

Opening remarks by Jörgen Holmquist

Public Hearing "Harmonisation of solvency rules applicable to Institutions for Occupational Retirement Provision (IORPs) covered by article 17 of the IORP Directive and IORPs operating on a cross-border basis"

Brussels, 27 May 2009

Check against delivery

Good morning Ladies and Gentlemen,

First of all welcome to Brussels. It is a pleasure to see you at our Public Hearing. We have a wide attendance here today from all across Europe. This clearly shows that there is a keen interest in the Single Market for occupational pensions.

In our Communication to the Spring European Council last March, we underlined that Europe's successful economic recovery will depend on our ability to make the most of both internal and global markets. The Single Market can act as one of the key drivers for recovery from the current global economic and financial crisis because it offers economies of scale and efficiency gains.

The financial turmoil we are experiencing is of a magnitude we have not experienced so far. A key lesson we all have drawn from the financial crisis is that we must look once again with a fresh eye at how financial markets and institutions operate and are regulated.

We must make sure to strengthen the fundamentals of the European prudential and regulatory framework, so that we prevent such violent crises to come back in the future.

Within this general setting, we focus today on occupational pension funds.

The main purpose of the Public Hearing is to follow-up on the consultation that we conducted last year. Today is indeed an important day to provide an answer, with the help of all of you, to the question: "what do we need to do - provided that we need to do something - to make sure that we have appropriate EU solvency rules for IORPs?"

And furthermore: Would that require further harmonization of current solvency rules?

I will outline how I see the tasks we have in front of us today focusing on two topics:

- First, I will say a few words on pensions in general.
- Second, I will outline the main features of the present EU solvency rules for IORPs.

1. Pensions in general

Let us first look at pensions in general.

Pension funds fulfil an important socio-economic role in that they help meeting the challenges of an ageing population.

Europe needs to ensure that current and future pensioners receive sufficient financial resources to sustain an adequate living standard.

Pension funds are also important institutional investors in the economy. Their investment behaviour therefore affects financial stability.

Although pensions are primarily the responsibility of Member States, occupational pension funds operate within a broader EU regulatory framework. The IORP Directive aims in particular at promoting cross-border activity of occupational pension funds within the internal market.

In view of the future cost stemming from a rapidly ageing population in Member States, long-term sustainability of public finances requires a strengthening of the link between contributions and benefits.

It also requires an increase of public and private funding. The latter is particularly important, as the current financial crisis has major implications for public finances.

The fiscal deterioration is in fact particularly evident for most advanced countries. There the increase in both government debt and contingent liabilities is unprecedented in scale and pervasiveness.

The loss in value for financial assets world-wide has been very significant in the last months, amounting to about the equivalent

of one year of world GDP. The decline reflects the reduced capitalization of stock markets, the loss in the value of bonds supported by mortgages and other assets, and the depreciation of many currencies.

The ongoing financial crisis has also heavily hit private pension systems. In the last year, private pension funds in the OECD area have suffered losses of nearly 20% of their assets.

In countries with a large number of pre-funded pension schemes the recovery of pension funds will be essential to protect the current and future income of pensioners. In response to the crisis, national supervisors have so far taken various actions.

They have used the possibilities provided in the EU framework and in national regulations to make it easier for pension funds to establish realistic recovery plans. These aim at returning to acceptable funding levels over time. Pension funds have also taken action by, for instance, increasing contributions from employers and/or reducing indexation.

Even before the 2008 crisis, there had been warnings about the need to reform private pensions. The OECD, for instance, have been very active on this topic and called on many occasions for various types of pension reforms including stronger pension fund governance rules and the design of new "lifestyle" rules for defined contribution systems.

We are all well aware that the crisis has forcefully demonstrated that financial markets can only function efficiently when there is trust and confidence. Fostering such an environment, in turn, requires solid prudential rules with well-designed solvency rules for financial institutions such as banks and insurers.

Given that occupational pensions involve complex explicit and implicit contracts over long periods of time this is particularly true also for IORPs. So let me now turn to the main features of the present EU solvency rules for IORPs.

2. Main features of the present EU solvency rules for IORPs

The IORP Directive is a very complex Directive because it needs to cater for a large degree of diversity in the way in which occupational pensions are delivered in the EU. The involvement of sponsoring undertakings differs considerably and in some Member States the insurance industry is instrumental in providing occupational pensions.

The aim of the IORP Directive is to facilitate cross-border activity and this requires a minimum set of common EU rules regarding prudential regulation, particularly in the area of solvency. On the technical provisions and funding side, the Directive requires prudent calculations computed and certified by an actuary on the basis of actuarial methods recognised by the authorities of the home Member State.

Furthermore, when an IORP covers biometric risks and/or guarantees a certain performance, the Directive requires a "capital" buffer above technical provisions to be computed on

the basis of the Solvency I rules, in the same way as in the case of a life-insurance business.

The recently adopted Solvency II Directive has not modified this situation, so that after its implementation, pension funds and life-insurers would, if nothing changes in the regulatory framework in the meanwhile, have to apply different solvency rules.

Article 17 of the IORP Directive allows Member States to go beyond the prevailing Solvency I rules by laying down more detailed rules provided that they are prudentially justified. They are thereby creating a non negligible divergence across Member States.

Switching now to the asset/investment side of IORPs prudential requirements, we must admit that the present rules are not very detailed and that they do not go beyond the introduction of a number of principles, such as that of the "prudent person", which allows for a wide variety of implementing practices across Member States. Therefore, it can be concluded that there are at

the moment no "hard" solvency rules at the EU level for defined contribution schemes.

In other words we are by no means close to a "homogeneous" set of solvency rules for IORPs in the EU.

But is there a need to change the present system? And if we need to take action, is harmonization the right thing to do? For what specific subset of rules: technical provisions? Capital buffers? Investment rules? Governance? Disclosure?

The main objective for the Commission at today's public hearing is to hear your views and understand why you believe that we should or we should not act. The Commission is therefore in a genuine "listening mode" today.

We have in fact not taken a decision yet on whether we will do something, how we might proceed and what reforms might be needed. But it is important that you tell us today what you see as the right course of action.

3. Conclusion

Let me conclude by saying that today's event has been organised at a critical time for occupational pension fund policy. In the De Larosière Report, IORPs are not at the centre of the recommendations. The Report makes it however clear that pension funds play an important role for financial stability. The existence of an appropriate prudential treatment for pension funds is therefore of great importance.

Today's agenda identifies all key challenges that the IORP Directive will have to face in the years ahead.

You have the floor now! It is very much your opportunity and responsibility to make today's public hearing a success and contribute to the objective of "getting the IORP prudential framework right".

With these words I leave you in the good hands of Elemér who has kindly made himself available to chair the entire day.