacement income provided by State provision in different countries. Arguably, the security needed for occupational pensions is not as great in those countries where replacement income is high as it is in those countries where

replacement income is low. However, this argument is less compelling where a pension plan established in one country (with one percentage replacement income) makes provision for a workforce in another country (with a different percentage replacement income).

CONSEQUENCES OF MAKING GOOD ANY HBS SHORTFALL

If a deficit is considered to need a (near) immediate injection of cash/real assets, then a substantial deficit could have dire consequences. In particular, as mentioned above, capital would be sucked out of the system that would otherwise be available for investment, growth and job creation.

This flows as both a direct and indirect consequence. The direct route would be that sponsors would have to divert capital to 'plug' the deficit. The indirect route would be that sponsors and trustees would be likely to divert capital from equities – including venture capital and private equity – into bonds, particularly government bonds. This is a consequence of the fact that (in broad terms) under Solvency II, a high level of equity holding leads to an increase in the SCR. It follows that if the Solvency II approach is used to value the liabilities in the HBS, IORPs would likely seek to reduce the SCR by moving to high quality bonds such as gilts to reduce the HBS liability.

This appears to increase, rather than decrease, systemic risk – with all financial institutions chasing similar asset classes. Any substantial switch out from return-seeking assets to gilts would decrease the yield on gilts. If the Solvency II approach is used to value the liabilities in the HBS, lower gilt yields would result in increased liabilities and therefore a higher funding requirement.

If, by contrast, the HBS were used merely as a tool to assist the managers in understanding the current financial health of their IORP, then the end result could be little more than a codified version of current UK practice.

The final result is likely to fall somewhere between the two outlined, including supervisory intervention and heightened oversight and

member disclosures. Perhaps, a more realistic ambition, at least within the Commission, would be that additional capital would flow to the IORP – but over a timescale that was affordable. Even here, however, there are aspects of Solvency II that may not be appropriate for the United Kingdom. In particular, a liability measure that exceeds the cost of 'buying out' those liabilities with an insurer would have limited credibility as, in practice, the liabilities would, in all likelihood, be bought out before funding attained the level of that measure.

It is clear that the response to a HBS deficit will be critical in determining the effect on pension sponsors and therefore macro-economic impact of the proposals.

SO ARE IORPs THAT PROVIDE ONLY DEFINED CONTRIBUTION BENEFITS IN THE CLEAR?

Although DC arrangements are largely excluded from the potential effect of the capital adequacy provisions, there is a proposal that such IORPs should hold a 'buffer' (in the form of SCR) against operational risk – that is, the cost of putting things right when they go wrong. There is no detail as to how large such a buffer might be or how it might operate.

Perhaps, more importantly, in some countries, DC provision has guarantees in relation to 'minimum investment' returns and these IORPs are likely to be subject to very similar solvency requirements as defined benefit IORPs.

CROSS-BORDER PROVISION

A stated objective of the Commission's review of the IORP Directive is to facilitate the operation of the internal market. The Commission takes the comparatively low number of IORPs carrying on cross-border activity as an indication that the existing Directive is in some way inadequate. The number of IORPs across Europe exceeds 140 000, yet – as at June 2011 – there were only 84 that were conducting cross-border activity. However, these numbers need to be put into context.

Of the many thousands of IORPs, many are 'private' arrangements for SMEs and even

individuals. Only around 7000 IORPs have 100 or more members and Member States may disapply many of the Directive's requirements for the others provided that they do not carry out cross-border activity. (That said, EIOPA's Initial review of key aspects of the implementation of the IORP directive¹⁰ found that the majority of Member States have not done so.)

Moreover, certain of the Directive's provisions – such as the poorly defined requirement to be 'fully funded at all times' – have to date acted as a disincentive to setting up cross-border plans (at least those domiciled in certain jurisdictions). Perhaps, a positive prospect of the aforementioned new solvency regime is that this 'requirement' is likely to fall away as there will be no distinction between the funding regime required of domestic and cross-border IORPs. It has certainly been cited as an aspect that the Commission wants to address.

There is demonstrable demand for multi-country plans for the rank and file workforce. However, irrespective of the Commission's stated objective, the obstacles to cross-border activity are high and some of these cannot be addressed through a revised Directive as they lie outside the jurisdiction of the Commission.

Some of the cross-border IORPs that have been set up are for the provision of benefits for 'a few' internationally mobile employees. However, this has often been intended as a tentative step into cross-border provision with the ultimate intention of using this as a means of pensioning an entire 'workforce'. Moreover, countries tend to be included within a cross-border plan 'one at a time' and usually where there are similarities between pension systems. The reason for such caution is clear. The significant 'hurdles' to overcome before being able to operate successfully include:

- framing supplementary pension provision in the context of overall 'local' provision – consideration of the coverage under each country's State system being critical. The replacement levels and conditions attaching to such 'Pillar I' provision vary enormously across the EEA

- having to comply with a great variety of detailed social and labour law – broadly, the 'social' aspect of pensions legislation such as 'preservation' and 'equal treatment' requirements
- having to comply with a great variety of detailed conditions/requirements to qualify for beneficial tax treatment; although case law has ruled out 'discriminatory treatment' between domestic IORPs and IORPs based in another Member State that does not mean that the tax authorities cannot impose the same requirements as apply to domestic plans where they are acting as a 'Host State' under a cross-border IORP
- having to meet a variety of 'information' (disclosure) requirements – normally including ensuring that information is provided in the local language and takes account of local currency requirements
- internal 'political' challenges of persuading those involved with operating 'local' plans in each of the countries to cede some or all control.

The above challenges are real and can be time-consuming to overcome. Moreover, in many countries, the concept of IORPs is quite new and local supervisors are not used to dealing with cross-border matters – making the process, in some cases, protracted.

Furthermore, it can be noted that 'compartmentalising' countries in this way may not lead to the level of financial savings that the Commission and others might imagine. In many cases, assets are not pooled and so the 'gain' is limited to matters relating to governance as well as the 'softer' benefit of facilitating increased consistency of total reward policies across jurisdictions.

The main provisions of EIOPA's advice that cover cross-border issues are:

- the definition of cross-border activity
- ring-fencing requirements
- identification of what constitutes prudential regulation (and by extrapolation 'social and labour' law).

The last of these is important to cross-border provision as prudential legislation can – subject to

agreement through the legislative process – be harmonised through the Commission proposals. By contrast, Member States designate which of their own social and labour laws must continue to apply within a cross border IORP rather than relying instead on the local laws of the jurisdiction in which that cross-border arrangement was established. The Commission has no say over this, as social and labour laws are the responsibility of individual Member States. The ‘problem’ with this is that some countries designate vast swathes of requirements and there is a concern that they do so to make it more difficult for their citizens to be pensioned through an IORP based in a different country. The Commission’s intent in identifying prudential regulation (over which they do have authority) is to define, by exclusion, what constitutes social and labour law. This seems a resourceful solution, but unfortunately is not a panacea as there is still nothing to stop Member States designating prudential matters as social and labour law.

There is a proposal to harmonise the definition of what constitutes cross-border activity and this may assist the setting up of such plans – currently there are at least three different interpretations in use across the EEA. However, the Commission gave EIOPA clear guidance as to the answer it wanted and EIOPA has urged the Commission to consider this further as there remain distinct uncertainties and hence inconsistency. Switching to the Commission’s favoured definition would cause disruption and costs for existing arrangements established in Member States currently using a different definition (such as the United Kingdom). Of course, it is also possible that an IORP that is currently (under the local interpretation of what comprises cross-border activity) a ‘domestic’ arrangement will become a cross-border IORP, which brings with it the prospect of having to comply with the Host State’s relevant social and labour law and information requirements. It might be argued that the HBS will allow greater transparency and comparability of the security of provision from one country to another. Given the need to value the multitude of security and benefit adjustment mechanisms and the fact that there might not be

a single confidence level in operation, this must be doubtful. In addition, most sponsors, plan managers (trustees) and members will tend to favour the local provision that they know and understand. Without a compelling financial incentive to do otherwise, the number of cross-border IORPs is always likely to be low in comparison with the number overall.

GOVERNANCE AND DISCLOSURES (PILLARS II AND III OF THE SOLVENCY II DIRECTIVE) AND KEY INFORMATION FOR MEMBERS

The proposals here may appear largely benign (by comparison to the Holistic Balance Sheet, for example) – being largely concerned with matters that not only seem common sense but which are already addressed across many Member States. These cover areas such as

- (a) general governance requirements
- (b) fit and proper requirements for those managing IORPs and for key function holders
- (c) establishing and operating an appropriate risk management ‘system’
- (d) ensuring independence of an internal audit and compliance function, and
- (e) ensuring due diligence is carried out when outsourcing functions.

EIOPA has identified some of the main differences in the management of IORPs compared with insurers. In particular, while there is a requirement for trustees to be ‘fit and proper’ persons, with the ‘fit’ element perhaps equating broadly to being ‘professionally qualified’, EIOPA acknowledges the benefit of having lay members of a management board – leading to a conclusion that the ‘fitness’ test should be applied across the management board as a whole rather than individual members. Similarly, for each of the areas where the Commission has called for advice, EIOPA recommends how (if at all) the comparable articles of the Solvency II Directive should be amended in their application to IORPs.

As to the provision of information to supervisors, this appears largely to be concerned

with Member States ensuring that they provide the supervisory authorities in their jurisdiction with adequate powers to permit suitable intervention.

EIOPA's advice emphasises the need for proportionality – citing the difference in numbers of insurers and IORPs. The issue of proportionality is as applicable, if not more so, to the Pillar II and Pillar III proposals as it is to the capital adequacy issue. How one defines 'proportionality' is key, yet currently unclear. There is a huge difference between a requirement that is proportionate to the risk and a requirement that is proportionate to the resources of the IORP. Proportionality is also important in relation to the supervisory requirements. For example, providing detailed quarterly granular reports to the regulatory supervisor – as apply for insurers – may well not be appropriate for IORPs.

NEXT STEPS

EIOPA is currently considering how it will undertake the QIS and is being assisted by the Groupe Consultatif Actuariel Européen. At the time of writing, the QIS is expected to run from October to early 2013. Moreover, at the 1 March public hearing, the Commission stated that it 'may want to consult on [the QIS] terms of reference with Member States and stakeholders just as we did in the exemplary consultations for the Solvency II Directive for insurance'.¹¹ On 23 April, the Commission confirmed that it would do so in an evidence session to the UK Work and Pensions Select Committee. This consultation is expected to run from mid-June to late July.

As the wider macro-economic impact assessment will rely in part on the output from the exercise, even allowing for some overlap, it seems unlikely that the Commission will table its draft revised Directive until mid- to late 2013, rather than by the end of 2012 as was set out in the Commission's Roadmap.

Thereafter, assuming that the Directive's passage through the co-decision process takes from 12 to 18 months, it is unlikely that the revised Directive will come into effect until late 2014 or early 2015 at the earliest. Even this

timetable is challenging, given that Parliament elections will be held in 2014 and the Commission will change shortly thereafter. In the meantime, the Commission is likely to be working on Level 2 implementing measures.

CONCLUSION

The review of the Directive is, in part, to make it more applicable to the operation of the European pension provision. In relation to future accrual, this is likely to be defined contribution, at least in the private sector. Much of the angst and ire surrounding the proposals concerns the solvency requirements for defined benefits. The Commission appears keen to stick to the principle that these requirements should be as close as possible to those applicable to insurers under the Solvency II Directive – at least for future accrual. The favoured way of dealing with the back book of liabilities appears to be to permit these to be brought under the new regime after a lengthy transition period – possibly as long as 30 years.

If this is considered politically acceptable – including to those Member States with significant defined benefit liabilities (85 per cent of which reside in the United Kingdom and the Netherlands) – it remains open as to quite what this new solvency standard will really achieve for members. The Directive is subject to 'qualified majority voting' (QMV) in the council of ministers, whereby each country has a weighted block of votes. A proposal will be passed on just under 75 per cent of these weighted votes. It follows that just over 25 per cent of votes are needed to block a proposal. The United Kingdom, the Netherlands, Ireland and Germany account for 90 per cent of defined benefit liabilities within the EU and have strongly opposed the Commission's starting premise of basing the review on the Solvency II Directive. Under QMV, those same four countries hold just over 20 per cent of the voting rights, which is not enough on their own to block the proposals.

Arguably, the security of future accruing defined benefit provision will improve but, outside the public sector, will employers retain

an appetite to provide this? As for cross-border provision, the ‘comparability’ of the security of pension ‘promises’ seems unlikely to boost the numbers of, or employers’ appetite for, cross-border plans (which are likely to be largely defined contribution anyway). Thus, when it comes to judging whether the outcome of the review of the IORP Directive is ‘good’ – in increasing the adequacy and sustainability for European pension systems – it may well be found wanting.

REFERENCES AND NOTES

- 1 Directive 2003/41 on the activities and supervision of Institutions for Occupational Retirement Provision.

- 2 https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/submissionstotheec/ReportIORPdirective.pdf.
- 3 https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/submissionstotheec/ReportonFundSecMech.pdf.
- 4 http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf.
- 5 Para 3.4.2 <http://ec.europa.eu/social/BlobServlet?docId=5551&langId=en>.
- 6 Paragraph 50, <http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2011-0025&language=EN>.
- 7 http://ec.europa.eu/internal_market/pensions/docs/calls/042011_annex_en.pdf.
- 8 Paragraph 5.4 of the Annex (see link from footnote 4).
- 9 Paragraphs 2.2.8 and 2.2.9 https://eiopa.europa.eu/fileadmin/tx_dam/files/consultations/consultationpapers/CP06-11/EIOPA-BOS-12-015_EIOPA_s_Advice.
- 10 https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/submissionstotheec/ReportIORPdirective.pdf.
- 11 Closing remarks by Jonathan Faull; Director General of DG Internal Market and Services.

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