Pensions in Europe

Nickolas Reinhardt and André Ghione (Eds.)

Commemorating 30 years of the EFRP

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Section

European pensions in a changing world

"Stable economic growth is what funded pension systems need if they are to be successful. This means being able to deliver to the beneficiary the promised retirement income."

Chris Verhaegen
Secretary General, European Federation for Retirement Provision

➔ Pension funds in the current turmoil: Part of the problem or part of the solution?

Ieke van den Burg

Former Member of the European Parliament

Five years ago, on 20 June 2006, I had the honour of speaking at the European Federation for Retirement Provision's (EFRP) 25th anniversary. At that time, second pillar pensions and pensions in general were not a particularly sexy subject. Neither was the case for stronger European supervision of financial markets, which was another of my favorite subjects as a Member of the European Parliament.

The world has changed in the last five years. Financial markets are in heavy turmoil. Sovereign bonds in the Eurozone, considered to be zero-risk under the prudential rules of insurance and pension supervisors, are presenting unforeseen volatility and spread. European governments are struggling to reduce and finance their debts. European banks are in distress and need to recapitalise. Political leaders are held back from taking firm steps forward to, for instance, issue common Eurobonds and establish a fiscal union by an anti-European, populist mood. The European Commission is weaker than ever. The newly invented Council President is neither internally nor externally visible as a leading force. The 'Merkozy' couple is trying to balance on a fearfully thin rope between national voters' sentiments and market sentiments.

Welcome to the new era, where an ageing Europe is facing a lengthy recession, unprecedented youth unemployment, growing old-age poverty and strong new global powers in Asia and Latin America. We see a fragmented European Union, where Governments are freezing their public budgets and toning down welfare state provisions whilst anxiously trying to persuade their parliaments and voters that they are fully in control and will not give up powers to Brussels bureaucrats.

In this climate it is neither easy nor attractive to formulate and advocate an offensive strategy for second pillar pension funds. Just like all asset owners and investors, they are pulled down by the swings of asset values on equity markets and the low interest rates on the liabilities side that shrink their assets to liabilities ratio. At the same time, life expectancy continues to increase. Neither the perspective of a long recession with deflation, nor a scenario where inflation will rise far beyond the percentages of which former European Central Bank (ECB) President Jean-Claude Trichet boasted is attractive.

The accumulation of these developments has brought funded pensions into a negative spiral of doubts and criticisms. The era of growth and prosperity is over. In a shrinking and ageing labour market it is difficult to keep up with the promises of defined benefit systems. Company sponsors want to eliminate the risks on their balance sheets, and workers reach the ceilings of contributions to the schemes from their pay checks. The younger generation doubts whether collective systems will give them a fair share. Solidarity is becoming an obsolete concept.

And still—despite all of these ominous prospects—I am firmly convinced that the second pillar system of funded old age pensions, with its enormous amounts of pension fund assets worldwide is not a failure or a burden. Instead, it bears potential solutions for getting the world economy, and the European economy in particular, back on track.

What the EFRP and its allies from other long-term institutional investors should push for on the EU and G20 political agendas and on the regulatory agendas of the Financial Stability Board (FSB), the European Systemic Risk Board (ESRB) and European Insurance and Occupational Pensions Authority (EIOPA) is a fundamental debate about liquidity demands and liquidity illusions. I suggest we revisit the work of old John Maynard Keynes, who signaled that financial markets run after the illusion of liquidity while we desperately need them to make illiquid investments in the real economy.

I remember that we had a last-minute discussion at the end of the European Parliamentary mandate in 2008 in the context of the Solvency II legislation. It was about the long-term horizon, something that was provided for in neither the prudential nor the accounting rules. The mood of the years around the turn of the millennium was short-termist, and focused on a high speed circulation of financial transactions.

Financial markets will have to adapt in the current climate and focus on the long term again. Prudential supervision and accounting standards should be informed by the long-term perspective of the need for investments with a long term horizon. Banking and financial infrastructure will have to centre on stable, better-capitalised and robust institutions that serve the real economy. A less profitable approach, perhaps, but from the economy's and society's perspective, a much more valuable one.

Governments should get their acts together and forge alliances with their long-term investors. Public-private partnerships, private placements, new green energy and innovation projects should be made more attractive asset classes than derivatives, Collateralised Debt

Obligations (CDOs), Credit Default Swaps (CDS') and other complex structured products.

Jointly-supported Eurobonds will make the Euro sovereign bond crisis disappear as snow under the sun and create a perfect tool for fiscal discipline.

I would invite the EFRP to ally itself and cooperate, not only with other long-term investors, but also with Finance Watch, the new European knowledge centre whose board I currently chair. Finance Watch was founded by Non-Governmental Organisations (NGOs), trade unions and organisations of small, private end-users of the financial industry and unites experts who want to reform the financial industry and financial regulation in the general interest.

A stronger general interest approach and a productive role for long-term investors, and pension funds in particular, is imperative for the well being of current pensioners or near pension-age babyboomers, and at least as important for our children and grandchildren.

Let us hope for clever and more daring courageous political leaders. And let the pension world play a constructive role in our future!

➔ The performance of pension funds: A long-term view and the financial crisis

Dr Luis Correia da Silva,
Sahar Shamsi and
Elizabete Ernstsone

Oxera

The financial crisis and economic downturn continue to have a significant negative impact on European equity markets. On a single day in September 2011, the German market suffered a loss of €23 billion in the market value of Dax 30 stocks, while French CAC 40 and UK FTSE 100 stocks lost €28 billion and £64 billion respectively.[1] These are staggering amounts, but the losses were short-lived—within three days, these equity indices had recovered. Given short-term market movements, it is important to maintain a long-term perspective in assessing returns on assets.

Amid capital market volatility, pension funds have faced pressure to invest in low-risk assets, such as bonds, to limit the losses suffered in response to falling asset values. Specifically, there is concern that the volatility of pension fund returns leads to inequitable outcomes for some pension scheme holders who retire at a point in time when returns are particularly depressed. However, distributional concerns may lead to unintended outcomes if pension funds switch to safer assets and generate lower returns which reduce retirement wealth for all of their investors. This article considers the economics of asset accumulation by pension funds—in particular, the long-term impact of a change in asset allocation.

The move away from equities in response to the crisis

There is evidence that pension funds have altered their asset allocations in response to the crisis. In Europe, pension funds have reduced their weightings for equities to an average of 31.6 per cent in 2011 (down from 43.8 per cent in 2006), while fixed-income holdings have increased to 54 per cent from 47.8 per cent in the same period.[2] Market evidence suggests that the move to bonds is deliberate, rather than a passive outcome of the reduction in the market value of equity assets. For example, in a survey in Q2 2011, 23 per cent of European funds responded that they planned to reduce their exposure to domestic equities, and 20 per cent of all funds planned to increase their exposure to domestic government bonds and/or non-traditional asset classes.[3]

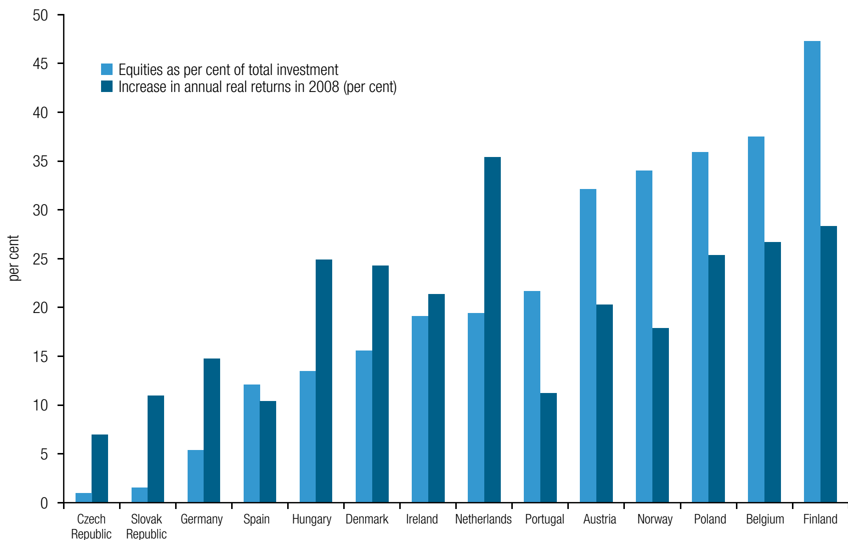
1. Oxera analysis based on Datastream.
2. Research by Mercer, cited in Waki, N. (2011), "Analysis—European pension funds need equities to beat inflation", Reuters, May 13th.
3. Mercer (2011), "Mercer launches annual European asset allocation survey", press release, May 3rd.

Is a shift from equities a good move by a long-term investor?

It can be argued that a long-term investor has paid too much heed to short-term volatility if pension funds have been driven out of equity investments by market uncertainty. For one thing, the current declines in the stock market are by no means unprecedented. Indeed, European stock markets fell by as much as 50% in the mid-1970s and recovered within a few years.[4]

There is some evidence to suggest that, over the past two years, pension funds that hold greater amounts of equity have recovered from losses at the height of the crisis faster than their counterparts that hold less equity, as illustrated in Figure 1. For example, in the Czech Republic equities account for less than 1 per cent of total investments and there has been

Figure 1: Recovery in pension funds' annual real returns relative to proportion of equity assets held



Note: Data for all European countries is not available. Data for equities as a per cent of total investment is as at 2010. Recovery is estimated as pension funds' 2010 real net rate of investment returns (per cent) minus 2008 real investment returns (per cent).

Source: Oxera analysis based on data from OECD (2011), "Pension Markets in Focus", no. 8, July and OECD (2009), "Pensions at a Glance 2009", Figure 1.3.

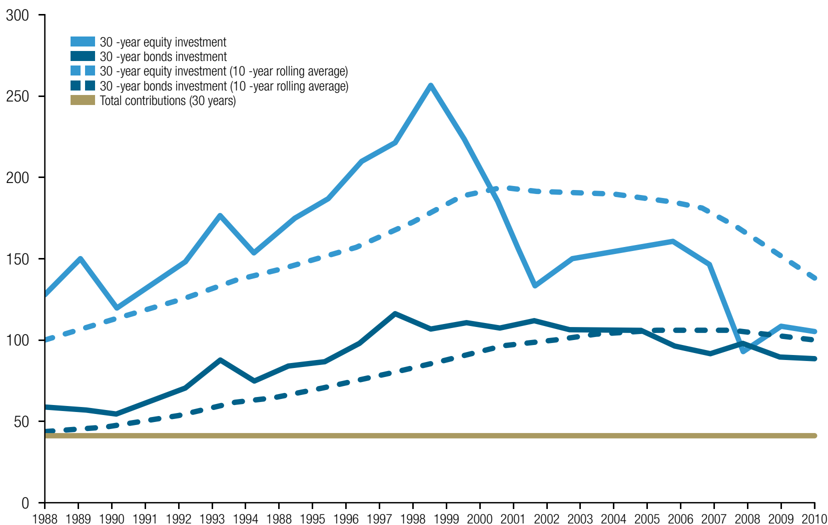
4. The stock market in the UK, for instance, fell by 58 per cent in 1974 and recovered within three years. Source: Barclays Capital (2011), "Equity Gilt Study 2011", and Dimson, E., Marsh, P. and Staunton, M. (2011), "Credit Suisse Global Investment Returns Sourcebook 2011".

a depressed recovery in real returns (rising from –7.2 per cent in 2008 to –0.4 per cent in 2010). On the other hand, in Finland, where equities make up 48 per cent of total investments, annual returns have bounced back from –19.5 per cent (2008) to 8.9 per cent (2010).
In addition, it should be noted that short-term volatility is not detrimental to long-term returns. In fact, given that there is a trade-off between risk and return, in the long run an equity investor would expect to receive higher compensation due to the stock market volatility observed in the current crisis.

What will be the longer-term impact of switching to fixed income?

The results of a simulation exercise undertaken by Oxera illustrate the impact on long-term returns of 100 per cent equity relative to 100 per cent bond allocation strategies. Based on historical data, it can be illustrated that holding a significant proportion of equity can result in significantly higher average retirement wealth for a policyholder, with a comparatively small increase in the risk of receiving very low levels of retirement wealth, given the long

Figure 2: Illustration of accumulated returns by year of retirement, over a 30-year investment horizon

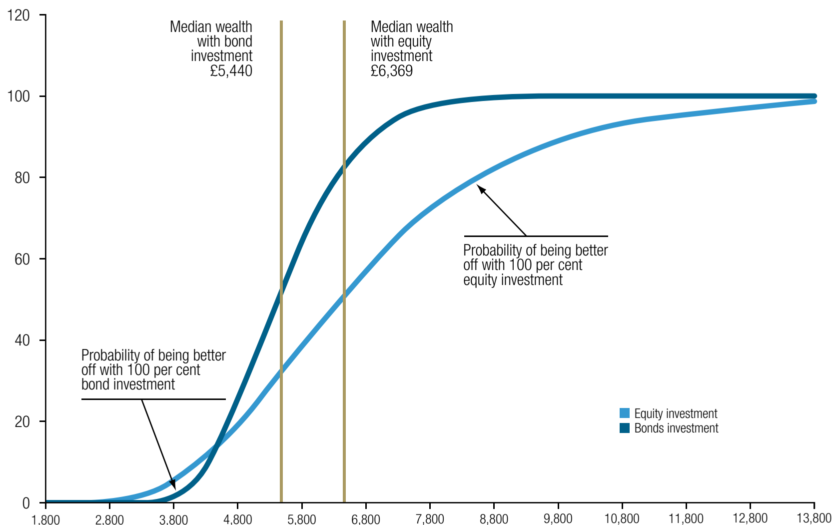


Note: Based on actual series of real government bond and equity returns for the UK from 1950 to 2010. The individual contributes £1,000 in the first year, and contributions then grow at a rate of 2 per cent (real) over 30 years. There is no tax and management fee.
Source: Oxera modelling based on data from Barclays (2011), "Equity Gilt Study 2011".

investment horizon over which pensions accumulate. This applies even more so in looking at performance for a pension fund, as the investment horizon is not constrained by an individual policyholder's retirement age.

Figure 2 (*page 11*) simulates the accumulated pension wealth for equity and bond investment using actual return series since 1950, relative to total contributions paid, for different hypothetical cohorts who make exactly the same contributions to a pension scheme in the last 30 years of their working lives, but who retire in different years—the last year being 2010. Clearly, individuals who invested everything in the stock market and who retired in 2009 would be significantly worse off than individuals retiring in 1999. However, it is apparent that, based on historical asset return data, investment in equity has never delivered negative overall returns, irrespective of when accumulation started or ended. Importantly, the 30-year return from equity investment has been significantly above the overall return on bond investment except for a very short period in 2008.

Figure 3: Distribution of pension wealth accumulated under different investment options, five-year investment horizon



Note: Simulations for 10,000 individual accounts, based on historical actual data for real government bond and equity returns for the UK from 1950 to 2010. The lines show the cumulative probability of accumulating the given amount of wealth or less; eg, around half of equity investors, but only 18 per cent of bond investors, would accumulate more than £6,400. See also note to Figure 2.
Source: Oxera modelling based on data from Barclays Capital (2011), "Equity Gilt Study 2011".

For the pension fund, relative to individual policyholders, there would be less impact of yearly variations in accumulated returns. This is because a pension fund does not face the same constraints and would not be obliged to crystallise a reduction in accumulated returns by purchasing an annuity at the height of the crisis. The average returns over a ten-year rolling basis are therefore also represented in Figure 2, showing that the overall return from equity investment has consistently exceeded the overall return from a 100 per cent bond investment strategy.

The aim of this is not to advocate a particular form of investment by pension funds—the simulations are, after all, based on a set of assumptions, including historical risk–return parameters that may not hold going forward. Rather, the point is a more general one: there is a trade-off between risk and return, and limiting risk usually comes at the cost of foregoing potential returns. Diversifying instead into higher-risk equity assets can deliver higher returns, at comparatively low risk over the long time horizon, which characterises pension investment.

Concluding remarks

It is not difficult to see that market crises and asset return collapses can have an impact on pension funds' returns. However, pension funds are long-term investors, so, ultimately, it is returns over the long run that matter. If pension funds reduce their exposure to assets with volatile returns, some policyholders who retire in a market downturn may be better off, but all policyholders may be worse off if the pension fund generates lower returns overall due to lower-risk, lower-return asset allocation. The challenge for the industry is to help restore the confidence of consumers in capital markets—and to develop products which allow for policyholders to mitigate risks associated with short-term downturns—while pension funds continue to invest with a view to long-term return maximisation.

➔ The European pension gap: Getting the mix right

Igal Mayer

Chief Executive Officer, Aviva Europe

We cannot ignore the fact that longer life expectancy and falling birth rates present new challenges for governments, individuals and industry.

Recognising that people across Europe are not saving enough for their retirement, Aviva began a pan-European debate with its 2010 publication *Mind the Gap: Quantifying Europe's Pensions Gap*. Our ambition was to establish where key partnerships and solutions might lie which would make retirement richer in every sense and help build a culture of sustainable saving across Europe.

That report, undertaken in partnership with Deloitte, was a unique attempt to model, for the very first time, the level of pension under-provision at the European level.

The conclusions of the report were clear: ignoring Europe's €1.9 trillion annual 'pension gap'—the difference between the savings that people retiring across the 27 EU Member States between 2011 to 2051 need to put aside to maintain an adequate standard of living in retirement, and the actual amount they are saving—is not an option.

To put this into perspective, €1.9 trillion equates to approximately 19 per cent of European GDP. An 'adequate' standard of living in retirement is defined as 70 per cent of pre-retirement income—a level used by the OECD and in line with our own consumer research (the 2010 Aviva *Consumer Attitudes to Saving survey*). In response to that survey, half of those questioned in the UK, France, Spain, Italy, Poland and Ireland said they would prefer to have, in retirement, at least three quarters (75 per cent) of their usual monthly income.

We also analysed the pension gap situation on a per person basis, comparing age ranges in 10 year segments from the ages of 20 to 60 years old. The most severe deficiencies exist for those within 10 years of the state retirement age, as they have no time to close their pension gap.

But the picture is brighter for younger savers. For example, a 40-year-old person in Spain must save €2,900 a year to close their gap, but this falls to €1,200—or 6 per cent of average disposal income—a year for a 20-year-old.

Socio-economic factors and variations in pension schemes will shape possible public policy responses, with each country likely to adopt a solution reflecting its specific situation.

But without any action today to save more, EU citizens will be forced to accept a combination of the following four options:
- Accepting a reduced standard of living in retirement—but even aiming for 50 per cent of pre-retirement income still leaves a €669bn gap.
- Retiring later—but a 10-year increase in the retirement age still leaves a €841bn gap.
- Relying on non-pension assets—but we estimate that this may fund as little as 17 per cent of the gap.
- Working into retirement—already, countries such as the UK expect to see the number of people working beyond retirement age double in the next 10 years.

Accompanying the *Mind the Gap* research were four Calls to Action, outlining where we believe targeted efforts could help to start tackling the 'pensions gap' facing future generations. This reflected the fact that no single policy reform would be enough.

We argued that as well as taking measures such as increasing the retirement age or incentivising greater private pension saving, there is a crucial need to raise people's awareness that they can choose to act earlier and save more.

But we also included a specific Call to Action on annual pension statements. My belief is that once a year, every year, all adult citizens in the EU should receive a user-friendly statement of their projected income in retirement, including the levels of State provision and expected entitlements accrued in occupational or private pension schemes.

Issuing such personalised statements to EU citizens would encourage consumers to consider the State pension as only part of a mixed strategy for providing for their future, and prompt them to take action as a result of seeing clearly what they stand to receive in retirement.

To help move the public policy debate forward on the idea of annual pensions statements, earlier this summer Aviva commissioned research company Datamonitor to look at current levels of pension statement provision in 35 countries around the world, including the 27 EU Member States.

The Datamonitor analysis considered the nature and frequency of statement provisions. It found that:
- Practices vary considerably throughout the EU. For example, pensions statements are issued from the age of 18 in Finland, but from the age of 55 in Belgium;

- In some European countries, though it is possible for individuals to find out how much they will be entitled to from the State in retirement, this information is not offered universally and must often be actively requested;
- The service varies from online calculators to personalised paper statements provided after a time delay.

Through the Datamonitor research we also explored the potential challenges of expanding annual pension statement provisions in EU Member States, three different lenses:

1. *Consumer*: Reluctance to think about the future, perceived complexity of the State pension system and low levels of financial engagement;
2. *Technical and design*: Creating annual pension statements through complex State and private pension systems and how consumers would connect with the information;
3. *Implementation*: The European Commission, Member States and the private sector working together to create a common platform for delivery.

Here, the Datamonitor analysis concluded that three elements would be crucial:

1. Clear presentation and language: This is key to capturing readers' attention;
2. Transparency: Pension statements should detail—in a clear and simple way—the constituent elements used in estimating retirement benefits;
3. Online access: The web is increasingly an important tool in providing more comprehensive, personalised and relevant information.

We do not have a co-ordinated EU policy on pensions as social security rests with individual European Governments.

Strengthening the adequacy of retirement income will require EU citizens to put more savings aside in their youth to sustain themselves in older age. Incentives and measures taken to encourage citizens to provide for their future will remain intricately linked to national policy frameworks and taxation regimes, but the EU can play an important role in changing consumer behaviour through monitoring and encouraging effective action.

At the European level, I believe there is potential for work to be undertaken to help people better understand the nature of the pension provisions available to them, what the various options are, and what outcomes these options are most likely to produce. Changing people's attitudes to saving and helping them to better understand the financial choices they need to make should be a common objective for both Member State Governments and the EU.

Although individual Member States will need to be in the driving seat to make changes at a national level to the information provided to their own citizens, the European Commission can have a positive impact by facilitating basic standards applicable throughout the EU. And in turn, Member State Governments should aim to work together with occupational and private pension providers.

In doing so, we would all be helping to create:
- Access to information;
- Common terminology and criteria; and
- Comparable Member State practices.

I recognise that annual pension statements will not be easy to bring about across the EU; they are an ambitious goal. But such reminders would make a big difference for bridging the gap in savings. This is why we should try to make them a reality.

Some EU Member States, notably Sweden and the Netherlands, are in the vanguard here and are proof that it can be done. We should learn from them, as we should learn from some non-EU countries, such as Japan.

Trusted private sector brands want to work in partnership with European policy-makers—at national and regional levels—to explore what could be done to help create a greater savings culture and build a more secure platform for individuals to plan for their retirement. This is what has happened in Sweden.

Increasing the knowledge and understanding amongst EU citizens about their pensions by providing easily accessible information using a simple, shared language across Europe would be a major step forward for consumers. It has the potential to increase the adequacy of pension provision for future retirees.

Success will require concerted effort and coordination at the EU level to combat current complexity—a view shared by the European Parliament. In its report on the European Commission's Green Paper *Towards Adequate, Sustainable and Safe European Pension Systems*, the Parliament noted that the first, second and third pillar pension schemes in Member States differ significantly from one another, and that the EU lacks a set of common criteria, definitions and an in-depth analysis which would thoroughly explain the various pension systems and their capacity to meet the needs of citizens.

So, I re-emphasise here my support for the EU in strengthening its role in pensions policy in the coming years, to deliver adequate and sustainable pensions.

➔ The outlook for pension systems in Central and Eastern Europe

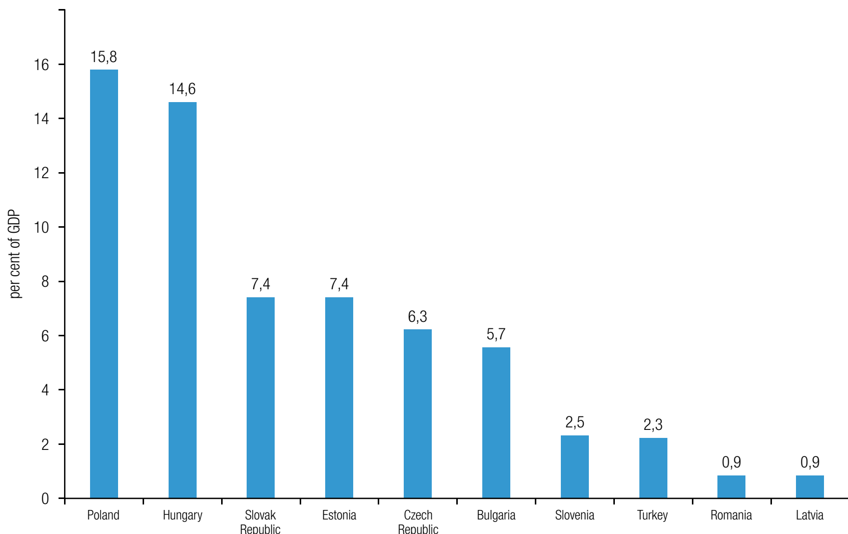
Agnieszka Chłoń-Domińczak

Institute for Statistics and Demography, Warsaw School of Economics

After economic transition, Central and Eastern European countries (CEECs) began to overhaul their pension systems as a part of broader systemic reforms. These reforms had several objectives, from reducing early retirement and deficits in social security systems to providing more pension security through diversification of future pensions' income. Many of the countries also embarked upon creating funded parts of their pensions system: mandatory, occupational and individual-based.

This meant a move from traditional pay-as-you-go (PAYG) defined benefit systems providing most of the income for old age, to systems with various sources of future pension provision.

Figure 1: Assets of pension funds relative to GDP in CEE countries in 2010



Note: for Estonia data refer to investment companies managed funds
Source: OECD Global Pension Statistics

1. See: OECD, Pensions Market in Focus, Issue 8, July 2011.

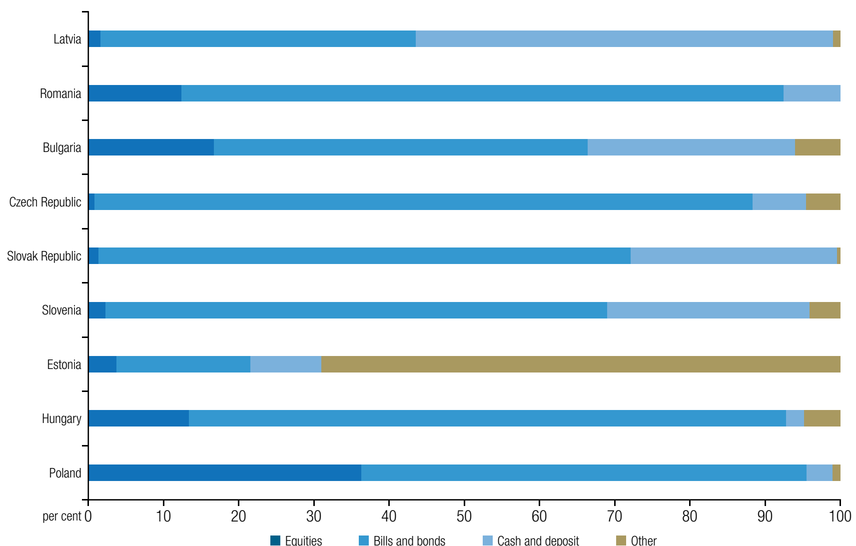
In the absence of individual savings in these economies, development of funded pensions was also seen as an opportunity to strengthen and develop financial markets. These reforms, initiated in the late 1990s, were recently affected by the ongoing economic and financial crises. In the case of certain countries this has meant some reduction in the levels of future pension provision.

This chapter provides an outlook of these latest developments as well as some thoughts about the potential future of funded pensions in Central and Eastern Europe (CEE).[1] For the analysis, data from the Organisation for Economic Co-operation and Development's (OECD) *Global Pension Statistics* is used.

Pension funds' assets in CEE

Most of the funded pensions in CEE are at the phase of fast asset accumulation. Given the relatively short time of development, the assets of pension funds have managed to reach quite sizeable levels in some of the CEECs.

Figure 2: Pension fund asset allocation for selected investment categories, 2010 (as per cent of total investment)



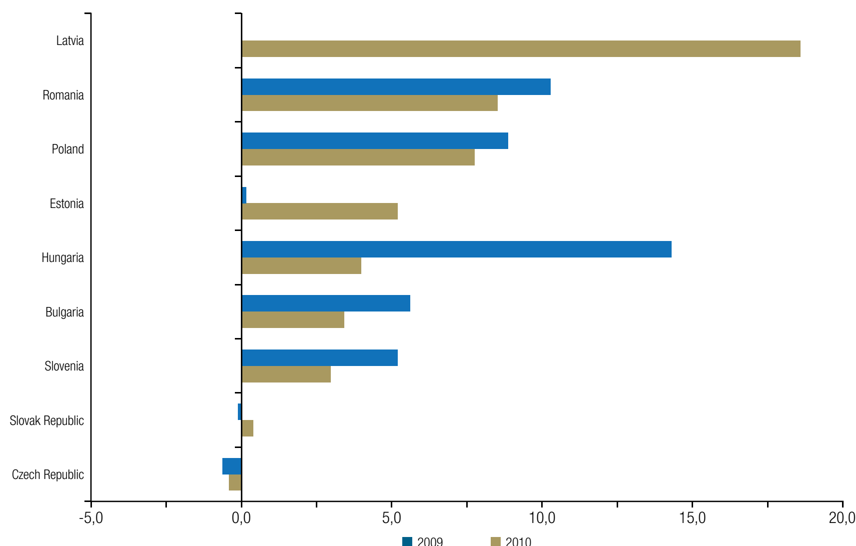
Note: In Estonia, a high value of the "other" category is mainly driven by private investment funds (65 per cent of total investments).
Source: OECD Global Pension Statistics

In those countries where funded pensions were mandated—Poland, Hungary, Slovakia and Estonia—pension assets are highest. The size of pension assets is also relatively high in the Czech Republic, where pension funds have developed on a voluntary basis with some support from the state. Nevertheless, pension funds' assets in these countries are still significantly below the OECD average.

Assets of pension funds are invested mainly in equities and government bonds. There is no common pattern of asset allocation in the region. In all CEECs investment in government bonds and bills prevails. Only in Poland, Hungary, Bulgaria and Romania do pension funds invest a significant part of their assets in equities; in Poland pension funds invest almost 40 per cent in this asset class. This indicates relatively conservative portfolio allocation of pension funds, which to some extent may reflect changes in portfolio allocation made after the financial crisis.

Pension funds' investment in equities also provides an additional stimulus for financial market development. Poland is an illustrative example: pension funds' investments in Poland have accounted for a relatively stable share of Polish stock market capitalisation in the past

Figure 3: Pension funds' real net rate of investment returns in selected OECD countries, 2009-2010 (per cent)



Source: OECD Global Pension Statistics

decade. Relatively fast growth of pension funds' assets also means equally high growth of the value of the stock market. This indicates the positive relation between pension funds' growth and the growth of domestic equity markets.

Pension funds' performance

As shown in Figure 3 (verso), for 2009 and 2010 pension funds' real returns were quite encouraging for most CEECs, with the exception of the Czech Republic and Slovakia. Returns were also higher than OECD countries' weighted averages, equal to 4.4 per cent in 2009 and 3.5 per cent in 2010.

These results, particularly in CEECs that have a noticeable share of pension fund investments in equity (such as Poland, Bulgaria, Romania and Hungary), show that pension funds in CEE can benefit from regional economic growth.

Funded pensions and the sustainability of public finances

The introduction of funded pensions in CEE, particularly where those systems were based on mandatory participation, entailed significant transition costs. Diverting part of social security contributions to pension funds meant higher deficits in social security pension systems, which still pay pensions based solely on a PAYG basis. The full cost of transition depended on policy choices such as the level of funded pension contributions and the potential number of participants. It also depended on individual choices in those countries which allowed certain groups of workers to decide on their participation in the system (for example in Poland, Hungary, Latvia and Estonia).

This resulted in the need to generate sources to finance these deficits. Such sources could be generated in three ways:

- State budget subsidies, increasing the burden on current taxpayers;
- Savings in the social security system; and
- Using extraordinary revenues (such as privatisation of state-owned companies).

In practice, a mixture of solutions has been implemented, but the main burden was put on State budgets to provide higher subsidies to otherwise unbalanced social security schemes. Only Estonia decided to explicitly increase pension contributions paid by individuals who decided to participate in pension funds. Transition costs, particularly in CEECs with relatively high funded contribution levels, reached the level of some 1 to 1.5 per cent of GDP annually.

Developing a voluntary pension fund sector with the use of public tools, such as tax breaks

or public co-payments (as, for example, in the Czech Republic), also generated costs to public finances, though on a much lower scale.

Funded pensions in the context of economic and financial crisis

The financial and economic crisis was one of the first stress-tests for CEECs' funded pension systems. It affected economies in varied ways. While Poland seemed to weather the storm—maintaining positive economic growth—other countries, in particular the Baltic States and Hungary, suffered a recession.

Public finances also deteriorated in CEE. In 2008-2009, State budget deficits increased in all CEECs, exceeding 9 per cent of GDP in Latvia and Lithuania, 8 per cent of GDP in Slovakia and more than 7 per cent of GDP in Poland.

This triggered decisions related to the functioning of funded pensions aimed at reducing transition costs. In virtually all CEECs, the size of funded pensions was scaled down. In Hungary, the system was effectively nationalised when the Government withdrew all guarantees for those remaining in the funded system. Most of these changes were made in the course of 2008 and 2009; Poland, which resisted longer than other CEECs, followed suit in 2010.

These decisions stood in stark contrast with the results of funded pensions, which performed relatively well in the last few years. While the funded sector resisted the storm, the public finance situation did not.

The long-term consequences of the decisions taken to reduce pressures on national budgetary positions are, first, higher overall implicit liabilities, and second, higher costs to public finances of future pension provision.

Outlook for the future

Developments over the last 15 years brought about the emergence of the individual-based funded pensions sector in CEE. Pension funds with mandatory participation or with strong encouragement from the State allowed for the relatively rapid accumulation of sizeable pension fund assets.

Yet, compared to other developed economies, the occupational sector of funded pensions seems underdeveloped. The question emerges whether there is room for occupational pension provision in CEE. Population ageing and changing labour market conditions may

create stimulus for such developments, but it seems that whatever the implemented changes, individual-based (mandatory or voluntary) schemes will maintain a dominant position.

Pension systems in CEE are also relatively young, and all comprise elements which require maturation and development. In particular, annuities markets are weak as regulatory frameworks have gaps related to the institutional framework governing annuities payments. Further modernisation of the schemes, by developing benchmarks, relaxing rigid limits on investments and introducing life-cycle investment approaches would be welcomed.

Experience of funded pensions' development in CEE shows that the initial broad support for change ebbs over time; trust in pension funds is still not developed. Though it is increasingly difficult to maintain momentum, the policy focus should be on providing the necessary strength to funded pensions to cope with foreseen demographic changes.

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➔ A long way from 1981: The EFRP's achievements over 30 years

Chris Verhaegen

Secretary General, European Federation for Retirement Provision

Over the years the European Federation for Retirement Provision (EFRP) has developed from a circle of pension fund managers—really a circle of friends—into a well-established European federation. It is widely considered a prime source of reliable information and reasoned opinion on funded pension provision in Europe. As such, EU policy-makers actively consult the organisation when proposing or debating new legislation.

That could be, in a nutshell, how the EFRP 'in-crowd' views its achievements. It all began on 30 March 1981 at the Brussels Europa Hotel (now the Crowne Plaza Brussels Europa). The founding fathers, all pension fund managers who felt that 'Europe' would affect their activities, came from Belgium, Ireland, the Netherlands and the United Kingdom. French occupational pension scheme managers also saw the value of such a group, but preferred to first send 'observers.'

The further development of the Federation reads pretty much as so many other European ventures. It was a challenging undertaking as there were no single, strong sponsors. Rather, the founders viewed it as a long-term project akin to the long march of Europe, which grew from a Community of 6 to a Union of 27. It was decided that 'starting gently' with an informal committee structure and volunteers collaborating on specific projects was the only way to move forward in the pioneering years.

In those days, EFRP meant a forum for an exchange of views, a useful way of finding out what was going on in other countries. But soon the Federation expanded, with Germany, Italy and Spain joining the group. Our constitution has now been re-written three times, in 1992, 2000 and 2005, demonstrating the dynamism of the organisation. Today, the EFRP has 26 member associations sourced from 15 EU Member States and 5 non-EU countries. Enlargement of the EU to Central and Eastern European countries (CEECs) has been mirrored in EFRP membership, with new associations joining and others working together with us in the CEEC Forum, an EFRP mechanism to structure our dialogue with representatives of funded pension schemes in the so-called 'new Member States'. Looking back, the founding fathers and their successors—Patrick Burke is the 11th EFRP Chairman—can be proud of the robust tree that has grown from their seeds.

The development of the organisation is not only a key achievement; it is also an obvious prerequisite for successful agenda setting and policy-casting. It is fair to say that the EFRP has achieved a lot with limited means. Many in the European landscape view the EFRP as the 'IORP Directive Organisation'. That is quite true, but there are also many other fields which have our attention and to which we dedicate resources.

EU conventional wisdom says that a directive needs at least ten years from inception to adoption. The **Institutions for retirement provision (IORP) Directive** (2003/41) took 14 years (1989-2003)—or longer when taking into account working documents and ongoing exchanges of views between EFRP representatives and Commission officials. The first 10 years of the EFRP's existence were characterised by thorough educational work with the EU world in Brussels and in Member State capitals. Some ideas that now seem self-evident had to be explained and supported with scientific literature. One of the toughest jobs was to make funded pension provision acceptable—desirable, in the EFRP's view—as a supplement to pay-as-you-go (PAYG) statutory schemes. To succeed in convincing interlocutors, the EFRP highlighted—and continues to highlight—the role of social partners and employers in second pillar pension provision.

The IORP Directive is largely the result of this groundbreaking work with the European Commission, the European Parliament and different Member States. Jacques Delors's launch of the White Paper on the Single Market in 1985 provided scope for pension funds to benefit from Treaty freedoms such as the free movement of capital and freedom of establishment, coupled with cross-border provision of services. It was crucial for pension funds to take advantage of economies of scale for their investments and to secure free access to non-domestic investment vehicles (EU and non-EU). The cross-border provision of services was needed to enable the establishment of pan-European pension funds with pan-European membership. The latter was conceived as a solution for cross-border pension mobility within one multi-national company rather than a commercially-driven scale enlargement.

The 'prudent person rule' as the yardstick for sound investment behaviour may have been seen as a breakthrough at the time; it is now widely accepted in financial services legislation. The EFRP has been instrumental in embedding this concept in EU law.

In recent years, the EFRP has been beset on all sides with the 'level playing field' argument as a justification to impose unfit insurance-based legislation on pension funds. As early as the 1990s there was an attempt to bring insurance legislation to pension funds; at that

time, the EFRP argued that, while there are conflicts of interests between pension funds and the insurance industry in some Member States, a solid pension fund Directive is not about market share across industry participants such as pensions funds, insurance companies and banks distributing managed funds. Rather, the primary dimension should be providing employees across Europe with the best possible retirement provision at the lowest possible cost to help European industry remain competitive. This can only be achieved through extensive and effective funded retirement provision executed by the most flexible and cost-effective (non-profit) funding vehicles, i.e. pension funds. That argument remains valid. The objective has remained the same as well, though it is now being re-phrased as the delivery of safe, sustainable and adequate pensions.

Every Member State uses the **tax** lever to steer citizens' behaviour. It has been widely established that the exempt-exempt-taxed treatment (EET) of pension systems is most adequate for encouraging citizens and employers to save in a specific pension scheme. With a view to widening the coverage of occupational pensions, it is critical for tax incentives to remain relevant.

In retrospect, taxation was a major hurdle to cross-border investments (i.e. withholding tax on dividends and interests to non-domestic pension funds) and provision of services (i.e. discriminatory treatment of cross-border scheme contributions). Building on the insights expressed in the European Commission *Communication on the elimination of tax obstacles to the cross-border provision of occupational pensions* (2001), the EFRP—together with PricewaterhouseCoopers (PwC)—lodged complaints with the Commission (2005) against 17 Member States that we believed had infringed EU rules in their treatment of interest and dividend payments to non-domestic pension institutions. This is another major achievement given the results obtained (with some still pending): five complaints ended up with a referral to the Court of Justice of the European Union, and nine Member States modified their legislation to eliminate discriminatory treatment.

Other areas in the taxation area include the deductibility of cross border transfers to occupational schemes, the value-added tax (VAT) treatment of services provided to pension funds, the EU Savings Taxation Directive, and most recently the US Foreign Account Tax Compliance Act (FATCA) and the financial transactions tax (FTT).

Although somewhat farther down the timeline, we cannot close this article without mentioning the tumultuous, but ultimately successful, combat of the **retrospective effects of the Barber judgement** (17 May 1990). That judgement was trailblazing in the sense

that it equalised the retirement age between men and women in occupational pensions. Had it been applied with retrospective effect, the cost would have reached damaging levels to the funding position of defined benefit (DB) schemes that had made assumptions based on gender-differentiated retirement ages. The EFRP tabled a report in which financial services consultancy Towers-Perrin (now Towers Watson) had quantified the costs involved, which went a long way towards convincing the Commission and the EU Presidency to table a Protocol to the Maastricht Treaty limiting the retrospective effect of the Barber judgement. It was accepted with unanimity, an unprecedented result. The EFRP takes pride in having achieved this to the benefit of all employers that provide DB pensions.

It is striking, though, that our main areas of concern and interest have remained nearly unchanged over the years. To name but a few:

- Equal treatment of men and women is still an issue where differences between the occupational pension field and third pillar individual pensions have not been settled, which risks affecting IORPs and their sponsors.
- Diversity in occupational pensions legislation—especially those parts that are embedded in social and labour law—in different Member States stifle the development of pan-European IORPs, an aspect that has been under-estimated in the IORP Directive. The way to overcome this kind of hurdle is not yet clear since Member States are keen to keep this area under exclusive national competence.
- A lack of understanding of the differences between life insurance and pension funds. This may seem a popular theme but it is a very serious issue as it may generate over- or ill-conceived regulation. To date, pension funds have been able to avert the worst.

The long march has not yet come to an end: Europe is now seeking better governance of its monetary union in order to ensure stable economic growth. Stable economic growth is what funded pension systems need if they are to be successful. This means being able to deliver to the beneficiary the promised retirement income. These days, the security of pension delivery has become the prime concern of policy-makers and supervisory authorities alike. The EFRP will work together with the Commission to find an appropriate approach balancing security, adequacy and affordability to allow IORPs to further develop as wholesale providers of occupational pensions.

➔ Changing demographics: Is Europe becoming the 'old' continent?

Anne-Sophie Parent

Secretary-General, AGE Platform Europe

Europe's ageing has been public knowledge for several decades. It is, however, only in recent years that the impact of the EU demographic challenge has become an issue of public debate at national and EU level. In all Member States, citizens are now aware that the large, broadly-based age pyramid they saw in their schoolbooks has turned into a mushroom standing precariously on a narrowing foot. For the first time ever in peacetime, the percentage of older people is growing rapidly while the proportion of working-age people is shrinking. Since 2008, the number of those who are lucky enough to have a job is shrinking even faster as a result of the economic crisis. The media remind us every day that with the large numbers of baby boomers who will retire in the coming two decades and the sharp increase in the number of 'very old' people, difficult questions arise as to who should be responsible for ensuring a decent old-age income and dignified ageing for all. Today's economic context makes a consensual answer even more difficult to achieve.

Europe has known for a while that it is ageing and that this requires some radical rethinking on the way life risks—i.e. unemployment, old age and dependency—should be shared across the population and age groups. But until recently, many political leaders have adopted the same behaviour as the older members of their constituency when faced with their own ageing: they procrastinated, thinking that they could postpone the most difficult decisions until later, i.e. after their next national elections. Some years ago, a few political leaders introduced major reforms to address the expected changes in the dependency ratio and to guarantee more sustainable pension systems in the future, often opting for a higher reliance on private defined contribution schemes at the expense of adequacy. For many, the issue at stake is not so much the long life expectancy that EU citizens enjoy, but the relatively small number of years that they spend in paid employment building their pension rights as compared to the long years during which they draw upon their pension.

As the European Commission said in its Green Paper on Pensions, adequacy and sustainability of pension systems are two sides of the same coin. Longer working lives, together with a closer link between contributions and pension benefits, were presented as the panacea for Europe's demographic challenge. In today's context this is easier said than done. Older workers are blamed for retiring too early, yet little is done to help them remain in employment until the

statutory retirement age and they are the first to be made redundant in restructuring. Young people are no better off, with youth unemployment skyrocketing in many Member States. Employers, meanwhile, complain that they cannot find the skilled workforce they need to remain competitive.

Some wonder whether the core mission of Europe's long-praised social security systems should not be radically reviewed. With the crisis dragging on, governments are now seizing upon the sense of urgency to reform their systems in order to restore financial markets' confidence in their ability to keep public spending under control; they urge other Member States to do the same by fear of a spread of the public debt crisis. As a consequence, the objective of pension reform seems to have evolved almost overnight: from ensuring an adequate income in old age to alleviating poverty among older people. This is quite a radical change from the objectives of adequacy agreed not long ago, and it may have a significant impact on the future design of pension schemes.

The general trend of reinforcing the link between pension contributions and benefits by extending the number of years one needs to contribute to be eligible for a full pension is mainly aimed at lowering overall future pension claims; it takes no account of the negative impact this will have on pension rights of those with shorter careers, mainly women and those with long periods of unemployment. The shift from pay-as-you-go (PAYG) systems toward funded schemes continues, in an attempt to reduce pension claims on public systems.

But several Member States recently acknowledged that they are pleased to have retained a strong first pillar. It is clear now that financial markets' behaviour is perceived as a much more serious threat to the sustainability and performance of funded schemes than demographic ageing's impact on first pillar schemes. In the last few weeks, it has become obvious that the solutions proposed to solve Europe's demographic challenge are no longer going to be enough to save our economic and social model.

The main challenge for Europe is no longer the fact that it has become an 'old' continent but, rather, that the EU lacks the maturity and wisdom that usually come with age. Its economic and financial governance is still in its infancy. How can our political leaders manage to keep the fire that has started in Greece under control and prevent it from spreading to other Eurozone members if they do not have the right tools at their disposal? The major challenge today for EU policy-makers is to rebuild their citizens' confidence in the fact that lessons have been drawn from the past and that the dramatic mistakes which were made will be avoided in future.
Whatever pension model they choose to promote—PAYG or occupational funded schemes—

policy-makers will need to demonstrate that their aim remains guaranteeing adequate protection to all, and particularly the most vulnerable. Rather than push back the life risks to individuals and leave the most vulnerable to care for themselves, pension schemes must continue to be based on fundamental principles of solidarity and pooling of risks. The risks linked to EU citizens' long life expectancy and to financial markets' fluctuations must be spread across generations, and reforms must seek to achieve not only better sustainability but also a better pooling of important life risks (child and elder care, career breaks, unemployment, disability, etc.).

Both PAYG and occupational funded schemes will be under severe threat if the EU enters into long-term recession. Member States and EU leaders must tackle the ever-increasing democratic deficit and must help citizens regain confidence in their leaders and trust in their future. In the most severely affected countries, young and old are together in the streets to protest against the austerity measures and they will continue to do so as long as they are not convinced that their leaders are addressing the roots of the problems. The severity of today's crisis calls for an increased role for the EU to bring back sound governance rules at global, EU and national levels. The EU must ensure that all Member States do their utmost to balance their public budgets within a reasonable period without jeopardising social cohesion. Regaining citizens' confidence is more important than ever and Member States should retain enough flexibility to reform their pensions and social protection systems in a way that is fair and socially acceptable.

No one doubts that Europe is becoming an 'old' continent in terms of demographics, but in terms of economic governance Member States have to allow the EU to mature quickly and to provide itself with the necessary tools to regain the control of financial markets that national governments have lost. Europe must become the 'wise' continent that leads the way to global economic recovery. Our leaders should go back to our fundamental values and redesign the principles that should rule our economic and social models. Citizens and consumers must feel confident that whatever model is proposed is chosen in their best interest and in the interest of future generations. Europe's most valuable resource is its human capital; we must all do our utmost not to allow the current crisis to waste it. Our future must be European. It is a question of confidence: confidence in our common strength and ability to recover.

The European Federation for Retirement Provision (EFRP) is celebrating its 30th anniversary in very difficult times. Yet this reinforces the need for such an organisation to continue to promote its members' values in EU and national debates on pension reforms. AGE shares these values and will be happy to continue to cooperate with EFRP for many years to come.

Pension funds in the regulatory environment

02
Section

"In pensions, there are no second chances. Time that is lost is forever gone. Intelligent regulation is a necessity — the sustainability of our pension system depends on it!"

Heribert Karch
Managing Director, MetallRente

➔ Pension portability: The forgotten child of the Single Market?

Koos Richelle

Director General, DG Employment, Social Affairs and Inclusion, European Commission

Long ago, the barriers to free movement were seas, rivers and mountains. A man could only travel as far as his horse would carry him. Nowadays, physical borders are de facto eliminated; nonetheless, the mere presence of state borders can prevent one from moving from one place to another. Not because of the borders themselves, but because crossing a border also means crossing into different social security and tax systems. Since the Treaties of Rome in 1958, the free movement of people has been at the heart of the European project. In fact, the Treaties of Rome establish—on the very first page—as a goal of the then European Economic Community "to ensure the economic and social progress […] by common action in eliminating the barriers which divide Europe". This means that we must find ways to make differences in social security and tax systems between Member States work for European citizens.

Practically, we have already achieved a great deal: discrimination on grounds of nationality is prohibited; only one body of social security legislation applies at a time, with rules established to determine which; it does not matter in which Member State one has worked, since coordination provisions provide for aggregation. This means that periods of insurance, employment or residence completed under the legislation of one Member State are taken into account, when necessary, for the entitlement to a benefit under the legislation of another Member State; and rights already acquired are protected by allowing benefits to be exported. If a person works in more than one Member State, they do not lose out when it comes to their statutory social security pension entitlements: no contributions will be lost, acquired rights will be protected and every Member State will pay a pension corresponding to the insurance periods completed there. Every state pays neither more nor less than the pension which has been 'earned' through the contribution, working career or residence record of the workers.

The European Union as a whole would not have had the same economic growth without the Single Market. If individuals faced fewer barriers to movement between Member States, the European labour market would be able to function more effectively, thus potentially leading to lower unemployment and greater economic growth. Employers can hire specialists that are not available within their own Member State. Employees can look beyond national borders for jobs that reward their experience and knowledge.

Though the world around us may have changed over the past 50 years, we still build on the fundamentals laid down in 1958. On 1 May 2010, Regulation (EC) No 883/2004 and its implementing Regulation (EC) No 987/2009 replaced Regulation (EEC) No 1408/71 and Regulation (EEC) No 574/72. These regulations deal with the coordination of national social security systems and apply to national legislation on social security benefits, including statutory social security pensions (often referred to as 'pillar I' pensions).

However, there is no similar arrangement for occupational pensions ('pillar II' pensions). This means that people who move between jobs (including within Member States, if this involves changing occupational pension schemes) may lose out on their pension rights. For instance, the pension rights they have with their former employer do not keep pace with inflation and thus lose value in real terms over time, or their entitlement only vests after a long period of continuous employment with their employer. This represents a potential barrier to the mobility of individuals who wish to move to find employment in another Member State. By moving, people may lose some or all of their previously accrued supplementary pension rights.

With Member States' increasing reliance on occupational pensions in retirement provision, the issue of how to better ensure the portability of 2nd pillar pension rights is rapidly gaining importance. Losing pension rights by changing jobs not only affects more people, but also a larger proportion of their income in retirement. Another key impetus to removing barriers comes from the huge upswing in cross-border working following the 2004 enlargement.

The European Commission already recognised in 1991 that pensions can form a barrier in realising the full potential of the Single Market; it consequently issued a Communication. A first basic step was Council Directive 98/49/EC which aimed to ensure that people moving across borders were treated no worse than those moving within a Member State. Recognising the limited nature of this Directive, the Commission proposed a new Directive in October 2005 on improving the portability of supplementary pension rights. This Directive covered three aspects: transfers of pension rights, timely acquisition of pension rights and preservation of pension rights once granted. It has, however, proved difficult to agree, being subject to unanimity in Council and co-decision. In 2007, the European Parliament considered the matter. This led the Commission to amend its proposal, placing the emphasis of the proposed Directive on timely acquisition of pension rights and ensuring such rights were preserved (i.e. indexed so that inflation would not erode them).

Since then, the issue at hand—removing obstacles caused by supplementary pensions to the free movement of workers—has grown more important. In today's labour market, characterised by demands for greater flexibility, and in the context of the financial and economic crisis, people need to be able to change jobs easily and without hardship; employers need to be able to easily recruit the right person with the right skills. At the same time, with ageing demographics, people need to have opportunities to work more and build up and retain pension rights. It cannot be that young and flexible people willing to work where employers need them most cannot do this for fear that changing jobs will result in foregone occupational pension rights.

In a world where State pension provision is facing cutbacks due to sustainability concerns, well-organised supplementary pension provision is key for citizens' pensions. In the *Annual Growth Survey*, the Commission stressed that opportunities to save in complementary pensions can represent an important contribution towards achieving adequate pensions. However, an increased reliance on supplementary pensions that is not coupled with good coordination tools across borders is not satisfactory.

Given the importance of the issue and in light of the difficulties in reaching agreement on the Commission's 2007 proposal for a directive on portability, the July 2010 Green Paper on pensions included a question on this. The vast majority of replies strongly supported the principle of free movement and felt it was important to avoid anything which could inhibit this. The European Federation for Retirement Provision (EFRP) also contributed to this discussion.

In order to address the aforementioned issues of an increasing need for labour market mobility and reliance on supplementary pensions, the Commission announced in the Single Market Act that it will re-launch the proposal for a Directive on the acquisition and preservation of pension rights. In so doing, it will take due account of the responses to the Green Paper consultation.

The Commission recognises the importance of tackling the issues as soon as possible. It intends, therefore, to launch a proposal for a Directive in 2012. This proposal will of course be accompanied by a thorough impact assessment. The new proposal needs to make sure in particular that EU legislation does not weaken the resolve of employers and trade unions to establish and develop second pillar pensions.

The proposal must stimulate labour mobility and improve the pension adequacy of flexible workers. This will require an effort on multiple fronts. First, people need to be able to build

up pension rights in an adequate way. That means that issues of vesting rights and minimum ages must be addressed. Second, once pension rights are established, they need to be safeguarded against inter alia inflation after leaving the pension scheme. Third, people need to be able to keep track of their pension rights. Respondents to the Green Paper argued that pension tracking services are to be encouraged and facilitated so EU citizens can keep track of all their pension entitlements.

In the forthcoming White Paper on Pensions the Commission will take these ideas forward. The Commission intends to engage with stakeholders on the proposals. I am sure that the EFRP will make a valuable contribution to this and help us lift the barriers to the free movement of workers.

➔ Can regulation ensure sustainable pensions?

Heribert Karch

Managing Director, MetallRente and Chairman of the Board of Directors of the German Association for Occupational Pensions (aba)

Pension systems must be designed in such a way that our actions today do not cause problems for future generations. "Meeting the needs of the present without compromising the ability of future generations to meet their own needs" is the concept of sustainability as defined by the United Nations' Brundtland Commission in 1987[1] in the context of sustainable development. Even if it is borrowed from another sphere, the principle of sustainability is nonetheless highly relevant for pension systems, which are expected to deliver equitable outcomes across generations. In this piece, I will focus on the role that regulation has in achieving this objective. In particular, I will concentrate on:

1. Risk-sharing between the employer and the employee
2. Protection against insolvency of the sponsoring employer
3. Enhancing coverage

1. Risk-sharing between the employer and the employee

Occupational (2nd pillar) pension provision is more than just a long-term savings process. In most countries, the payment of benefits is triggered by a 'biological event', e.g. reaching retirement age, death, or disability. Systems of tax relief often favour income streams, either in the form of a life annuity or capital drawdown plan. The 2nd pillar is designed to supplement, and in some cases partially replace, the 1st pillar of State provision; it is, therefore, important that the system provide stable outcomes in order to facilitate stakeholders' planning decisions. In my view, these are essential elements of a pension system that seeks broad acceptance by the population.

Achieving this is easier said than done. Defined benefit (DB) systems, which in the past appeared stable, have proved unaffordable in an era of low returns, high volatility and short-term market pressures on sponsors. Defined contribution (DC) schemes, with the lure of individual choice and flexibility, have also failed to deliver, being too costly and exposing members to risks they may neither fully understand nor be able to manage.

In Germany, we have historically followed a middle path with collectively managed schemes that offer both a guaranteed component (based on conservative assumptions) and a

1. "Our Common Future", Report of the Brundtland Commission (1987).

'performance-related' component, the latter often viewed as compensation for inflation but also serving as a kind of capital buffer.

This system, in our view, fairly shares risk between employer and employee. The pension fund plays a role in distributing this risk, in that it can smooth investment returns and biometric experience from year to year. Current accounting and prudential standards in Germany support this practice. Whilst technically it could mean that a scheme may be over- or underfunded on a mark to market basis, the smoothing approach ensures that in an overfunded situation, excess returns are not all distributed to stakeholders in one go; in an underfunded situation, stakeholders are not immediately subject to increased contributions or benefit cuts at a time which may pose other economic challenges.

Some may argue that this smoothing approach simply hides the economic truth we must all face one day. But let us be frank: if the economic truth is negative real returns for the rest of our days, then we might as well close shop; saving in such a scenario makes no sense. In any event, it is not clear whether mark-to-market valuation is any less distortive than other methods of valuation.[2]

For occupational pension provision to be sustainable, risks (and returns) need to be spread as widely as possible (including past and future generations of workers). Effective prudential regulation should be accommodative of the long-term nature of pension provision and not introduce pseudo-risks which promote short-term and, quite possibly, counterproductive action.

2. Protection against insolvency of the sponsoring employer

In a system that relies on employer sponsorship, it is important that members are protected in the event of employer insolvency. One way of achieving this is to impose capital requirements ensuring that insolvency has no impact on the pension fund's ability to pay out accrued benefits. Given the low frequency but high-impact nature of this risk, it is economically far more efficient to cover it by way of an insurance pool.

Germany has had a mandatory nationwide insolvency protection scheme (PSV) since 1974; this scheme is currently supported by some 83,000 companies. Historically it has covered book reserve and similar schemes in the private sector. It operates on the principle of general insurance, whereby employers pay a premium that is a function of the absolute level of their pension liabilities and the previous year's total claims. Since inception, the

2. See for example Chapter 3 by Dr. Paul Woolley in Adair Turner and others (2010), The Future of Finance: The LSE Report,London School of Economics and Political Science.

system has experienced some 14,000 insolvencies, all while maintaining protection for beneficiaries. It has remained solid during the recent economic and financial crises and currently pays out pensions to over 1.2 million beneficiaries.

To date, premiums to the PSV have not reflected the underlying insolvency risk of sponsoring companies. Yet there is no strong evidence of incidences of moral hazard. In an economy dominated by *Mittelstand* companies, individual risk-rating would indeed pose a number of practical challenges. Nevertheless, there have been calls from industry to modify the premium structure to better reflect the likelihood and magnitude of asset recovery from sponsoring employers in the event of insolvency. These calls have centred on sponsors whose schemes are backed (either voluntarily or mandated) by assets to which the beneficiaries have legal recourse in the event of insolvency. By taking these assets into account in the premium calculation, many companies that have set up voluntary funds would experience a substantial discount. On the other hand, those that have not would pay more, as the total claims experienced would, *ceteris paribus*, remain the same. To the extent that the ability to put aside voluntary funds reflects the underlying health of the enterprise, this factor would act as a proxy for the company's underlying credit risk. Experts seem to agree that this modification would make a meaningful contribution to the efficiency and sustainability of a system that has served us well.

3. Enhancing coverage

In Germany, coverage is one of the biggest challenges facing a system that has historically been based on the principle of voluntarism. High coverage levels are, however, essential if the 2nd pillar is to achieve its goal of being a dependable complement to the 1st pillar while remaining sustainable. Coverage levels received a boost in the last decade when employee salary sacrifice was introduced as a right in the Pensions Law. In spite of this, however, coverage levels remain below those of our peers, such as the Netherlands. This is all the more astonishing given that our system has fared comparatively well in the recent economic and financial crises. One explanation is that Germany lacks a common tradition of private pension provision, as large sections of the population have only needed a relatively small supplement to their State pension in order to secure a comfortable standard of living in retirement. This notion is supported by the fact that it is not so much an issue of employer willingness to establish schemes, but rather one of employee participation within schemes. Awareness of the looming pensions gap is permeating too slowly into the public conscience, although extensive discourse surrounding the topic of demographics and the ageing society in both schools and the media have had an impact. It is doubtful, however, that these measures alone will be sufficient to motivate all those affected by the decline in State

provision brought about by reforms more than a decade ago. It is thus not surprising that some voices are calling for compulsory participation in the 2nd pillar.

Compulsory participation, however, has a number of drawbacks. Not only does it infringe upon a basic freedom, but it risks reducing occupational retirement provision to just another payroll tax. It may be more effective to instead place greater emphasis on a package of measures with the aim of strengthening collective systems, overcoming inertia and promoting automatic elements. In particular, workplace or tariff agreements with a base employer component and an opt-out mechanism could be a model for the way forward. The role of social partners is key in this. They should be encouraged to establish industry-wide collective schemes that can cover wide sections of the workforce and, hence, quickly benefit from economies of scale. Wage negotiations, for example, could include an automatic linkage to contributions, so that a meaningful level of provision will result over time.

The role of Government is equally important. It must ensure that occupational pension provision does not overburden employers in terms of legal, regulatory and administrative requirements, and it must facilitate provision in small and medium enterprises. It should consider targeting tax relief to those companies that are successful in providing a certain minimum level of coverage to the entirety of their workforce.

Regulation is a double-edged sword. Well-designed and reasoned regulation can be the deciding success factor in any public policy initiative, occupational pensions included. The opposite is also true. In pensions, there are no second chances. Time that is lost is forever gone. Intelligent regulation is a necessity—the sustainability of our pension system depends on it!

→ Pension fund provision: Not just another insurance policy or mutual fund product

Gerard Riemen

Director General, Pensioenfederatie

The Netherlands has one of the best pension systems in the world[1], and no other country has allocated as large a portion of its assets for retirement on a per capita basis[2]. This remains true in today's economy, despite the current crisis.

Better together

What makes the Dutch pension system so strong is that almost all pension arrangements are made collectively. Because all the costs and risks are shared, pensioners enjoy a better pension than would be available if every individual were responsible for his or her pension provision. Such a collective pension system, together with low costs and risk sharing, results in significantly higher pensions at the same price.

An added benefit is that Dutch pension funds are not profit-driven: their only goal is to provide good, affordable pensions to their members. The lack of a profit motive and the lack of shareholders eager to cash in also results in higher pensions at the same price.

One of the strongest features of the Dutch pension system is its collective nature. The vast majority of Dutch employees—some 90 per cent[3]—participate in a collective pension scheme. The pensions administered through a pension scheme are based on risk-pooling and solidarity. Pension funds are managed by social partners or, in the case of company pension funds, employers and employees. This means that the stakeholders in pension funds manage the fund together, that costs of pension administration are borne collectively and that risks are shared based on intergenerational solidarity.

Sharing risks

The period during which we accrue pension entitlements and receive pension benefits extends over many decades and can last as long as 75 years. During this period, our society

1. The Dutch pension system was listed at the top of the Melbourne Mercer Global Pension Index 2011, an international comparative study of pension systems conducted by the Australian Centre for Financial Studies. The study covered the following countries: Australia, Brazil, Canada, Chile, China, France, Germany, India, Japan, the Netherlands, Poland, Singapore, Sweden, Switzerland, the United Kingdom and the United States.
2. Of the 34 OECD member states, the Netherlands has the largest amount of pension fund assets in relation to GDP: 130 per cent, which is twice the OECD average (Source: OECD, Pensions at a Glance 2011).
3. Approximately 80 per cent of Dutch employees accumulate pension entitlements through a collective pension fund, while 10 per cent participate in a collective pension provided by an insurance company. The remaining 10 per cent do not have a pension scheme.

will inevitably undergo radical change. The long-term nature of pension arrangements involves a number of risks, which are shared as part of a collective pension scheme.

To ensure good, affordable pensions, contributions must be invested; on their own, they are not sufficient to fund the benefits. However, investment inevitably involves risk, and in the Dutch pension system these investment risks are shared among all the members of a pension fund. This risk sharing prevents radical cuts during an economic downturn to the pensions of those who are already retired or who will retire in the near future. While individual investors have to face the consequences of poor investment performance, members of pension funds share setbacks among several generations, just as the proceeds during good years are shared. Since pension funds invest on behalf of large numbers of members at the same time, the investment assets of most pension funds are substantial, making wide diversification possible. Besides being diversified among different investment classes such as property, equity and bonds, investments are also spread by region and by industry. Pension funds invest all over the world, which also ensures risk diversification. In addition to sharing investment risk, pension fund members also share other types of risks, based on the principle of solidarity. Those with a long-term illness or a work-related disability usually do not have to worry about their pensions: they continue to accrue entitlements, paid for by those who are able to work. If an employee dies prior to retirement, their partner—and usually their dependents—receive a life-long survivors' benefit. Alternatively, members can make arrangements for a survivors' benefit after they retire.

Sharing costs

Those who participate in individual private pension plans tend to face high costs. Pension funds administer pension schemes collectively for a large number of members at the same time—this larger scale results in cost savings, and the lower level of costs means higher pensions at the same price. And since pension funds are not profit driven, all the revenue received in the form of contributions and investment income actually goes towards pensions, once the relatively low administrative costs have been deducted.[4]

Mandatory participation

Collectivity and solidarity only work if everyone participates. It is just like with Dutch dykes, schools, and the road network: it works because we are all required to contribute. In the Netherlands, employees working in an industry or company that has a pension fund are therefore required—either contractually or by law—to participate in a pension scheme. This

4. In their study of the costs and benefits of collective pension systems, Van der Lecq and Steenbeek arrive at a cost level for pension funds during the period 2000-2004 (inclusive) of an average of 4.4 per cent of the contribution. Source: S.G. van der Lecq and O.W. Steenbeek (Eds.), Kosten en baten van collectieve pensioensystemen ("Costs and benefits of collective pension systems"), Kluwer, 2006.

mandatory pension accrual, combined with the old-age pension provided by the government, ensures that comparatively few people in the Netherlands live in old-age poverty.

The Minister of Social Affairs and Employment orders mandatory participation for a particular industry or section of an industry if social partners so request and if the fund satisfies the applicable requirements.[5]

This means that all companies subject to mandatory participation are required to make employees join the pension fund. The mandatory pension scheme is provided for in collective bargaining agreements (CAOs); exceptions to this rule are companies that have own pension schemes that are at least equivalent, from an actuarial perspective, to the industry pension fund. An added advantage of the system of mandatory participation is that companies operating within an industry do not compete with one another in terms of pension schemes.

Drawbacks of mandatory participation

Despite the numerous advantages of a mandatory collective pension system, not everyone is in favour of its compulsory nature due to the lack of freedom of choice. That is to say, members and employers cannot choose the pension administrator to which they pay contributions, nor can they choose the pension scheme.

Dutch pension funds are well aware of this lack of freedom and are responsible for doing everything they can to manage the funds and liabilities entrusted to them prudently. Good governance (i.e. control and participation) and the support test used to assess whether an industry pension fund has sufficient support in the industry ensure that pension funds are reminded of keeping and fulfilling their responsibilities.

To conclude

Solidarity and collectivity are the main characteristics of pension funds in the Netherlands. Sharing the risk not only within but between generations distinguishes our pension funds from insurance companies and—to a certain extent—from mutual funds. From an economic point of view, all members profit from this system. Other EU Member States have organised this kind of solidarity and collectivity through the State. In every Member State, the pension fund has specificities that differentiate it from insurance companies and mutual funds. It was and will be the task of the European Federation for Retirement Provision (EFRP) to respect these differences and to show Europe that in every Member State pension funds are a valuable asset in the organisation of old age benefit schemes.

5. Participation is mandatory for occupational pension funds (such as, for example, for general physicians or civil law notaries) if a majority of the occupation group is in favour of this. This is assessed periodically.

➔ Pension fund regulation: Application of insurance regulation from an actuarial perspective

Philip Shier

Senior Actuary, Aon Hewitt

In its call for advice to European Insurance and Occupational Pensions Authority (EIOPA) on the review of the institutions for occupational retirement provision (IORP) Directive, the European Commission identified three main reasons for undertaking the review:

- To facilitate greater cross-border pension provision;
- To introduce risk-based supervision of pensions; and
- To modernise the prudential regulation for defined contribution arrangements.

Most debate will focus on the direction taken by the Commission in relation to the introduction of risk-based supervision. There has been much comment on the merits of the introduction of a Solvency II-type regime for pensions. This article focuses on the quantitative aspects as they might apply to defined benefit IORPs, although some of the qualitative provisions of Solvency II in relation to governance, reporting and disclosure could also play an important role in providing security and transparency for members of all IORPs.

The Commission has asked EIOPA to consider the development, for IORPs where the risk is covered by the sponsor, of a balance sheet which incorporates sponsor covenant and pension protection schemes as an asset. This approach is considered at length in the EIOPA consultation document issued in October 2011 and has been given the title 'Holistic Balance Sheet'.

I believe that, as a starting point, all stakeholders would agree that the aspiration for an IORP should be to have assets which are sufficient to cover technical provisions and provide a reasonable margin or a 'risk reserve' to address volatility and adverse events. Indeed this is already the position outlined in the IORP Directive.

The discussion in the EIOPA consultation document on the quantitative aspects of a new risk-based regime runs to almost 200 pages. At a high level, this can be reduced to four key questions:

1. "Our Common Future", Report of the Brundtland Commission (1987).

1. How should the technical provisions be determined?

Technical provisions are calculated as the present value of future cash flows on appropriate assumptions. There is considerable discussion in the EIOPA consultation document on the cash flows to be considered, but my own view is that benefits which are guaranteed, or contingent upon defined criteria, should be taken into account. I do not think that it is appropriate or desirable to include benefits which are purely discretionary, as members have no realistic expectations of such benefits, unlike the situation in insurance where policyholders are generally entitled to the benefit of surplus funds.

The key actuarial assumption in relation to the calculation of technical provisions is the discount rate to be adopted, and the current IORP Directive envisages two possible approaches:

(a) A discount rate based on the yield on high-quality government bonds, or

(b) A discount rate based on the expected return on assets held to meet liabilities.

The former approach would have been characterised as 'risk-free' although this terminology is being re-evaluated in light of the current sovereign debt crisis. There is ongoing debate in relation to the implementation of Solvency II for insurance, where a 'risk-free' approach is mandatory, around the determination of the yield curve to be used in the calculation of technical provisions, and the basis on which allowance should be made for cash flows which can be closely matched, or where liquidity is not required. These issues would also be very relevant for pensions if this approach were to be adopted. Alternatively, if it were decided that it is appropriate to use the expected return on assets to determine the discount rate, there are many issues which should be clarified to ensure that an appropriate rate is used for this purpose.

At present, countries such as the UK, Belgium and Ireland adopt the 'expected return' approach, whereas the Dutch FTK system has required the use of a prescribed yield curve based on AAA-rated government bonds. It is, however, interesting to note that the recent proposals for change in the Netherlands include switching, at least in part, to an 'expected return' approach.

The use of an 'expected return' discount rate is, in normal circumstances, likely to lead to technical provisions which are significantly lower than those adopted using a 'risk-free' discount rate. For example, if the expected return is 2 per cent per annum above the 'risk-free' rate, and the average duration of the liabilities is 25 years, the increase in technical provisions arising from the use of a 'risk-free' rate would be approximately 50 per cent.

It is clear that there would be significant difficulty if countries which currently adopt an expected return approach were required to increase their reserve requirements to this extent.

2. What risk margin or additional assets should be held?

Both the existing IORP Directive and the Solvency II framework provide for risk margins to be included in technical provisions. Solvency II also imposes requirements on insurers to hold assets in excess of the technical provisions sufficient to cover the Solvency Capital Requirement (SCR), which is a risk-based calculation of capital requirements sufficient to ensure that the undertaking will be in a position to meet its commitments over a one year time horizon with 99.5 per cent probability. There is also a Minimum Capital Requirement (MCR) which, if not met, triggers immediate supervisory intervention. The EIOPA consultation document contains much discussion on how capital requirements might be determined for IORPs.

In my view, the Solvency II framework is overly complicated for IORPs, and the need for 'risk margins' and 'capital requirements' could be more easily expressed as a need for a buffer, calculated on a risk-based approach, which IORPs should be required to hold in addition to technical provisions in order to satisfy the regulatory requirements. In particular, the use of the term 'capital' in the context of IORPs is misleading, as there are usually no external shareholders or investors from whom capital can be obtained; in practice additional capital means further sponsor commitment to the IORP.

3. What assets should be taken into account, and how should these be valued?

It is widely accepted that actively-traded assets for which a realistic market value can be obtained at any date should be listed on the balance sheet at that rate. An IORP may also hold illiquid assets, such as property or private equity investment, for which a market value may be less readily available but some reasonable proxy can be used.

Under the holistic balance sheet approach, the asset side would also include the value of the sponsor covenant, and the EIOPA consultation document discusses at length how this might be evaluated. It is clear that this is a complex exercise, and it may not be practical to do this on more than a yearly basis, but inclusion of the sponsor covenant would recognise in a quantitative way the role of the employer in funding deficits which may arise in the IORP over time. The Commission also suggested that pension protection schemes should be included as an asset, although there are mixed views on how this

could be done. Clearly the availability of such ‘stop loss’ protection improves the security of members of the scheme and communication with members should be clear on this point.

Under Solvency II, assets are ‘tiered’ according to their quality, and it would appear desirable to require a significant part of the technical provisions and/or capital requirements to be covered by high-quality assets i.e. securities owned by the IORP rather than softer assets such as sponsor covenants. However, it may not be appropriate to adopt the same requirements as Solvency II for IORPs.

4. At what point, and to what extent, should supervisory action occur?

It is important to recognise that the calculation and reporting of a funding position should not necessarily lead to supervisory action. In my view, it is entirely reasonable for IORPs to be required to report on a consistent basis to enable their position to be fully understood, but it would be undesirable for the Directive to impose an automatic requirement for specified supervisory action based on reported figures.

Pension funds are long-term investors which are not subject to the commercial pressures of insurance companies, and supervisors should have sufficient flexibility to enable IORPs to address funding shortfalls in a way which is appropriate to their circumstances and in the best interests of the beneficiaries in the longer term. Accordingly, the SCR and MCR triggers which have been set for insurance undertakings may not be appropriate or necessary in the context of an IORP, although regulators must ensure that appropriate steps are taken on a timely basis to address difficulties when they are notified to them, not least to preserve intergenerational equity.

It may not be practical or desirable to require IORPs to report to the regulators more frequently than annually, and the supervisory regime should be designed to minimise additional compliance costs.

More detailed consideration is necessary before a firm view can be taken on the appropriateness or otherwise of the introduction of risk-based supervision along the lines of Solvency II for IORPs, and of course a quantitative impact assessment is essential. There are significant differences both in background and structure between IORPs and insurance entities. It is, therefore, important that the introduction of risk-based supervision designed to improve the security of members’ benefits does not lead

to a diminution or withdrawal of such benefits as a consequence of the imposition of material additional cost and complexity on the existing IORP framework.

Pension regulation: Creating choice

Karel Van Hulle and Jung Lichtenberger[1]

Respectively Head of Unit and Desk Officer for Insurance and Pensions Unit in DG Internal Market and Services, European Commission

Introduction

Pension policy in the European Union (EU) is decided by Member States. But the EU can help. The EU can help develop coherent systems that deliver sustainable, adequate and safe pensions. In order to respond to the challenges of an ageing society, and accelerated by the economic and financial crisis, the European Commission released a Green Paper last year. It launched—for the first time at EU level—an integrated policy discussion about pension adequacy, fiscal sustainability and financial regulation[2], and triggered the interest of a wide range of stakeholders. In March 2011, following the consultation deadline, the Commission Services released a summary of the responses received.[3]

The Green Paper is now being followed up through a number of channels. As part of the European Semester, a new element of the EU's macroeconomic policy framework, structured pension reform discussions with Member States are taking place as an essential part of economic policy. The Commission is also preparing a White Paper on pensions by the end of 2011 to announce a wide range of EU initiatives in support of Member States' pension policy. In parallel to the White Paper, the Commission is also pursuing the review of Directive 2003/41/EC concerning the activities and supervision of institutions for occupational retirement provision (IORP Directive) in order to present a proposal by the end of 2012. The Green Paper consultation has confirmed that the EU Single Market can best support pension adequacy and fiscal sustainability through the reinforcement of an efficient and safe environment for businesses and people.

Why review the IORP Directive?

The EU already achieved an important milestone with the adoption of the IORP Directive in 2003. The Directive enables an employer to set up a pension fund (an IORP) in another Member State. Conversely, an IORP can be sponsored by employers located in one or more

1. The views and opinions expressed in this paper are those of the authors and do not necessarily reflect those of the European Commission or of the Commission Services.
2. Green Paper - towards adequate, sustainable and safe European pension systems (COM(2010)365 final) of 7 July 2010.
3. Available on http://ec.europa.eu/social/main.jsp?catId=700&langId=en&consultId=3&visib=0&furtherConsult=yes

other Member States. The idea is to tap the potential of the Single Market to realise further efficiency gains through economies of scale, risk diversification and innovation. This creates more choice and reduces the cost of occupational retirement provisions.

Although the development of the IORP Directive did not come about without great difficulties, it constitutes only a first step in the creation of a Single Market for occupational retirement provisions. The Directive takes an 'old-style' approach based on minimum harmonisation and mutual recognition. The implementation of the Directive in Member States, therefore, produces an outcome which is not necessarily conducive to an efficient organisation of the market for occupational pension funds. For instance, some Member States have gone beyond the common EU rules by introducing modern prudential rules at national level. Other Member States have given an extensive interpretation to important concepts used in the Directive, such as 'cross-border activity' and 'social and labour law'. This has created a situation where de facto sponsoring employers and IORPs still face considerable legal, regulatory and administrative complexity within the Single Market. This increases transaction costs and acts as a major brake on cross-border activity. Today, only 84 of more than 140,000 IORPs engage in cross-border activity. This is a tiny proportion and the Single Market must do better in order to support pension adequacy and fiscal sustainability.

The review of the IORP Directive has two main objectives. First, it aims at further facilitating cross-border activity in order to realise efficiency gains. Second, the review will introduce risk-based supervision for IORPs with a view to strengthening the safety of scheme members and beneficiaries. Risk-based supervision will also enable employers to use a wider range of risk-mitigating techniques to encourage an efficient use of capital. Clearly, firms need to maximise their financial resources for productive investment to compete successfully in global markets.

Risk-based supervision will also be beneficial for IORPs in their capacity as major institutional investors with a long-term investment horizon. Risk-based supervision is likely to encourage the internalisation of environmental, social and governance (ESG) factors in the investment policy of IORPs. This would strengthen their potential to contribute to socially-responsible investment and the efficient financing of infrastructure projects.

What can be done to facilitate cross-border activity?

Cross-border activity is hampered by legal, regulatory and administrative uncertainty. Several changes to the IORP Directive are likely to improve the situation. For example, the definition of cross-border activity itself has been interpreted in three different ways by

Member States. This gives rise to situations where supervisory authorities cannot agree on whether or not an activity is cross-border, leading to considerable delays in the authorisation process, or double regulation. Employers are, therefore, often discouraged from the get-go from sponsoring an IORP located in another Member State.

The current IORP Directive also contains rules for cross-border activity: recovery plans need to be shorter and host Member States (countries where the sponsoring employer is located) are permitted to impose, under certain conditions, additional investment rules and additional information disclosure requirements. The review will determine whether these additional rules for cross-border activity—which can hardly be said to be in conformity with an internal market approach—are still necessary.

A further complication for sponsoring employers and their IORPs is that prudential regulation is determined by the home Member State (country where the IORP is located) in accordance with the national transposition of the IORP Directive, while the social and labour law applicable to the pension scheme remains the competence of the host Member State (country where the sponsoring employer is located). There is not only an unclear line between prudential regulation and social and labour law: that line differs from one Member State to another. The review of the IORP Directive will seek to clarify the scope of prudential regulation in relation to social and labour law.

Finally, the current IORP Directive excludes certain types of occupational pension schemes operating on a funded basis. This leads to regulatory gaps and is inconsistent with the conclusions of the G20 Pittsburgh Summit, which emphasised that all financial institutions should be regulated and that there is a greater need for common and equivalent rules.

But why change the solvency rules?

The solvency rules applicable to defined benefit (DB) schemes are not risk sensitive. They do not take account of the various security mechanisms that are at the disposal of IORPs to mitigate risk or adjust the level of their liabilities in going concern. The review of the IORP Directive will seek to better reflect benefit cuts, conditional indexation, contingent assets and liabilities, reinsurance and collateral in a pension protection scheme. To the extent that the IORP itself offers protection against risk—in particular market risk, longevity risk, or inflation risk—the own fund requirements differ from those applicable to similar financial institutions. There is no valid reason why IORPs offering DB schemes would remain subject to Solvency I when life assurance undertakings will be able to benefit from a modern risk-based solvency regime as from 2014 (Solvency II). This leads

to an unlevel regulatory playing field between IORPs and life assurance undertakings.

Where the risk is taken by the sponsoring employer (not by the IORP), there should be a simple illustration of the assets of the IORP (e.g. adding sponsor covenants) and the liabilities of the sponsor to ensure comparability with the IORPs that carry own-funds to meet capital requirements.

Moreover, rules on governance, information disclosure and investment policy need to be more elaborate. This is particularly true for defined-contribution (DC) schemes where the risks are shifted from the provider to individual households. While not terribly prevalent at the time of the IORP Directive's adoption in 2003, a recent European Federation for Retirement Provision (EFRP) survey has illustrated that today nearly 60 million Europeans rely on DC schemes for an adequate retirement income.

Where do we go from here?

The legislative proposal to review the IORP Directive is scheduled for the end of 2012. As part of its preparatory work, the Commission sent a Call for Advice to the European Insurance and Occupational Pensions Authority (EIOPA) on 7 April 2011.[4] Despite the technical complexity and political sensitivity of some of the issues, it is already possible to see the light at the end of the tunnel. The four work streams which EIOPA has organised for developing its draft advice have clearly addressed the questions raised by the Commission, and it appears that considerable progress has already been made in clarifying some of these questions and demystifying the debate. After EIOPA has completed its consultation on the draft response[5], it will finalise its advice and deliver it to the Commission. A first impact assessment will then be carried out by EIOPA. The Commission will hold a public hearing on 1 March 2012 in order to put EIOPA's advice to stakeholders and to canvass their views. The Commission will then decide on the way forward, conducting a more detailed impact assessment once more clarity is found on the parameters to be used for the development of the solvency regime.

It is important to stress that the Commission does not want a one-size-fits-all approach for IORPs. On the contrary, in working towards a risk-based solvency regime, the Commission will seek to distinguish between form and substance, concentrating on reflecting the substance of the pension promise in the solvency rules. By providing an adequate solvency regime for occupational pension funds and by further facilitating cross-border operations, the Commission hopes to contribute to a further development of the occupational pension sector, thereby providing another element of choice, which is essential in the context of the broader pension debate.

4. Available at http://ec.europa.eu/internal_market/pensions/commission-docs_en.htm
5. https://eiopa.europa.eu/consultations/consultation-papers/index.html

➔ The European Insurance and Occupational Pensions Authority's contribution to supervisory convergence in the European pensions industry

Gabriel Bernardino

Chairman, European Insurance and Occupational Pensions Authority (EIOPA)

European Insurance and Occupational Pensions Authority's (EIOPA) main objective is to protect the public interest by contributing to the short-, medium- and long-term stability and effectiveness of the financial system, for the European Union's economy, citizens and businesses.

To achieve this EIOPA shall contribute to improving the functioning of the internal market, including in particular a sound, effective and consistent level of regulation and supervision; ensuring that the taking of risks related to occupational pensions activities is appropriately regulated and supervised; and enhancing consumer protection.

Furthermore, EIOPA shall foster supervisory convergence by playing an active role in building a common EU supervisory culture and consistent supervisory practices.

This role is even more relevant when we consider that the pressures on the sustainability of public social security systems reinforce the need to create sound conditions for the development of the second and third pillars of pension provision. I believe that the development of a modern principles-based framework for private pensions safety within the EU will help to promote efficiency, deepen the Single Market and better safeguard members and beneficiaries.

I believe that only by acting on the **regulatory** and **supervisory** fronts can we contribute to a safer, more transparent pensions industry with better awareness by, and information to, members and beneficiaries.

On the **regulatory** front EIOPA has worked hard on its answer to the call for advice from the European Commission on the revision of the institutions for occupational retirement provision (IORP) Directive. I would like to mention some important aspects of this advice which is currently under public consultation.

First, let me stress that, while we are only dealing with occupational pensions, it is desirable that members and beneficiaries of all types of pension schemes should be protected by high standards of governance by the institutions operating pension schemes and by appropriate regulatory and supervisory standards.

Consequently, I would like to emphasise the EIOPA recommendation that the Commission should consider the nature of member protection in pension schemes falling outside the current scope of the IORP Directive, namely the so called Pillar 1-bis and individual pension schemes, and take legislative initiative if it concludes that the protection offered by national/ EU frameworks is not adequate.

Second, I would like to highlight that in order to build a risk-based approach to pensions regulation we need to develop a comprehensive framework encompassing robust solvency requirements, strong governance structures and processes, and appropriate transparency requirements.

In this context, I would draw attention to the innovative concept of the 'holistic balance sheet' developed in our draft answer to the Commission's call for advice. The 'holistic balance sheet' should be seen as a prudential supervisory assessment tool rather than a 'usual' balance sheet based on-generally-agreed accounting standards. It includes all economic exposures to which IORPs are exposed, whether or not the elements would be on- or off-balance sheet in an accounting sense. The term 'holistic' has been added since it also takes into consideration conditional, discretionary, or contingent elements like some security and benefit adjustment mechanisms.

Additionally, the emphasis on sound risk management practices and robust internal control procedures will certainly have a positive effect on the protection of members and beneficiaries, by raising the standards used in the day-to-day management of pension schemes.

Finally, on the transparency side, it is our advice that information provided to members and beneficiaries in all phases of their participation in the pension scheme should be proportional to the choices to be made.

Information should be correct, understandable and not misleading. 'Correct' implies that the information provided should be regularly updated, in particular after substantial changes to the scheme. 'Understandable' implies that all information documents are written in a way and have a layout that has proven to be clear and understandable and hence useful for

people. ‘Not misleading’ implies that members should not receive information which gives them an unjust impression of the functioning of the pension scheme.

Importantly, we believe that information has to be improved in the case of defined contribution (DC) schemes where members bear the investment risk and are asked or have the right to make choices at individual level. In this case, EIOPA believes that the introduction of the requirement of a pre-enrollment information document similar to the key investor information document (KIID) will be useful. However, information provided needs to be relevant to pension schemes and should extend to aspects beyond investment.

On the **supervisory** front, we recognise of course that in practice pensions are diverse, both in their type and in their supervision. We also recognise that a European role in occupational pensions, as opposed to insurance, has been developed relatively recently with the IORP Directive only coming into force in 2005. The extent of convergence is therefore relatively limited so far.

Supervisory convergence is, in EIOPA’s view, a process rather than an abrupt outcome. It is not separate from EIOPA’s principal objective of protecting occupational pension scheme members; it is a key component of that objective.

One reason supervisory convergence is important is its role in improving the internal market. Both employers and employees will gain from making it easier to offer pension schemes cross-border. Developing the internal market will be easier and quicker with convergence towards common standards and processes both in respect to IORPs themselves and also in their supervision. And it is surely beyond dispute that there is potential to improve the internal market in a sector in which only 84 of 140,000 pension schemes operate across borders.

Another reason is lessons we should have learned from the crises of the last three years. While pensions have escaped relatively unscathed, there are important lessons for the sector on the relevance of convergence. First, any future crisis is unlikely to be purely national in impact. Second, the ability in a crisis for Member States to be able to coordinate their responses is vital. A broader lesson is that prevention is better than cure and developing high and transparent standards for pensions throughout Europe constitutes sensible pre-emptive action.

Our publication in April on reporting requirements to supervisory authorities illustrates the

diversity of pension supervision. Reporting requirements differ widely between Member States. These differences concern the amount of information, its content and timing.

That is why it is important not to forget that, among the 23 areas covered in the call for advice, EIOPA has been asked to provide advice on supervision. Greater harmonisation in the regulatory framework for IORPs and enhancing the process of supervisory convergence are two sides of the same coin.

Our detailed advice on supervision is a practical manifestation of our general duty to contribute to supervisory convergence. EIOPA's draft advice on supervision includes:

- Options for a set of principles on ringfencing of assets and liabilities to be applied by supervisors in situations including where schemes are operating cross-border or in times of stress.
- That the protection of members and beneficiaries should be expressly stated as the main objective of supervision and should be included in the revised IORP Directive.
- That supervisors consider the potential pro-cyclical impact of decisions. This, of course, is an area where the coordination of decisions at a European level may be particularly effective.
- A common set of principles for supervision: that supervisors should take a prospective and risk-based approach, and that there should be proportionality in implementation of these principles.
- That supervisors should be transparent in their conduct and carry out their duties in an accountable manner. The governance structures and processes of supervisors should also be transparent.
- That there should be a common format for disclosure of information by supervisors in areas such as the general criteria and methods used in the supervisory review process. This would be in the context of a new IORP Directive with of course the ability of member states to require more specific information in addition.
- That supervisors should have the power to carry out stress tests on IORPs.
- An option that supervisors have common areas of review.

Consultation on EIOPA's draft advice runs for ten weeks, until 2 January 2012. We know we can count on the European Federation for Retirement Provision (EFRP) to contribute to this process! We welcome all comments.

EIOPA wants to maximise the gains from a Europe-wide approach to insurance and occupational pensions. EIOPA's contribution to this in the area of supervisory convergence has different dimensions including reporting on developments, bringing supervisors together

and providing technical advice. The direction of travel towards supervisory convergence is clear but two things must be stressed. One is that certain aspects, particularly where harmonisation is concerned, have a political as well as technical dimension and will need to be decided in a political forum. The other is that convergence must be seen as a process rather than a destination.

I am confident that it will be possible to develop an EU pensions safety framework that will provide a high degree of security for members and beneficiaries at a reasonable cost for sponsors, fostering risk management practices and strengthening transparency to members and beneficiaries. This will, in turn, be a catalyst for more convergent and consistent supervision.

EIOPA is, and will continue to be, ready to contribute to this ambitious outcome.

The real economy and social role of the pensions industry

03 Section

"We suggest that greater attention to risk (which has to be carefully defined for members who, for the most part, are not investment experts) rather than historic returns would make sense. It is no wonder that the industry is debating at length the issues around effective member communications."

Joanne Segars
Chief Executive, National Association of Pension Funds

The fiduciary principle: Putting investors first

Thomas Bergenroth and Andrew Todd

Respectively Senior Vice President and Managing Director and Solvency II Client Communications Manager, State Street

The fiduciary principle can best be described as a legal or ethical relationship of confidence or trust between two or more parties. In a fiduciary relationship, one party, in a position of vulnerability, justifiably vests confidence and trust in another by seeking their aid, advice or protection. In such a relationship, good conscience requires the fiduciary to act at all times for the sole benefit and interest of the other party.

This fiduciary principle has been at the heart of retirement savings since the creation of the first defined benefit (DB) scheme, governed by a trustee board structure rather than the plan sponsor. However, DB schemes have been in decline for more than 40 years, and in the last 10 years DB has been all but replaced by defined contribution (DC) plans. The transfer of investment risk that has resulted, from plan sponsor to plan member, is widely recognised as an unwelcome consequence.

For DB schemes, the challenge is how to stay focused on the growth imperative amid the increased liabilities associated with ageing populations. In the race to balance risk awareness and bolster returns, DB schemes will increasingly seek to leverage the strategic, valued-added capabilities that service providers and other participants in the value chain can provide.

The absence of specific fiduciary responsibility, particularly under contract-based DC arrangements, is of equal, if not greater, concern. The challenge facing contract-based DC plans, in terms of fiduciary oversight, is a more fundamental one. While it is clear where the fiduciary responsibility of a trust-based DC scheme lies, this is not the case under contract-based arrangements.

Scrutinising governance

As attention focuses on fiduciary oversight, pension funds are likely to feel growing pressure from both savers and regulators. Pension savers, in both DB and DC vehicles, have good reason to scrutinise their plan's governance, which affects the overall cost, performance and transparency of decision-making. In particular, a plan's design, investment strategies

and risk-based controls should be intrinsically linked to its governance structure and the fiduciary requirements that guide it. Policy-makers are also examining plans' governance as concerns grow over the adequacy of retirement savings to meet future needs.

The UK Government's structuring of the National Employment Savings Trust (NEST) as a trust-based scheme is a significant milestone. Intended to assist employers in meeting impending legal duties to automatically enroll workers into a workplace pension vehicle, it is scheduled for introduction in 2012. NEST will serve up to six million workers in the UK, many of whom have no current occupational pension provision.

NEST is likely to blaze a trail for DC best practice as it matures over the next 10 years. NEST has placed an emphasis on the development of a 'default fund' that aims to avoid exposing members to too much volatility in the early years of making contributions. It is estimated that 90 per cent of contributions will be invested in the absence of any specific investment selection made by the contributing member. The success of NEST will depend largely on public perception of the default fund as a robust and trustworthy investment vehicle.

Strengthening the DC model

Additional measures are required, both to strengthen the current DC model in general and, specifically, to implement a robust form of fiduciary oversight for contract-based schemes. This oversight is necessary given the likely reliance on default funds within both contract and trust-based DC structures, and is also closely aligned with the continuing need to improve participants' access to information to optimise their investment planning and investment choices, and to deepen fiduciaries' understanding of fund operations. Indeed, it could be argued that an optimal structure would be to combine the fiduciary responsibility of a DB scheme's trustee board structure with the fund choice and web-based information delivery capabilities of a contract-based DC model, such as a group personal pension (GPP), all underpinned with a robust and member-specific default fund based on a target retirement date approach.

Serving participants

A fundamental question still remains: how can a pension plan's governance structure best serve the interests of its participants? Given the complexity of issues facing pension funds today, the range of options their fiduciaries must consider, and the decisions they must take, it makes sense to review the qualifications necessary for assuming fiduciary responsibilities. Only a few jurisdictions specify qualifications for trustees. Australia, for example, considers whether potential trustees have the capabilities—knowledge, understanding and technical

skills—sufficient to support essential decision-making. Similarly, it is prudent to revisit the roles and duties that both fund fiduciaries and staff are expected to discharge.

This brings the question back to how well a scheme educates participants about its investment options. The financial crisis underscored the importance of making timely, reliable and useful information easily available to participants. Indeed, improving 'pension literacy' has become a high-priority objective for many schemes. This need also extends to pension providers, meaning that the need for independent advice from independent and qualified experts is also growing.

Risk management

As observed above, both DB and DC schemes face the challenging task of pursuing growth—or offering growth-positive options—to meet participants' retirement planning while ensuring that robust risk awareness and investor protection controls are in place. Given the crisis of confidence that afflicted many pension savers, transparency is essential from the process and criteria for choosing a fund manager to the fund's levels of exposure.

A key driver of risk is the increasing complexity of investment strategies across all asset classes and instruments as funds attempt to navigate short-term pressures caused by volatile stock markets and the long-term structural impact of an ageing population. This evolution is already evident in the growth of fixed-income derivatives that underpin liability driven investment (LDI) strategies within DB schemes. The innovation has resulted in an environment that calls for sophisticated risk analytics and robust risk systems at all levels of a fund's structure, external managers included.

New deliverables

What are the implications of this expanding focus on governance for pension funds? Market demand is creating a new set of target deliverables for every participant in the chain, with asset managers, custodians, administrators and consultants all having a role to play in equipping people to understand and fulfill their respective fiduciary responsibilities.

Pension funds are increasingly looking to third parties to help them address expanded reporting requirements. Custodians and fund administrators, in particular, bring deep experience and wide-ranging capabilities that can assist pension schemes as they strive to meet evolving governance standards. Their cross-functional resources enable them to

do this in several ways, including state-of-the-art reporting and performance tools that keep ahead of evolving investment strategies, as well as offering transparency and risk mitigation support, and fiduciary and compliance expertise.

Innovative portals, data platforms and dynamic, interactive information technology can provide an on-demand, detailed and integrated look at performance and risk data. The increased complexity of investment strategies designed to meet challenging growth targets will only heighten the value of these reporting tools.

Fund managers and fiduciaries are likely to see a larger portion of their attention consumed by governance and compliance demands in general. To better serve the interests of members, they will be called on to broaden their understanding of investment issues, options and processes, along with associated risks. With their best-practices perspective, deep resources and expertise, independent providers can ease the burden, allowing pension funds to concentrate on their core growth objectives and control costs.

Leading global service providers such as State Street are playing an expanding role in helping support pension funds achieve a critical balance between risk and reward on behalf of their participants. As pension funds increasingly seek to leverage external providers' technological resources, scale, multi-market presence and investment experience, they can better position themselves to face the challenges ahead

➔ What is the right balance between risk and returns for pension funds?

Joanne Segars

Chief Executive, National Association of Pension Funds

Introduction

In the case of pension funds whose liabilities stretch many years into the future, there is a need to assess the balance of risk and return on an ongoing basis. With increasing numbers of funds tracking risk against liabilities rather than an index benchmark, the industry is moving towards a different assessment of risk exposure and risk appetite, which brings with it its own challenges. This approach can also be adapted for defined contribution (DC) pensions, although the right tools are still under development. At the same time, given the weak economic outlook, greater attention is being paid to sponsor risk.

Pension funds and investment management

The investment management process for pension funds can be summarised in four key stages: investment objectives; investment policy; manager selection; and measurement and evaluation.

The first step, development of the fund's investment objectives, involves trustees setting the long-term objectives of the pension fund. The process takes into account the pension fund's liabilities and current funding position, longevity risk, time horizon, liquidity requirements, strength of the sponsor covenant and other considerations. Starting from this assessment, the investment objectives determine the long-term required rate of return and risk tolerance of the pension fund.

The second step involves the pension fund trustees setting out the fund's investment policy in the Statement of Investment Principles (SIP). The SIP sets out how the fund will be governed, the roles and responsibilities of the trustees and how the fund's assets will be managed. The SIP will also set out the strategic asset allocation of the fund—this is the optimal combination of exposures to asset classes that are expected to achieve the fund's unique risk and return objectives as defined in the investment objectives.

For UK pension funds, the third step, manager selection, usually involves delegating the day-to-day management of the funds' assets to external investment managers. Managers will be selected based upon their investment process and style, past performance and the

extent to which these complement the pension funds' investment objectives (and thus the balance between risk and returns).

Finally, the measurement and evaluation process involves monitoring the progress of investments to ensure that the pension funds' risk and return objectives are being met.

Pension funds and risk management

Pension funds are exposed to a great deal of investment risk, including market risk, credit risk, liquidity risk, operational risk and liability risk. It is therefore important that pension fund trustees and their investment managers are aware of the inherent risks and monitor and manage their portfolios accordingly.

Investment performance is typically measured on a risk-adjusted basis, with risk measurement done through the use of an ex post or ex ante risk measure. These risk measures typically use a benchmark against which to measure the variability and volatility of the portfolio's returns.

UK pension fund investment trends

When looking at pension fund investment trends in the UK, one notices a significant rebalancing of portfolios in recent years, with many funds moving away from UK equities. As pension funds have disinvested from UK equities, they have increased their asset allocation to international equities, but also to other areas, including fixed interest assets such as corporate bonds and index-linked gilts. However, the decrease in investment in UK equities is not equally matched by this increase in fixed interest, indicating that pension funds have turned to alternative sources of return. There has also been an increasing interest in 'bond-like' alternatives to government bonds.

For a great many years, the majority of pension fund assets were held in either bonds or equities. However, even between 2005 and 2010 this allocation shifted. In the NAPF's 2005 Annual Survey, the combined pension fund allocation to equities (UK and global) and fixed interest assets was 92 per cent. In the 2010 Annual Survey this figure had decreased to 81 per cent, meaning that a total of 9 per cent of pension fund assets has been allocated to alternative sources of return. Alternative asset classes, such as hedge funds (increasing from 0.5 per cent in 2005 to 2.7 per cent in 2010) and infrastructure (up slightly from 0.4 per cent in 2005 to 0.8 per cent in 2010), have seen increases in pension fund allocation during this time.

In the drive to de-risk and diversify their portfolios, defined benefit (DB) pension funds appear to have turned their attention to alternative assets. These include, for example, commodities, private equity, property, hedge funds and infrastructure. Each asset type or approach has defined risk-return characteristics. For example, commodities are considered to be high risk with volatile returns, but have high liquidity and low costs; private equity (venture capital) has very high potential returns, but with low liquidity and very high risk. Future new investment or asset allocation changes will be based upon an analysis of those risk-return characteristics.

Key considerations

It is important that pensions investment risk measurement and management be seen in the context of the wider pensions landscape, as there have been a number of important economic and regulatory challenges for pension funds in recent years.

Despite a focus on risk management and a trend towards modifying asset allocation to de-risk pension funds, there remains a mismatch between pension fund assets and liabilities. This is thought to be a significant contributor to funding deficits and, in their publication *Pension Fund Indicators 2011*, UBS Global Asset Management claim that this is more likely a failure of risk management than of asset allocation. They state that approaches to investment policy can sometimes ignore the risk and return characteristics of the liabilities they are trying to match, and that the use of peer group benchmarks (as opposed to individual liability benchmarks) is an imperfect measure. UBS also suggests funds should measure risk by assessing the volatility of the 'funding ratio'—the value of assets divided by the value of liabilities.

By adopting a risk management method which focuses on assets, liabilities, and the correlation between the two, schemes are likely to develop investment solutions that are specific to their own unique characteristics and investment needs.

Defined Contribution pensions

In our analysis above we have focused on the final salary pension fund which still represents the major part of pension fund assets in Europe. However, for many reasons these schemes are now closing and are being replaced with DC plans in which investment risk is transferred to the scheme member rather than being carried by the sponsor. All of the evidence suggests that members, due to a lack of expertise, use the default fund on offer with little regard for their own circumstances. While that may well be appropriate for the average member, it certainly will not suit all. There are significant issues for employers who wish to

help their employees save for retirement in deciding what should be the default fund and how to encourage members to consider their own circumstances when selecting a fund or funds. We suggest that greater attention to risk (which has to be carefully defined for members who, for the most part, are not investment experts) rather than historic returns would make sense. It is no wonder that the industry is debating at length the issues around effective member communications.

Conclusion

So what is the right balance between risk and return for pension funds? The answer is simply that there is no 'one size fits all' approach to risk and return profiling, and the right balance will depend on individual funds' unique characteristics.

→ Responsible investment for a more sustainable economy

Paul Abberley

Chief Executive, Aviva Investors London and Global Investment Solutions

Aviva's ambition is to provide prosperity and peace of mind to all of our customers. When one of our customers entrusts us with their money, they do so with the understanding that we will take and grow it for the next 20, 30, 40, 50 or 60 years in order to provide them with an income during their retirement. This is something we take very seriously.

However, we know that our customers want more than just a retirement income; they want to know that the company to which they are entrusting their savings is sustainable. They also want to know that the investments we are making on their behalf are equally as sustainable. They want to know that we are acting responsibly with their money to protect their future and ours, together, as a global community.

At Aviva, we believe that there is only one way to deliver prosperity and peace of mind to our customers: responsibly, sustainably and with integrity. We believe that positive and sustainable commercial outcomes only come from a properly communicated understanding of our commitments to our people, our customers, our environment and the communities in which we work. We believe a well-managed, responsible business will perform better and create more sustainable value over the long term.

As Aviva and via our asset management company Aviva Investors, we have striven to achieve responsible investment. We were the first financial services company in the world to put its corporate responsibility report to a separate shareholder vote at our Annual General Meeting (AGM) in 2010. Globally, we are in the top 10 per cent of sustainable companies according to the Dow Jones Sustainability Index. Aviva Investors has played a leading role in driving the asset management industry to act in a more sustainable fashion, and since 2001 it has been our approach to vote against the report and accounts of a company if it does not disclose what we consider to be material corporate responsibility performance information.

The United Nations (UN) 1992 Earth Summit in Rio did much to set all stakeholders on the right path towards responsible investment, and we acknowledge there has been significant progress by both companies and investors towards achieving this objective. It is abundantly

clear, however, that more needs to be done.

Markets are driven by information. If the information they receive is short term and feeble then these characteristics will define our markets. If companies do not provide an assessment of the broader environmental, social and governance (ESG) risks and opportunities to which their business models are exposed, how can the market assess the sustainability of these companies?

With the 20th anniversary of the Rio+20 Earth Summit on sustainable development in June 2012, we believe the time has come to invite Heads of State and Government to take further action. The world needs to move from the pioneering approach of a minority of companies to a truly global, mainstream practice.

A Convention on corporate sustainability reporting

In September of this year, Aviva convened a Corporate Sustainability Reporting Coalition (CSRC) at the "United Nations Private Sector Forum on Sustainable Energy for All" event, calling on United Nations member states to commit to developing a policy framework on corporate sustainability reporting. The CSRC is a coalition of more than 40 like-minded organisations, including institutional investors, managing approximately US $2 trillion. This coalition is calling on nations to adopt at the 2012 Earth Summit a binding international commitment to develop national regulations which mandate the integration of material sustainability issues within companies' Annual Report & Accounts. Furthermore, these national regulations should provide effective mechanisms for investors to hold companies accountable for the quality of their disclosures, including, for instance, through an advisory vote at the AGM. Importantly, this initiative is a market-based mechanism that promotes enhanced self regulation within the market.

We believe that the production of a report and accounts that integrate sustainability throughout will help create the right kind of discussions within boardrooms and throughout firms, and encourage investors to think about sustainability. We believe this will help capital to be allocated to more sustainable, responsible companies and strengthen the long-term sustainability of the financial system.

It is our belief this measure offers an opportunity not only to improve the long-term profitability of corporations, but also to improve returns to their investors. It should improve the quality of markets on which they are listed, increase macro-financial stability and make a material contribution to the lives of those impacted—as we all are—by corporate activity.

Sustainable stock exchanges

This call to action is a direct evolution of a broader collaborative engagement initiative driven by Aviva Investors in partnership with other investors, the UN Global Compact, UN Principles for Responsible Investment (UNPRI) and the UN Conference on Trade and Development (UNCTAD).

The Sustainable Stock Exchanges (SSE) initiative began in 2008 and has been urging all stock market listing authorities to make it a listing requirement that companies consider the responsibility and sustainability of their business models. Subsequently, the SSE requests companies put a forward-looking sustainability strategy to the vote at their AGM.

The Johannesburg Stock Exchange has been leading on integrating sustainability into listing rules for many years; progress has been made by other notable stock exchanges such as those in Singapore and Malaysia. Elsewhere however, there has yet to be a serious commitment to sustainability by, for example, integrating it into the guidance that they issue to companies or including the commitments in their listing rules. Aviva Investors' research has found that a majority (57 per cent) of exchanges do not provide sustainability reporting guidance for listing companies.

Based on feedback that we have received, it is our belief that stock markets require support from governments and regulators before they will take the steps that we are proposing. That is why we believe this is a relevant issue for the global forum of the Earth Summit 2012.

Global framework on corporate sustainability reporting

At Aviva and Aviva Investors, we believe that an international policy framework should adhere to four key principles:

1. **Transparency** - companies should be required to integrate material sustainability issues within their report and accounts—or to explain to the market why they cannot.
2. **Accountability** - the corporate sustainability report or the explanation should be put to an investor vote. This should encourage investors to read the information, form an opinion and provide feedback to the company.
3. **Responsibility** - board duties should explicitly include setting the company's values and standards, ensuring that its obligations to its shareholders and other stakeholders are understood and met.
4. **Incentives** - companies should state in remuneration reports whether the remuneration committee considers ESG factors which are of material relevance to the sustainability

and long-term interests of the company when setting remuneration of executive directors, thereby aligning remuneration with the interests of shareholders and other key stakeholders, including customers and employees.

Role of pension fund trustees

We do not claim that corporate sustainability reporting alone is the solution to achieving more sustainable capital markets. We believe that all actors must be involved in ensuring sustainability.

In the UK, fiduciary duties are often misinterpreted as a straitjacket which prevents investors from taking a long-term sustainability approach. In today's complex capital markets many pension funds rely on asset managers and professional investment advisors, so these principles must permeate the entirety of the value chain.

We believe that fiduciaries must recognise that integrating ESG issues into investment and ownership processes is a part of responsible investment and is necessary to managing risk and evaluating opportunities for long-term investment.

We at Aviva and Aviva Investors urge as many pension funds as possible to consider joining our coalition and look forward to working together for a sustainable future.

Further information about the call to action can be found here - http://www.aviva.com/corporate-responsibility/programme-updates/13023/

To discuss our work in this area or to join the CSRC please email public.policy@aviva.com.

→ Socially responsible investing: A guiding principle for the 21st century

Philippe Desfossés

Chief Executive Officer, Établissement de Retraite Additionnelle de la Fonction Publique (ERAFP)

For too long, Western economies have been indulging themselves in cheap credit and over-consumption. As Herbert Stein once said, "If something cannot go on forever, it will stop". In its 78th report (2007) the Bank for International Settlements (BIS) made a clear statement: "The unsustainable has run its course." Here we are.

The question is how we reached this point of near collapse when so many clear signals should have warned us. It appears that the West chose to grow through mass consumption. The counterpart, as well as the means to finance this profligacy, has been credit. One could just read what was written on 4 October 1929, when the *New York Times* quoted Secretary of the Treasury M. Snowden who believed investors "acted as if the price of securities would infinitely advance".

After World War II, reconstruction, the baby boom and a strong optimism combined to raise standards of living and to finance a generous welfare state. This model began to weaken in the 1970s at the time of the first oil shock. The whole building is now falling apart. It is obvious that some social security systems resemble gigantic Ponzi schemes; there should be a strong adjustment to bring them back to a sustainable path.

Deleveraging will be painful and will last several years. In that respect, socially responsible investment will be a guiding principle for the 21st century.

Let us consider the three themes encompassed by socially responsible investment (SRI): society, governance and environment.

For the past 20 years, there has been a massive concentration of revenue and wealth that has made it increasingly difficult for the middle class to live without recourse to credit. Businesses, under pressure to deliver an ever-increasing return to their shareholders, had no choice but to limit direct salaries (trying sometimes to defuse anger from their employees by granting them under-priced social benefits[1]). Those same households leveraged their

1. In the US, many companies and even more so many public employers compensated low increasing salaries by granting social rights (retirement benefits as well as health coverage) that were not financed or that created "hidden liabilities" (cf. http://www.bloomberg.com/news/2010-09-15/-death-spiral-awaits-state-worker-pensions-as-illinois-leads-underfunding.html)

balance sheets through cash credit and by borrowing more and more against their homes. Now that a large deleveraging is underway, a more balanced distribution of revenues is necessary to allow cash-strapped households to resume consuming. Considering what has happened in emerging markets, no sustainable development is achievable without allowing the local population to get a just return on their efforts. In that respect, the level of investment in countries like China, beyond the question of efficiency, raises the issue of the equal distribution of the benefits of growth. For investors, it also means that in a fully connected world it will become harder and harder to ignore how large western businesses can benefit from the low salaries, lack of collective bargaining and poor social benefits that plague many of their suppliers.

Considering governance, we cannot but acknowledge that misalignment of interests and short-termism have gone hand in hand. In large companies, management has behaved as if they own the business. Generous incentive packages that rewarded success without punishing failure created a culture of unaccountability. Why pay attention to the future when there is no claw-back mechanism on stock options? How governments run their State has also suffered from increased short-termism. Until the sovereign debt crisis blew up, investors relied on the ratings of the rating agencies. It is easy to accuse them of all sins though, as they rightly say, they were just providing opinions. Every investor should still have exerted his own judgement, perhaps even listening to those same agencies' many warning shots to sovereigns.

Stopping environmental destruction is obviously one of the most pressing challenges humankind has to address. In 1804, the world's population reached 1 billion. This is the amount by which it has increased in the last 12 years. We are reaching the point where it is more than urgent to ensure that our prices take into account the cost of the damage our activities inflict on non-renewable assets: water, farmland, biodiversity. As long as we maintain prices that ignore negative externalities, all economic agents continue behaving 'rationally' to achieve an irrational objective.

To summarise, addressing the challenges of tomorrow in the three areas that will reshape the economy of the 21st century means overcoming our short-termism and adopting the principle of sustainability. It is where big long-term investors have such a large responsibility. To adopt this new approach means being able to reassess many of the ways in which we used to work.

First, one cannot be a responsible investor if one is not responsible in the way one calculates

the price of benefits or promises sold to clients or beneficiaries. Obviously an annuity will be much more attractive (i.e. cheaper) if optimistic assumptions on the expected returns of the assets that backed it can be used. But the crisis reminds us that discounting future revenues with overoptimistic expected returns generates explicit and implicit debts that will be long and hard to wind down. Is it responsible of a retirement benefit scheme to distribute benefits whose generosity is made possible only through the sacrifice of the young or of future contributors? When a pension fund discounts its liabilities with a rate that is treble the rate of growth of added value, has it any choice but to invest in assets delivering high returns but also proportional risk? This widespread under-pricing of social benefits encouraged putting more pressure on the businesses so they reach double digit returns on equity (ROE). The risk that a financial intermediary accepts to bear is always borne on the liabilities side of its balance sheet. Regulators should pay more attention to this issue.

Second, for big long-term investors, assuming that they can (and should) no longer rely on expected returns that a sustainable economy cannot deliver, the question becomes: can responsible investment remain the icing on the cake—a marginal share of their investment—or should it become an integral part of the investment process? This can be discussed, but long-term investors are increasingly considering that an SRI approach (fine-tuned to their specific situations) should be applied to the full spectrum of their investments. In that respect, a 'Best in Class' approach seems most suited although it may present less appeal than an approach based on exclusion or a thematic approach.

Exclusion is simple to understand and makes it possible 'to make a statement'. But if it fits the needs of small communities sharing strong beliefs, it is difficult for large pension funds managing tens of billions of euros for millions of people to determine what should be excluded (beyond the obvious exclusions resulting from the law or international treaties). For a public pension scheme like the *Retraite Additionnelle de la Fonction Publique* (RAFP), could we imagine the members of the Board having to decide whether the companies that develop medical research using stem cells should be banned from our investment universe? Everyone may have their own opinion, but as long as it is legal, a public pension fund cannot a priori exclude companies that are doing business in this area.

Thematic investment is easy to identify and is attractive as it is a way to address issues that public opinion can easily understand and that contribute to solving problems (wind farms, waste management). But pension funds and other large investors are simply too big to invest solely in thematic investments. Besides, funnelling too much money towards quick fixes will only lead to new bubbles.

A Best in Class approach starts with the acknowledgment that the world of tomorrow will largely be the world of today. We may not like it, but there is no magic wand that will make it possible to avoid using steel, cement or oil in the near future. Accepting that all economic sectors will remain necessary to the sustainable growth we want to promote, our challenge becomes determining how in each of these sectors we will rank the issuers in order to weed out from our investment universe those who are not serious about addressing societal, environmental and good governance challenges and conversely to select those that have understood that being proactive will give them a competitive advantage.

Third, long-term investors should behave like long-term investors. What is the use of managing liabilities in a responsible (i.e. prudential) way, of implementing a Best in Class approach to investment, if our governance is still unable to detach itself from quarterly returns? For too long, market cap benchmarks have led investors to prefer following the herd rather than exerting their judgement. One must recognise that regulators' failure to understand the peculiarities of long-term investors have set up rules that increase procyclicality. Long-term investors, especially those that still enjoy net positive cash flows, should take advantage of their ability to exercise the option they have against the market. The price of liquidity having been underestimated, we have seen lately that many investors could be forced to sell at punitive prices. It is precisely during times of disruption that investors able to stay invested for a long period (buy and hold investors) can profit from good entry points and also contribute to stabilising the market. Once again we come back to the concept of sustainability. Being a responsible investor also means occasionally acting like a contrarian. When asset prices become overvalued (i.e. they exit the upper band of the sustainable valuation path), long-term responsible investors, by starting to sell, can send a signal that the risk of a bubble is increasing. Conversely, when the markets lose confidence and valuations become so low that only an apocalyptic scenario could justify it, long-term responsible investors can and should step in.

Up until now, we have said nothing about individuals. Does this mean they are not interested in responsible investment? Obviously not. But individuals tend to be short-termist, and the financial products that they have been sold lately exacerbate this trend. For households, responsible investment is attractive when it materialises in thematic products and exclusion. Best in Class is quite difficult to understand and it lacks the appeal of the others as it is a pragmatic answer to a very complex issue. People like the idea that their investment makes an immediate difference. Buying shares in a fund that invests in wind farms is perfect: we can see exactly what we invest in, and it is always rewarding to get the feeling that we are doing good.

Before the crisis, SRI attracted, at best, a polite interest. The last three years should have opened our eyes. We are on a collision course. Developed countries leveraged to the hilt realise they can no longer discount growth rates that were made possible by the long period of reconstruction after World War II, cheap energy and ever-available credit. Emerging countries have no intention of giving up their hope of reaching the same standard of living. There is no doubt that promoting sustainable investment—an investment that addresses the three great issues—is essential. SRI will be a guiding principle for the 21st century. The earlier politicians acknowledge that long-term investors will be the main engine giving traction to this move, the better. It is time for them to design rules and regulation that value the long term.

➔ Long-term investment returns: For all of our tomorrows

Dörte Höppner

Secretary General, European Private Equity & Venture Capital Association

The number of retired people in Europe compared to those financing their pensions is forecast to double by 2060. This demographic transition means many of Europe's pension plans will find it increasingly difficult to meet their long-term liabilities. One crucial part of meeting these structural challenges is the ability for pension fund managers to deploy capital into long-term growth asset classes.

However, if the EU's principles towards regulation for investing institutions is carried out to the bitter end, it could make it more expensive for pension funds and other investing institutions to invest in long-term, patient asset classes to protect investors and mitigate systemic risk. In fact, such moves would jeopardise pensioners' incomes and the very stability of the financial system.

The problem occurs because, in the light of the financial market volatility and illiquidity crises of recent years, governing classes have become preoccupied with the short-term tradeability of investments rather than just the actual capital at risk. The method is borrowed from the risk-based approach to proposed rules governing insurance companies, called Solvency II. Under this regime, a short dated BBB-rated bond would require less capital than a longer term AAA-rated bond. This bias towards assets that can be instantly bought or sold, or what Keynes called 'the fetish of liquidity', provides a false comfort for pension funds, reduces long-term capital for economic projects and decreases the overall stability of the financial system. Long-term investments are better suited to the nature of pension fund's long-term liabilities, while the cost of 'instant access' is often not worth paying.

Any migration of such a scheme to pension funds would create a perverse incentive to attempt to meet long-term liabilities with short-term investments. In a low interest rate environment this will compound the challenge of pension fund managers to invest in assets that will enable them to meet their liabilities under fixed return and defined benefit schemes.

A partial retreat of institutional investors from long-term or 'illiquid' markets would also be felt by the economy at large; there would be a structural shortage of investment capital for

long-term or illiquid projects. All of this at a time when sovereign states are struggling to provide capital for these activities.

Private equity funds, which operate over at least a decade, have for many years been trusted by many of Europe's largest stewards of current and future pensioners' incomes as a source of stable, strong, risk adjusted returns. This explains why, in the period from 2006 - 2010, pension funds accounted for over 36 per cent of all funds raised by the European private equity industry.

Allocations from US pension funds to private equity have been historically higher than from European pension funds, but the latter have been catching up quickly in recent years, spurred by initiatives such as the 1999 Myners Report in the UK. Meanwhile the Nordic countries, the Netherlands and other European regions have also built public pension fund exposure to private equity.

In delivering strong returns to pension funds, private equity also delivers growth in the real economy. It is this long-term growth, sustained by long-term, patient capital, that provides a foundation for job creation, investment and tax revenues. Over the past four years, European pension funds have invested €53bn in European companies via private equity. 83 per cent of private equity backed companies are small- and medium-sized enterprises (SMEs)—the backbone of the European economy.

Systemic risks

A system that prejudices patient capital in favor of instant tradability could also increase systemic risk. The stabilising role of long-term investors in global financial markets would be undermined. Pension funds covered by the IORP Directive manage assets of €2,500bn. To comply with a regime comparable with the risk-based Solvency II, pension funds would be required to hold extra assets worth €1,000bn. The Bank for International Settlements (BIS) envisages a sale for equity instruments given their new capital weight (39 per cent for global equities/49 per cent for other equities such as private equity). This could trigger a reduction of about 5 per cent of total assets invested in European shares. This translates into a €750bn loss to European stock markets.

Additional solvency rules would also raise the cost of retirement provision. This could lead to fewer defined benefit (DB) schemes being offered by employers or the closure of such schemes to new entrants. DB schemes, while guaranteeing a secure income for millions of Europe's pensioners, are also an important source of capital for long-term asset classes

such as private equity and infrastructure which, in turn, generate income for pensioners. This virtuous circle of wealth creation could rapidly disintegrate in times where sources of credit remain scarce and companies' cash flows have not yet recovered from the financial crisis.

While such a prejudice against assets that do not provide 'instant access' makes no sense for pension funds, it also goes against many of the European Commission's stated ambitions for financing SMEs and venture capital. The European Commission is committed to making "an efficient European venture capital market a reality". This ambition will be challenged further if pension funds can not access private equity.

Pension funds under the IORP Directive cover 25 per cent of the EU's working population. Reducing these pension funds' ability, through long-term investment, to match their current and future liabilities is a significant disconnect with EU ambitions to ensure adequate incomes in retirement. The European Commission is committed "not to penalise the system".

A more certain future for Europe's savers and pensioners is certainly warranted. Severing the virtuous relationship between long-term growth asset classes such as private equity and infrastructure and their ability to help meet the long-term liabilities of pension funds is not the way to start.

Final thoughts

→ The expansion of occupational pensions in Europe: A socially desirable objective

Patrick Burke

Director, Irish Life Investment Managers and Chairman of the Board of Directors, European Federation for Retirement Provision (EFRP)

Predicting the long-term future of pensions in Europe is a difficult task at any time, but at this moment, December 2011, with the path of the European project itself uncertain, I am sure of only one thing: that forecasting the future with precision is an impossible task.

Personally I am a strong believer in the underlying objectives of the European project and expect that, through this crisis, inevitable systemic flaws which were accepted due to political necessity will be addressed. This is based on the assessment that a strong and united Europe is of critical importance to the optimal future development of all Member States.

While believing that too much political and economic capital has been invested in the European project to allow it to fail, I do recognise that blind faith does not always reward the believer. The cost to retrieve the project will be difficult to bear and, for those less culpable, difficult to accept in the absence of accountability for the mistakes of the past and strong centralised governance going forward.

Accordingly, though the size of and the relationships within the EU and the Eurozone may change, I expect the weaknesses which have now been exposed can be addressed so that the economic and social ideals of the European project can progress further.

From this perspective, I offer the proposition that the expansion of occupational pensions across Europe will secure its place as a common policy objective of the EU. I say this because I believe that strong occupational pensions are, in themselves, a social ideal which resonates strongly within Member States and at the heart of the EU. As such, each element of their development—coverage, adequacy and security; fiscal policy, funding approaches and benefit design; and the governance, investment policies and structure of second pillar pensions—will be informed by the socially desirable objectives outlined below.

Coverage, adequacy and security

Assuming one accepts that each of the above are socially desirable objectives, the question for Europe and for every Member State is to what extent these objectives fall between the individual and the State to resolve.

Focusing on the development of second pillar pension coverage, I am strongly of the view that Government policy across Europe (with notable exceptions where second pillar coverage is already very high) will proceed in the direction of auto-enrollment strategies in order to supplement first pillar pensions.

The sustainability of first pillar pensions is under review throughout Europe and reforming measures are widespread, leading to lower State pensions for an increasingly aged population. Consequently, the relevance and necessity of auto-enrollment systems has increased, and I am happy to predict that second pillar coverage ratios will improve over the next 20 years as a result.

However, I am not as confident that the average adequacy of second pillar pensions will improve over the same period. In many jurisdictions, though the adequacy of first and second pillar pensions was significantly enhanced over the last 20 years, this was done on a basis which largely ignored increased longevity and which favoured the political advantages of increasing pension promises in the short term without due regard to long-term sustainability.

Nonetheless, I believe that the policy efforts of the EU and its Member States will focus on ensuring that the combination of first and second pillar pensions will deliver the socially desirable objective of providing all workers with an adequate standard of living in retirement, with first pillar pensions focusing on the social imperative of protecting citizens from absolute poverty in old age.

It is probable that expansion of coverage in the second pillar will, in some parts of the system, be accompanied by a drop in average adequacy levels. I argue that the adequacy objective which dominated second pillar pensions for the past 20 years has been the social ideal of targeting replacement income which would maintain post-retirement living standards by reference to pre-retirement income.

This socially desirable ideal may be diluted for high earners in the future by a lower socially desirable objective of delivering an adequate standard of living across a broader population, leaving the gap for higher earners to be funded (or ignored) by the individual. On the bright

side, increases in coverage will essentially mean improved adequacy for many on lower incomes, offsetting some of the negative impact on the better-off of reduced pension adequacy.

There is an economic reality to this: socially desirable ideals are more expensive than socially desirable objectives and, against the backdrop of the current macro-economic outlook for Europe, it is difficult to see grounds for believing that the more expensive policy option will be pursued.

The question of security is obviously very difficult to forecast given the focus of the current review of the institutions for occupational retirement provision (IORP) Directive. As such, I will speak of a preferred approach rather than a predicted outcome. My preferred approach requires a common policy on pension security across Europe with a strong, shared supervisory regime. This common approach should reinforce Member State responsibility and accountability while ensuring sufficient flexibility to recognise the extant security provisions within each jurisdiction.

The diversity of systems is so great that one harmonised regime of technical standards and security rules cannot work effectively without actually bringing about a reduction in the quality of occupational pensions across the EU. However, there ought to be a common base to ensure that political weakness at Member State level does not undermine the core policy objective.

To my mind this must be based on the socially desirable objective of ensuring security. Not for all benefits, perhaps, but at least for those aligned to the objective of providing all workers with an adequate standard of living in retirement.

The negative impacts of excessive security measures on sustainability, coverage and adequacy can be mitigated if policy recognises that the security objective is not to provide absolute protection but to provide strong security for a socially desirable level of benefit. The collective and not for profit nature of occupational pensions allows policy to be holistic in this regard.

It is preferable that the future security of occupational pensions be governed on a common basis from within the EU (with recognition of the distinct and exceptional features required on a Member State level under the principle of subsidiarity), with a focus on protection for an adequate level of retirement income.

Fiscal policy, funding approaches and benefit design

The socially desirable objective of occupational pensions supports the thesis that Member State and EU policy will continue to use fiscal measures to incentivise the deferral of consumption in order to provide for adequate retirement provision.

However, one can expect that the fiscal constraints a low-growth environment and periods of austerity are likely to impose in many Member States will put pressure on the availability of fiscal incentives. It is likely that these will contract for those seeking to amass substantial wealth in retirement and will be spread more evenly across the population, particularly as coverage objectives increase.

Accordingly, I predict that fiscal policy will, in unconstrained jurisdictions, impose appropriate caps on the benefits and contributions which arise within the pensions system. The challenge for those engaged in delivering adequate occupational pensions is to ensure that these constraints do not undermine the attractiveness of pre-funding for pensions in retirement for the general population. Encouraging workers to defer consumption in favour of pension saving remains a priority.

By and large, the pre-funding of occupational pensions has been and will continue to be preferred. Member States' and EU policy will encourage pre-funding as the sustainability of pay-as-you-go (PAYG) systems is further called into question. The alternative to pre-funding implies a potential transfer of the sustainability risk from the individual and their collective pensions institutions to the State, a transfer for which there is insufficient political appetite.

To ensure that this risk is not overlooked, EU policymakers must ensure that Governments resist the temptation to use existing funded pension arrangements for current expenditure. Some Member States have already resorted to the transfer of assets and liabilities from pre-funded arrangements to the Treasury in order to fund current budget deficits and capital requirements.

The correct EU policy in this regard should be to disregard such transfers for budgetary and deficit accounting purposes and to give credit for assets which have been accumulated on a pre-funding basis. I believe this will be the case, as the socially desirable objective of pre-funding is to improve the sustainability of the system across the board and to enhance the confidence which employees have in the pensions system generally.

In the last 20 years, benefit design in the second pillar has shifted dramatically away from pure defined benefit (DB). The primary motivation has been to transfer investment and longevity risk from employers to individuals. To form an opinion as to the likely continuation of this trend, one should reach back to the socially desirable objectives of occupational pensions.

Here, adequacy and sustainability return to the fore. If one accepts the proposition that benefits will be determined at a level which is socially desirable (e.g. providing all workers with an adequate standard of living in retirement), it seems likely to me that we will see greater flexibility in the DB promise upon which employees can rely.

This suggests that DB arrangements will be adapted to protect a minimum level of benefit while providing additional benefits above that level on a basis where the associated risk is, at least partly, transferred to the individual.

While I do not foresee a significant shift in private sector appetite for defined contribution (DC) arrangements, I do believe that greater flexibility in the level of promised benefits in traditional DB arrangements will occur. As a consequence, the rate of transfer from pure DB arrangements to pure DC arrangements will reduce over the next 20 years.

The governance, investment policies and structure of second pillar pensions

Concluding the theme of the social desirability of occupational pensions, I wish to highlight the significant advantages of occupational pensions provided through institutions which include member representation and where benefit design, investment policies and risk-sharing are considered without regard to commercial objectives.

Collective arrangements—negotiated and managed by social partners (employers, trade unions and members)—are far and away the most efficient and effective arrangements for maximising the social objective of pensions. Costs are maintained at their most efficient levels, risks are managed in the primary interests of employees and adverse experiences can be smoothed and shared without compromising the system's integrity.

Investment policies for occupational pensions will continue to evolve with respect to the principles of social desirability which run through this essay. Institutional investors will be required by their members and by supervisors to pay more attention to the environment, ethics and sustainability associated with investment ideas pursued, and the strength of corporate governance in the companies and projects to which their capital is deployed. These considerations are critical to the test of social desirability and to my mind they will increase in prominence over the years ahead.

Liability-driven investing will continue to grow in prominence and growth asset investing will evolve to reduce volatility by the expansion of absolute return and alternative investing. However, the availability of capital for investment in the real economy is something which I believe has been under-appreciated in the formulation of current policy initiatives such as the European Commission's Call for Advice to the European Insurance and Occupational Pensions Authority (EIOPA) for the purposes of the IORP Directive review.

I expect that a thorough Impact Assessment will remind policymakers of the economic importance of occupational pensions as long-term investors and of the relevance of this factor in driving European economic growth.

In summary, it can be expected that the increase in coverage predicted above will, to satisfy socially desirable objectives, be delivered primarily through collective occupational pension institutions with a governance framework which reflects all stakeholders' interests. These frameworks must continue to evolve and to retain the professionalism, expertise and experience currently in place in the management of occupational pension arrangements. This continued evolution is essential to avoid imbalances between the skills and experience required.

Conclusion

The demographic and economic outlook for Europe is such that the direction and development of occupational pensions should be considered by reference to realistic and socially desirable objectives.

From this perspective, occupational pension coverage will increase, largely as a consequence of Government policies (including auto-enrollment), while the average level of benefits is likely to decline due to sustainability issues (with a simultaneous improvement in the average level of benefits across lower income bands). Security

policies and frameworks will improve, with greater commonality across the EU, increased central regulation and supervision and increased Member State responsibility and accountability for measurement and control. Security ambitions should target socially desirable levels of protection rather than seeking to provide absolute guarantees for all levels of benefits.

It is not unreasonable to expect that fiscal constraints will result in more concentrated incentivisation rather than absolute incentives for all benefit and contribution levels. One hopes that the socially desirable level of benefit dictates strong incentivisation not just for a minimal level of pension ambition but to ensure continued economic growth as the European population ages.

All evidence points to an expansion of collective occupational pensions and an expansion of the current mix of DB and DC arrangements towards more “hybrid” arrangements which reflect the merits of collective risk sharing. Pensions today are only less sustainable than those of previous generations if they fail to evolve and adapt to changing economic and demographic realities.

As the voice of pensions in Europe for over 30 years, the European Federation for Retirement Provision (EFRP) will continue to promote the development of occupational pensions by reference to a broader vision and ambition—a vision which sees coverage, adequacy and security unconstrained at the heart of occupational pensions.

Using the collective expertise and experience of our members, we will ensure that today’s pensions systems evolve and adapt to cope with changing realities. In doing so, we will help further the development of the occupational pensions so vital to the 75 million EU citizens who depend upon them.

It is my honour to lead the EFRP at this time and I thank those who have gone before me, our member associations, the supporters and staff of the Federation—in particular our departing Secretary General, Chris Verhaegen, who has committed her very soul to the development of the EFRP. I thank each and every one of you for the enormous effort that has been devoted over the last 30 years to our shared objectives.

European Federation
for Retirement Provision

➔ Authors
Short biographies

Paul Abberley is Chief Executive, Aviva Investors London and Global Investment Solutions, having joined Aviva Investors in 2008 and worked in the asset management industry since 1981. In his dual role Paul is responsible for all Aviva Investors' high alpha business in the UK and for the delivery of investment solutions to clients worldwide.

Thomas Bergenroth has been with State Street Corporation for more than 20 years, holding multiple positions in the United States and Europe. Most recently, he is in charge of managing the Global Relationship Management Program for the bank and their large global institutional client base, which includes leading asset managers, insurance companies and pension funds.

Gabriel Bernardino was selected Chair of the European Insurance and Occupational Pensions Authority (EIOPA) in January 2011. Prior to this appointment, Mr Bernardino served as Chair of the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) from 2009 to 2010. During the Portuguese Presidency of the European Union in the second semester of 2007, he chaired the Council Working Group responsible for the European Commission's proposal on Solvency II.

Patrick Burke is Chairman of the European Federation for Retirement Provision, past Chair of the Irish Association of Pension Funds and has previously served as Chairman of the Irish Trustee Forum. As a Director of Irish Life Investment Managers, Patrick is responsible for the strategic development of investment solutions to the institutional pensions market. Patrick is a solicitor by profession, an Associate of the Irish Taxation Institute and an Associate of the Irish Institute of Pension Managers.

Agnieszka Chło -Domi czak is an Assistant Professor at Warsaw School of Economics and Educational Research Institute in Warsaw. She has previously served as Deputy Minister of Labour and Social Policy responsible for developments of pension systems, member of the core team in the Office of the Plenipotentiary for Social Security Reform in Poland, and consultant to the World Bank, the International Labour Organisation and the Organisation of Economic Cooperation and Development.

Dr Luis Correia da Silva leads the Corporate Finance and Regulation teams at Oxera and applies his economic expertise to finance, competition, regulation and policy issues across a wide range of industries. Luis has directed strategically important projects on regulatory design across a large number of sectors, including telecoms, postal, transport, energy and financial services.

Philippe Desfossés was appointed Chief Executive Officer of ERAFP, the French Public Service Additional Pension Scheme, on 11 June 2008. With more than €11 billion invested in accordance with a wholly socially responsible investment approach, ERAFP is Europe's leading SRI institutional investor. ERAFP is also one of the largest public pension funds in the world in terms of members with nearly 4.6 million beneficiaries, 40,000 employers and close to €1.7 billion in contributions each year.

Heribert Karch has been the Managing Director for over 10 years of MetallRente, which has evolved into Germany's major industry-wide occupational pension scheme by membership. Since May 2011, Heribert Karch is also Chairman of the Board of Directors of the German Association for Occupational Pensions (aba).

Dörte Höppner has been Secretary General of the European Private Equity and Venture Capital Association (EVCA) since 2011. She represents the industry at the very highest levels of business and government and is a regular commentator in the international media on all aspects of the private equity industry.

Jung Lichtenberger is an economist in the Insurance and Pensions Unit of the European Commission's Directorate-General Internal Market and Services. Jung deals with European pension fund issues, with a particular focus on the review of the Directive on Institutions for Occupational Retirement Provision (IORP Directive).

Igal Mayer is a main Board Member and Chief Executive Officer, Europe of Aviva, the world's sixth largest insurer with nearly 45million customers worldwide. It is also one of the biggest insurers in Europe, where Aviva operates in around a dozen Member States, most notably Poland, France, Spain, Italy, the UK and Ireland. Igal joined the Aviva Group in May 1989. Prior to taking up his current European role, Igal has been Chief Executive of Aviva North America, Chief Executive of Aviva UK General Insurance and Chief Executive Officer, Chief Financial Officer and Executive Vice-President of Aviva Canada.

Anne-Sophie Parent is Secretary General of AGE Platform Europe, an EU network which brings together 165 member organisations directly representing 30 million people aged 50+ across the EU-27. She has led AGE Platform since 2002. AGE aims to voice and promote the interests of the 150 million inhabitants aged 50+ in the European Union.

Koos Richelle, as Director-General for the European Commission's Directorate General for Employment, Social Affairs and Inclusion, is responsible for employment and social policy, the protection of occupational health and safety, and the free movement of workers within the EU. He manages the budgets that support these activities, particularly the European Social Fund and the European Globalisation Fund.

Gerard Riemen is Managing Director of the Federation of Dutch pension funds, which links the umbrella organisations for industry-wide (VB), occupational (UvB) and company (OPF) pension funds. Approximately 85 per cent of the total number of Dutch employees is a member or beneficiary of a pension fund associated with the Federation of Dutch pension funds.

Joanne Segars has been the CEO of the National Association of Pension Funds (NAPF) since 2006; she is also a Board member of the European Federation for Retirement Provision (EFRP). Prior to this she worked at the Association of British Insurers and the Trades Union Congress. In the 2003 Queen's Birthday Honours, Joanne was awarded an Order of the British Empire for services to the pensions industry.

Philip Shier is a senior actuary with Aon Hewitt in Dublin. He is a member of the Pensions Committee of the Groupe Consultatif Actuariel Européen and is a member of the European Insurance and Occupation Pensions Authority's (EIOPA) Occupational Pensions Stakeholder Group, representing users of pension services.

Andrew Todd is a Vice President at State Street Bank & Trust Company. Andy is responsible for the development of investment administration strategy, with particular focus on long-term savings, at State Street. Andy works with both central and local government organisations, in addition to UK and multi-national corporates as they seek to design, develop and implement pensions and other long-term savings vehicles for their employees and members. Most recently Andy has collaborated with NEST overseeing the design, testing and implementation of the administration solution for

NEST's default fund. Andy is a graduate of Napier University in Edinburgh and Member of the Chartered Institute of Bankers in Scotland.

Ieke van den Burg is a former Member of the European Parliament and served two terms (1999-2009). She currently serves on the supervisory boards of both ASML and APG, the Dutch Corporate Governance Monitoring Commission for listed companies, and the European Systemic Risk Board's Advisory Scientific Committee. In addition, she chairs the board of Finance Watch AISBL.

Karel Van Hulle is Head of Insurance and Pensions at the European Commission. He is in charge of the Solvency II project as well as the revision of the IORP Directive. He is a member of the Technical Committee of the IAIS and represents the Commission within EIOPA. He is a lawyer by training, joined the Commission in 1984 and has occupied several positions in the areas of company law, accounting and auditing.

Chris Verhaegen has been Secretary General of the European Federation for Retirement Provision since 1997. A lawyer by training, she began her career as a journalist and subsequently worked as a policy adviser to the Flemish employers association and the Flemish Government before joining the Belgian Association of Pension Institutions in 1988. In May 2011, she was elected Chair of the Occupational Pensions Stakeholders Group of the European Insurance and Occupational Pensions Authority (EIOPA).

European Private Equity and Venture Capital Association (EVCA)
EVCA is the voice of European private equity and venture capital. It promotes the interests of more than 1,200 members—from early-stage venture capital to the largest buyouts—to ensure they can conduct their business effectively. EVCA engages policymakers and promotes the industry among key stakeholders, including institutional investors, entrepreneurs and employee representatives. In addition to its outreach and promotional efforts, EVCA develops professional standards, research reports and holds professional training and networking events.

Fleishman-Hillard
Fleishman-Hillard Brussels is one of the top European public affairs and communications agencies and is part of the Fleishman-Hillard global network. Its staff of 65 multinational and multilingual consultants, who have had first-hand experience in European Union institutions, national governments, business and journalism, work closely with our clients to fully understand their objectives, the forces driving them, and their issues. Our programmes reflect this investment, while at the same time striving to deliver tangible, measurable results.

Aviva
Aviva is the world's sixth-largest insurance group and one of the leading providers of life and pension products in Europe, where it operates in around a dozen Member States, most notably Poland, France, Spain, Italy, the UK and Ireland. It employs over 35,000 people, who serve around 45 million customers in 28 countries around the world. With over 300 years of heritage, Aviva combines established life insurance, general insurance, health insurance and asset management businesses under a single global brand, focused on helping provide customers with prosperity and peace of mind.

→ list of EFRP chairmen

	Title	Name	Nationality	Start date	End date
1	Mr.	Maurice Oldfield	UK	1981	1983
2	Mr.	Govert van Tets	NL	1983	1985
3	Mr.	Jos Verlinden	BE	1985	1988
4	Mr.	John Jolliffe	UK	1988	1991
5	Mr.	Philip Lambert	NL	1991	1994
6	Mr.	Alan Broxson	IE	1994	1997
7	Mr.	Kees van Rees	NL	1997	2001
8	Mr.	Alan Pickering	UK	2001	2004
9	Mr.	Jaap Maassen	NL	2004	2007
10	Mr.	Angel Martinez Aldama	ES	2007	2010
11	Mr.	Partick Burke	IE	2010	ongoing

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EFRP
Koningsstraat 97 rue Royale
B-1000 Brussels
efrp@efrp.eu - www.efrp.eu