BUSINESSEUROPE

POSITION PAPER

28 November 2008

Public consultation on the harmonisation of solvency rules applicable to institutions for occupational retirement provision

Executive summary

BUSINESSEUROPE welcomes the opportunity to comment on the Commission's consultation. European employers emphasise that any changes to the solvency regime for Institutions for Occupational Retirement Provision (IORPs) need to be based on a sound business case and take into account the need to maintain high quality pension provision in the context of demographic change and an ageing population. Unlike many insurance schemes, IORPs are typically provided in association with an employer, and this engagement of employers with pension saving for employees is highly socially desirable. No changes should be made at an EU level which weaken this commitment.

BUSINESSEUROPE has decided to take a broad approach in responding to the Commission consultation. The reason being that the question of whether any further changes to the EU minimum solvency standards are necessary has a much broader focus than the questions in the consultation.

Having reviewed the available evidence, European business is not in favour of additional solvency requirements for pension funds. This is likely to raise funding standards for employers operating such schemes, despite such an increase in short-term funding being unnecessary to fund scheme members' benefits. This will impact negatively on the capital that business has available to invest in the business and on employees as fewer firms will be able to afford to maintain IORPs.

The main argument for further changes in EU solvency rules for IORPs appears to be the perceived need to establish a level playing field between IORPs and insurance schemes offering retirement benefits. BUSINESSEUROPE does not agree that action is necessary in this regard. Provision of an IORP is a choice made by an employer as part of their benefit plan, and the desired level of involvement that is required. It can in some cases be more costly for employers than an insurance scheme. Furthermore, most IORPs have a legal covenant with one employer or a group of employers and therefore operate in a very different way to insurance companies.

In conclusion, BUSINESSEUROPE believes the IORP directive has already set out the best and most workable solution for a minimum solvency standard framework. It is still new, however, and more time is needed for it to realise its full potential. The only action that should be taken in the short-term is the writing in of Solvency I standards for those schemes which currently apply those standards under the terms of IORP. This action is necessary due to the upcoming replacement of Solvency I.

THE CONFEDERATION OF EUROPEAN BUSINESS a.i.s.b.l.

AV. DE CORTENBERGH 168
BE-1000 BRUSSELS
BELGIUM
VAT BE 863 418 279

TEL +32(0)2 237 65 11
FAX +32(0)2 231 14 45
E-MAIL: MAIN@BUSINESSEUROPE.EU
WWW.BUSINESSEUROPE.EU

BUSINESSEUROPE

INTRODUCTION

The European Commission published a consultation on 9 September 2008. It aims to assess whether the specific characteristics of Institutions for occupational retirement provision (IORPs or pension funds) merit application of more stringent solvency rules. The main question of the consultation is whether stakeholders think that the harmonisation of solvency regimes for IORPs covered by Article 17 of the IORP Directive and IORPs operating on a cross-border basis is desirable or not and why.

The Commission has highlighted that the decisions in respect of solvency requirements for pension funds should be driven by a very strong business case and that the potential cost for employers – and therefore their willingness to continue to provide IORPs – is a key question.

GENERAL REMARKS

BUSINESSEUROPE welcomes the opportunity to comment on the Commission's consultation on solvency rules for IORPs under article 17 and IORPs operating on a cross-border basis. European employers share the view that possible changes need to be based on a solid business case and a rigorous analysis of costs and benefits in line with better regulation.

In the context of demographic change and an increasingly ageing population, ensuring the sustainability of the pension system is paramount. At a time when many member states are reviewing first pillar state pensions, second pillar supplementary pensions are becoming increasingly important in providing income security in retirement. This role is only likely to increase in the future.[1] It is therefore very important that occupational pensions are able to provide benefit security at a reasonable cost.

The title of the consultation has a rather narrow scope, limited to IORPs covered by article 17 of the IORP directive. The consultation in fact only affects a small proportion of the IORPs that are regulated by the IORP directive. This is, however, contradicted by a much broader focus in the questions and despite wishing to avoid 'preconceived ideas', already refers to harmonisation and suggests that solvency rules for IORPs are as relevant and necessary as those for insurance undertakings. BUSINESSEUROPE is therefore taking a broad approach to the question of solvency rules for pension funds by way of a more general position paper.

BUSINESSEUROPE is not in favour of additional European solvency requirements for pension funds, as this would potentially unnecessarily increase short-term costs for employers operating such schemes and no doubt also have potential negative effects on employees as current and future beneficiaries of such schemes. While there is no doubt that employers will have to fund their schemes to the appropriate level in the longer-term, higher solvency standards which require money now will have several harmful effects.

[1] EC MEMO/08/625, "Social Protection and Social Inclusion in Europe – key facts and figures"

BUSINESSEUROPE

The only cogent argument for amending the standard set out in the current directive is based on the false perception that a level playing field needs to be created regarding competition between IORPs and insurance companies offering retirement benefits. BUSINESSEUROPE does not accept that insurance company-provided benefits compete with IORPs. Provision of an IORP is a choice made by an employer as part of their benefit plan and the desired level of involvement can be more costly for employers than an insurance scheme. IORPs are usually associated with a single sponsoring employer or group of employers and do not have the same market position as insurance companies when offering such products – they do not typically seek further "business", as their primary purpose is not to earn a return for their sponsor, but to provide their sponsor's employees with a valuable benefit. The contrast with profit-seeking insurance-provided funds is therefore very significant. BUSINESSEUROPE members believe that this difference is significant enough that action to create a level playing field is unnecessary, as well as destructive of growth and employee benefits.

Similarly, BUSINESSEUROPE refutes the suggestion that similar solvency rules are necessary for pension funds, as for insurance companies, to ensure the same level of security for beneficiaries. The legal employer covenant in the case of pension funds provides the necessary security. In some member states, a guarantee fund also exists.

Furthermore, European business recalls the wide diversity of approaches to retirement income provision in the European Union. Because of this it is essential that the importance of national rules for pensions, adapted to different national structures and systems is recognised. It is important to recall that it is the prerogative of member states to devise pension systems and rules thereof.

Bearing all of these concerns in mind, BUSINESSEUROPE members believe the IORP directive already provides a suitable legislative framework which has the potential to improve the efficiency and affordability of pensions. Furthermore, this directive is still young, with implementation in an early phase so more time is needed to see the full results. This is also the case in the context of cross-border provision of occupational pensions, where an internal market is only in its infancy. Any changes to IORP made in the near future should be designed to maintain the current standard and approach – for instance writing in Solvency I standards when Solvency I is replaced by Solvency II.

BUSINESSEUROPE also warns of the danger of this consultation hindering the implementation of solvency rules for insurance companies, under the Solvency II proposals. BUSINESSEUROPE supports these proposals as an important framework for insurance companies.

SPECIFIC REMARKS

POTENTIAL COSTS FOR EMPLOYERS

BUSINESSEUROPE is not in favour of additional solvency requirements for pension funds. Employers will certainly be committed to funding their schemes to the

appropriate level in the longer-term, however higher solvency standards which require money now will have several harmful effects:

- Fewer schemes will be offered by employers, as fewer employers will be able to afford them, damaging the stock of funded pension saving and increasing the call on state-funded benefits in retirement.
- Those firms with the capacity to maintain schemes – and those with schemes which are closed to new entrants and will finish once current entrants have entered retirement – will have less available capital and will be less able to invest in growth, damaging the Lisbon goals of growth and jobs.
- European pension funds hold total assets worth €2500 billion. If they were to comply with Solvency II requirements they would have to hold extra assets worth €1000 billion[2] and investment of funded pension assets from IORPs would move away from investment in private equities, such as company shares, to government bonds. This would lower the price of government bonds and starve firms of equity capital for future growth, which would have a negative impact on financial markets and economic development.
- Such funding is also unlikely to prove necessary. This will lead to firms tying up billions of Euros of surpluses invested in government bonds in IORP schemes for 40, 60 or even 80 years, when far better investment choices could and should be made.

Additional solvency requirements for IORPs would mean that IORPs would be obliged to considerably increase their assets. This is likely to increase the costs for employers which provide occupational pension schemes via IORPs. Many employers are committed to offering high quality workplace pensions to their employees, providing funding and guarantees for income upon retirement, over and above state pension provision. Additional European solvency requirements would unfairly penalise such companies.

Calculations in some member states, for example UK, Netherlands and Germany have estimated a rise of between 30 – 50% in the immediate cost of operating such pension schemes, were additional solvency rules to apply. While these costs would still be met – if necessary to fund benefits over the longer-term – bringing them forward would be undesirable for both companies, who would face higher contribution rates and employees who would see at least a reduction in pension benefits and more likely scheme closure.

Besides this, additional solvency funding for IORPs would leave schemes with a significant level of unused assets at the end of the life of the scheme. In some member states, (for example the UK), it is very difficult and in some cases impossible for companies to recover this so-called trapped surplus.

[2] Data from European Association of Public Sector Pension Institutions 2008 'On the issue of the application of Solvency II rules for institutions for occupational retirement provisions'

BUSINESSEUROPE

The ultimate losers in this will be employees themselves, as current or potential future beneficiaries of such types of schemes. It is clear that if IORPs were subject to additional solvency requirements, employers are likely to become unwilling to continue these, with most schemes closing to new accrual immediately. In addition, companies may change to other forms of occupational pension schemes which in the specific national context may expose the employee to less secure pension provisions. In this sense solvency rules would have the opposite effect of that desired, actually reducing security for current fund members and disadvantaging potential future beneficiaries.

LEVEL-PLAYING FIELD

The Solvency II Directive, supported by BUSINESSEUROPE, once adopted will mean that from 2012 new rules apply to life insurance companies in terms of the capital they have to hold. The same rules will not apply to IORPs, which in some cases offer similar products. The Commission's argument is that such variations in solvency requirements do not ensure a level-playing field or fair competition between insurance companies and IORPs offering similar products and that this must be remedied. BUSINESSEUROPE refutes this argument.

Life insurance undertakings and pension funds offer pension plans in very different ways. First and foremost, pension funds are schemes specifically associated with one sponsoring employer or a group of employers, i.e. an employee can only enter into a pension fund if he is the employee of the sponsoring employer. The bespoke nature of these schemes means they do not compete against insurance provider models, as pension funds do not have the same possibilities as life insurance companies to gain clients on the market. Different solvency rules can therefore apply without causing unfair competition in terms of pension provision. Pension funds, compared to insurance companies, have additional security mechanisms and longer periods for recovering deficits. Applying the Solvency II directive to pension funds would lead to high funding requirements, which would be unnecessary given the possibility pension funds have to spread their risks between different participants and generations.

In actual fact, in most cases IORPs do not operate in retail markets or are in fact non-profit organisations (e.g. in Finland). In other cases, the board of the IORP is bipartite (e.g. in the Netherlands), or has member nomination to the board by democratic processes and a legal obligation for the board members to protect members' benefits and interests (as in the U.K. and Netherlands). In some cases the IORP is supported by a collective agreement.

COMBATING RISKS AND PROVIDING SECURITY

European employers also refute the suggestions that differences in solvency rules mean that there is less member protection in IORPs and that an IORP is therefore more 'risky' in terms of pension benefit guarantees than a life insurance company.

BUSINESSEUROPE

Contrary to insurance schemes, pension funds are able to rely on the support of a sponsoring employer, in other words there is a legal covenant from the employer. Therefore the pension fund can go back to the sponsoring company if it needs to raise more money. A life insurance company has no such covenant to fall back on; it is reliant on the market to raise more money. Therefore lower funding levels can exist for pension funds than will be the case for life insurance companies under Solvency II.

In the case of insurance companies, the financial and demographic risks inherent in pension products are underwritten by the institution and shareholders. However, in the case of pension funds, the risks are shared between employers and employees, depending on the scheme. Therefore a different approach is necessary.

Besides this, pension funds have a long term life-span (often up to 40 years) and the flexibility to absorb shocks through various instruments. In fact, at times of economic downturn, additional solvency standards would increase funding expectations, thereby reversing this long-term view, as they would take a snapshot rather than a smoothed view of scheme assets, leading to unnecessarily high demands for contributions.

IMPLEMENTATION OF THE IORP DIRECTIVE

It is still too early to judge the impact of implementation of the IORP directive, whilst recognising the potential of this legislative framework. In this context, European employers do not share the concern of the Commission regarding “regulatory arbitrage”. This is when a company draws benefits from choosing a nominal place of business in a market with a slightly weaker regulatory system, whilst still operating in markets with more stringent regulatory systems, thereby avoiding additional regulatory costs. There is as yet no evidence that diversity in funding regulations across Europe has led to this, particularly since cross-border activity and an internal market in occupational pension provision is still underdeveloped. On this basis, there is no need for harmonisation regarding capital requirements for occupational pension providers; it is simply too early to call for such measures.

NATIONAL RULES FOR NATIONAL STRUCTURES

Member States have the prerogative to organise their overall national pension system, including which institutions may provide occupational pensions, and to establish the rules for second pillar occupational pensions. They are also responsible for deciding on the elaboration of solvency requirements for pension products and/or providers, which already exist in some member states. As highlighted in the CEIOPS Paper[3], existing frameworks for IORPs in member states are very diverse, but this does not necessarily imply substantially different security levels provided to pension beneficiaries. The resulting analysis is that national pension supervision frameworks do not have to be identical. In this way, it is completely acceptable that differences exist between the Member States regarding occupational pension provision.

CONCLUSION

[3] CEIOPS-OPSSC-11/08, 30 May 2008, “Key issues on solvency for the European occupational pension sector”

BUSINESSEUROPE is not in favour of additional solvency requirements for pension funds, due to the increased cost for employers, which offer such funds. This would ultimately be of detriment to employees as current and future beneficiaries of pension funds, at a time when occupational pensions will be playing an increasingly important role in providing income security in retirement.

European employers see the IORP directive as a suitable framework and urge the Commission to await further results of implementation of this directive before taking premature action.

BUSINESSEUROPE also urges the Commission to undertake an extensive analysis of market data at member state level, before commencing any future work in this field. Data of a financial and technical nature must be collated, as well as social and labour law aspects influencing occupational pension provision.