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**CEEP OPINION ON THE PROPOSAL FOR A DIRECTIVE ON
THE ACTIVITIES AND SUPERVISION OF INSTITUTIONS FOR
OCCUPATIONAL RETIREMENT PROVISION (IORP II)**

Executive summary

In its initial press release published on 28 March 2014, **CEEP** welcomed the fact that the Commission definitive proposal for a directive on the activities and supervision of institutions for occupation retirement provision (IORP hereinafter) **did not include SOLVENCY II's capital requirements** or aspects of a market-based balance sheet **for IORPs**. CEEP also welcomed the fact that the Commission proposed to improve governance and information requirements.

CEEP's vision on the general approach and on the objectives of the directive

- CEEP is fully dedicated to quality, sustainable and well-funded pension schemes which represent, through their various activities an important means of achieving social cohesion in Europe. **Guaranteeing their long-term viability through quality framework regulation fully respecting their diversity at the EU level is an essential mean to this end.**
- **Thus the regulatory approach** implemented in the new IORP directive proposal should respect the **great diversity of pension funds at the EU level and therefore only contain qualitative principles that should be concretized by and within the member states with respect to existing Social and Labor Law.**

The Social nature of the services delivered by IORPs

IORPs are different from insurance funds or banks because there exist fundamental differences between the services each of these institutions deliver to the public. Whereas banks and insurance funds deliver financial services for commercial purposes, IORPs provide **essential long-term services with a strong social purpose, embedded in national social and labour law which differ strongly between European member States.**

CEEP's concerns about the possible implementation of quantitative requirements and inadequate harmonization through the delegated acts

- The proposal includes the possibility for the Commission to address the risk evaluation via **delegated acts** which give powers to the Commission to make changes to laws, provided these do not affect the "core" legislation decided by Parliament and the Council. CEEP wishes to highlight its concern for these delegated acts to result in additional funding requirements even after putting the Solvency II quantitative pillar aside.
- The same holds for the delegated acts dedicated to the concretization and standardization of the proposed information requirements towards beneficiaries (pension benefit statement): The proposed one-size-fits all approach is not appropriate for the diversity of pensions all over Europe since the requirements stem from the retail investment product area which does not fit to IORPs, where social partners are often represented in the management of the IORP.

- Member States should therefore be responsible for the concretization and implementation of the general principles formulated in the IORP II Directive instead of relying on inadequate harmonization via delegated acts.
- Last but not least it has to be mentioned that second pillar pensions (occupational pensions) are linked to employment, so the possibility of and the responsibility for shaping these schemes lie with the Social Partners. This specific responsibility has to be respected, too.

All these characteristics are fundamental to the way IORPs function and CEEP calls the regulator to always take them into account when it intervenes in the field of occupational pensions funds.

Introduction

The European regulatory regime for IORP is based on the directive 2003/41/EC. The initial directive contained basic requirements for IORPs which could be completed at national level by the European Member States. The initial directive gave much flexibility in order to properly cope with the important diversity of Pension funds at workplace level in the whole European Union.

This diversity is fully linked to the diversity of the European member States' social models including national social and labour law, taxation practices and models of pension provision. Additionally national social dialogue is embedded in the delivery of occupational pensions and its role toward the managing of IORP may vary considerably at EU level. The European Commission (EC hereinafter) identified certain issues in the previous IORP regulation and assessed that it needed to be updated because of recent transformation in the pension sector.

Thus, the EC assessed that the Economic and financial crisis revealed a range of risks associated to the governance structure of IORPs, that an adaptation to the evolution of IORP landscape from defined benefit schemes to defined contribution schemes was necessary, that burdensome cross-border procedures impeded the development of cross-border activities of IORPs and finally that members and beneficiaries of occupational pension faced a significant deficit in the level of information they are provided.

After two public consultations, carried out by the European Insurance and Occupational Pensions Authority (EIOPA hereinafter), the institution delivered an advice to the European Commission on 15 February 2012. It proposed, on the basis of Solvency II, to modify the IORP directive of 2003 into a three pillar structure with quantitative requirement in the first

pillar, governance and other qualitative requirements in the second pillar and disclosure requirements in the third pillar. The European Commission finally decided after EIOPA assessed the quantitative impact of such a structure on the pension sector to postpone the transposition of Solvency II quantitative pillar to the IORP new directive and to focus the new text to the second and third pillars.

Finally on 27 March 2014, the European Commission adopted the IORP II directive covering only governance and disclosure aspects in the framework of the long-term investment package (which includes a communication on the long-term financing of the European economy, the follow-up of a green-paper, for which CEEP issued a specific opinion.)

The new IORP directive stays rightfully away from the quantitative requirements of Solvency II. This is an essential point for CEEP's members. **It should therefore stay within qualitative principles and requirements of reasonable transparency.**

Indeed, a possible harmonised solvency framework applied to IORP would have greatly endangered their ability to provide their services. This was an essential demand from the most directly concerned stakeholders and those Member States with the most important role of IORPs which has been fulfilled by the European Commission.

1. CEEP's concerns about the possible implementation of quantitative requirements through the delegated acts

It is among the core recommendations, delivered in the framework of the European semester, to ensure at Member State level the sustainability of pension systems. The fiscal consolidation processes, deemed necessary to ensure the long-term viability of public finances, has put an important pressure on the public pension schemes (first-pillar). In order to accompany this trend it is of high policy importance to increase the number of European citizens covered by a workplace pension.

In this framework, the IORP II directive needs to **create a flexible framework out of the quantitative pillar of Solvency II.**

However CEEP is concerned that this **quantitative pillar might still come into action at a later stage** as for instance in *recital 57*, it is clearly stated that

"EIOPA will be consulted by the Commission in order to review and report on the application of the directive on the basis on an assessment of the application of rules regarding the funding of technical provision, regulatory own funds, solvency margins, investment rules and any other impact relating to the financial solvency situation of the institution."

This recital opens the possibility to develop solvency like regulation for IORPs after a consultation phase with EIOPA in the near future. In this regard, CEEP advocates for a deletion of this recital 57.

2. Necessity for more flexibility when implementing the foreseen delegated acts

The IORP II proposal includes the possibility for the Commission to complement the legislation via **delegated acts**, which give powers to the Commission to make changes to laws, provided these do not affect the "core" legislation decided by Parliament and the Council. CEEP wishes to highlight its concern for these delegated acts to result in additional funding requirements even after putting aside the Solvency II quantitative pillar aside. Thus CEEP calls strongly for a careful implementation of level 2 legislation, one fully respecting the diversity of European Members States' way of regulating IORPs.

In the IORP II proposal for a directive, the European Commission is empowered to go beyond technicalities and clearly keeps in its hands the possibility to introduce further major modifications to the IORP regulation, notably regarding the Remuneration policy art 24(3), the Risk evaluation for Pensions art 30 and on the Pension Benefit Statement art 54.

For instance, article 54 contains a very detailed list for the content of pension benefit statement (PBS) which bears high risks of introducing burdensome administrative requirements for the Pension scheme sponsor which often bears most of the administrative costs. The differences between Member States on this particular field is important, should be respected and therefore **a one size fits all approach should be avoided**.

Transparency is an important aspect to improve the quality of pensions and protect members and beneficiaries. However, providing information should be effective. Indeed, the PBS is not tested on members and beneficiaries and pension systems differ greatly between member states.

We support the goal of transparency and providing this kind of information to members. However, we are concerned that the PBS will not be effective because members receive too much information in one document. More freedom on what elements are provided in a PBS and what elements are provided by other means of communication could help in this respect.

3. Recognition of IORP's essential social purpose

IORPs are different from insurance funds or banks because there exist fundamental differences between the services each of these institutions deliver. Whereas banks and insurance funds deliver financial services for commercial purposes, IORPs provide essential long-term services (workplace pensions, provided as an employment benefit) with a strong social purpose, embedded in national social and labour law, which differs strongly between European Member States.

The payment which is made from the pension funds provide pensions; as a consequence, IORPs therefore have a social purpose. To assess this essential social purpose IORPs play, it is important to define them as a **fiduciary** or as an entity who has undertaken **to act for and on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence**. To further highlight this dimension of confidence, the chosen word “Trustees” defines the people, acting separately from the employer, who hold the assets invested in the pension scheme for the benefit of the participants. The pension fund constitutes assets in order to insure the financial risks associated with invalidity and old age. The fund is entrusted to the pension institution and **is sheltered from the bankruptcy risk of the employer**. In many Member States, occupational pensions are mainly based on a voluntary commitment by the employer who often bear the administrative costs (partly or completely), and it is also at the benefit of IORPs members that no marketing costs is involved with the Pension fund.

The schemes benefit persons entitled to a pension, including those who form part of the constituent bodies of the pension funds, such as board members. In addition, the pension schemes are delivered as a collective agreement, rather than as an individual contract. This social purpose is reflected in the triangular relationship between employers, employees and the IORP which often closely involves national social partners. Indeed, IORP provide employees with a **contractual right to a specific set of rule and benefit** which may also be defined through social dialogue processes at national level.

This definition of IORPs’ social purpose allows determining how **fundamentally different** they are from other financial sector institutions such as banks or insurance funds. These financial institutions operate on the financial market where they sell financial products to consumers in order to make profits. IORPs are on the other side social institutions operating on financial markets and thus workplace’s pensions are provided as benefits, related to an employment contract, where some of the employee’s salary is deferred until retirement.

However, the IORP II directive contains several references that CEEP deems problematic as they do not fully consider this inner difference.

- Recital 20 of IORP II directive states that “Institutions for occupational retirement pension are financial service providers which bear a heavy responsibility (...)”
- Recital 30 states that (...) the products offered are similar to those of life-assurance companies and the institutions should hold at least the same additional own funds as life-assurance companies.

The vocabulary used in the present version of the IORP II directive contains a misconception on IORPs genuine nature which highly concerns CEEP members. The Commission seems to deem necessary the **reregulation of IORPs on the basis of a “consumer protection”**

approach. We estimate this reasoning as inappropriate for IORPs true role and functions as they deliver long-term services in the perspective of an employment contract and do not sell products to consumers. The triangular relationship between employer, employee and the IORP has to be respected as IORPs have a social function, and as a consequence the IORP directive needs to fit the specific nature of occupational pensions.

4. Overall necessity for a strict implementation fully respecting the Proportionality and Subsidiarity principles

A vast majority of the 125.000 IORPs identified in the impact assessment are small institutions **active on the local and regional level and fully embedded in national social and labour law.** That is why a careful implementation with the constant presence of the proportionality and subsidiarity principle is essential. Therefore, the regulatory changes should always take into account national diversity in order to give the Member States the flexibility and the possibility to adapt the requirements as they see fit for respecting the variations in national social models and systems.

In this regard, CEEP wishes to recall that the elaboration and the implementation of national social policy is beyond the remits of the European institutions and recommends carefulness when approaching the difficult question of pension funds regulation at European level.

CEEP is concerned by what is implied in the present formulation of article 60 and 61 on the scope and the general principle of prudential supervision. We believe that article 60 should clearly state right from the beginning that **the general legal framework in which the prudential supervision will be set should be the one of national social and labour law** or bear the risk of undermining them.

As for art. 61, stating the general principles of prudential supervision, CEEP's members believe it **lacks clear references to the proportionality required in regard to the core social purpose of the directive.**

5. Governance provisions and requirements for IORPs' management

The impact assessment identifies several problems in the governance area for IORPs and refers to problem drivers such as lack of professionalism in IORP management, risk management is not consistent and systemic, assets are not protected, members do not receive pension information) which is unfitting considering the variety of pension funds systems in the European Union.

The directive therefore proposes to introduce several rules in this area.

In the area of management, art. 23 states that:

"Member states shall require institutions to ensure that all persons who effectively run the undertaking or have other key functions at all times fulfil the following requirements:

- (a) their professional qualifications, knowledge and experience are adequate to enable sound and prudent management of the institution or to properly perform their key functions (fit); and (b) they are of good repute and integrity (proper)”*
- (b) they are of good repute and integrity (requirement to be proper*

CEEP is concerned by the lack of clarity in the wording of this article. For instance, the meaning of the verb “run” in the sentence is quite unclear and would better be replaced by the verb “manage”. As for the overall requirement for sufficient professional qualifications, knowledge and experience, we believe it to be problematic for IORPs actual practices, especially concerning the important part played by the social partners in their regular management. Indeed if these requirements contained in the IORP present proposal need to be applied **to each and every single member** of the IORP’s board of management, it might exclude the social partners from managing functions. CEEP believes as rightfully stated in the *OECD guidelines for pension fund governance*¹, that:

“the governing body should collectively have the necessary skills and knowledge to oversee all the functions performed by a pension fund, and to monitor those delegates and advisors to who such functions have been delegated”.

The present version of the article would enter in **clear contradiction** with existing systems of governance such as, for instance, the UK’s system of lay trustees. Indeed, if adopted in its current form, this would mean that most lay trustees would not satisfy the first limb of the “fit and proper” requirements.²

Furthermore, art 25(3) states that:

“the person or organisational unit carrying out the key function need to be different from the one carrying out a similar key function in the sponsoring undertaking unless they benefit a special exemption.”

CEEP clearly shares the concern of the Commission and its will to separate key functions in order to avoid possible conflicts of interest. **However, as the employer is liable and responsible for the good management of the IORPs, the conflict of interest is far from being obvious.**

¹ OECD, “OECD Guidelines for pension fund governance”, *Working Party on Private Pensions*, 5 June 2009, 14 p.

² A lay trustee is an employee who voluntarily sits on the board of his or her company pension fund. He or she - although not necessarily well versed in the world of pensions -- is tasked with making decisions based on the scheme's objectives. At the same time, they must ensure that the scheme members' interests are well protected.

Conclusion

- CEEP's members fully share the Commission's intent to improve the governance and the information provision for IORPs. Furthermore, CEEP welcomes the fact that no additional capital requirements have been included in the present proposal for a directive.
- However CEEP is concerned by several elements in the present IORP II directive which might contradict an important goal of the EU which is to facilitate the development of complementary private retirement savings schemes in the framework of increased pressure on first pillar public pensions.
- Indeed the Pension sector is facing challenges and went through deep transformations during the last decade. It is necessary in this framework to develop further reasonable qualitative and disclosure requirements.
- However as many small sized IORPs, active at the local and regional level are fully depending on the voluntary commitment by the employer, who bears much of the administrative cost, we fear that too detailed and burdensome administrative requirements might impede the development of IORPs and complicate their day to day management.
- We also fear that the inner misconception on the core nature of IORPs which are essentially fulfilling social purposes, embedded into national social and labour law, might misguide the action of the regulator and conduct him to adopt a consumer protection approach which we believe inadequate for actual reality of the day to day management of IORPs.