SPEAKING NOTES

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27 May 2009

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

PUBLIC HEARING BY THE EUROPEAN COMMISSION, 27 MAY 2009

PANEL II - IS THERE A LEVEL PLAYING FIELD ISSUE BETWEEN PENSION FUNDS AND INSURANCE UNDERTAKINGS?

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1. Introductory remarks

The discussion about solvency rules for Institutions for Occupational Retirement Provisions (IORPs) started before the financial crisis struck. The current financial and economic situation adds an extra dimension in the discussion today.

The sustainability of pension systems has already been under discussion for some years because of the effects of demographic changes. Many member states are reviewing their first-pillar state pensions and second-pillar supplementary pensions are becoming increasingly important in providing income security in retirement. This fact alone calls for benefit security at a reasonable cost.

In general, the financial crisis has led to more focus on the structural issues surrounding the sustainability of pension systems and whether changes need to be made. How the crisis affects pension systems will depend highly on the kind of pension system. In this respect it is important to note that it is the prerogative of member states to organise their overall national state pension system. They also establish the rules for second-pillar occupational pensions, whereas the content and benefits of plans are the domain of employers or social partners.

BUSINESSEUROPE is not in favour of additional European solvency requirements for pension funds. Additional solvency requirements would mean that pension funds have to considerably increase their assets. This would unnecessarily increase short-term costs for employers operating such schemes and/or would have negative effects on employees. We therefore welcome the provision made in the Solvency II directive to amend the IORP directive in order to introduce the existing solvency provisions for article 17 IORPs in this directive instead of applying Solvency II provisions to these IORPs.

If the Commission does consider changing the solvency rules for IORPs, proposals should be based on a solid business case and a sound analysis of costs and benefits in line with the better regulation programme.

2. Statement on key questions

Level playing field?

There is a false perception that a level playing field needs to be created regarding competition between IORPs and insurance companies offering retirement benefits. Insurance company-provided benefits do not compete with IORPs – they offer pension plans in very different ways. Moreover, they offer different products which both result in occupational retirement provision for workers.

The main differences between IORPs and insurance companies that provide for occupational pension plans are the following:

Pension funds are schemes specifically associated with one sponsoring employer or a group of employers. That means that employee person can only join a pension fund if he is an employee of the sponsoring employer. The bespoke nature of these schemes means that 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. The primary purpose of IORPs is not to earn a return on investment for their sponsor, but to provide their sponsor's employees with a valuable benefit.

Conclusion: The difference of pension funds with profit-seeking insurance companies is significant enough to mean that action to create a level playing field is unnecessary.

IORPs and insurance undertakings offer products with different characteristics. Similar solvency rules are therefore not 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.

- As compared with life insurance companies, pension funds have additional security mechanisms and far longer periods for recovering from deficits caused by fluctuations on financial markets. Pension funds can accommodate solidarity and risk-sharing within and between generations. In short, they have flexible financial adjustment mechanisms.
  Insurance companies usually offer collective pension contracts to employers with terms of 5 to 10 years. The premium and the conditions of the scheme are specified in these contracts. Because of the short period, the fixed premium and conditions they lack the financial adjustment mechanisms enjoyed by pension funds. And, as a consequence, insurance companies can take less risk in their investment policy or should hold higher own funds to compensate for a higher risk profile.

Conclusion: Applying the Solvency II directive to pension funds would lead to higher funding requirements, which would be unnecessary given the possibility pension funds have to spread their risks between different participants and generations.

The overall aim of this solvency discussion is to provide workers with sufficient security with respect to their occupational pension. By increasing the solvency requirements for pension funds, the costs for companies providing these pension schemes could increase considerably. This could result in companies deciding to change the existing retirement arrangements for cheaper and therefore less secure ones for the workers concerned.

Are IORPs and life assurance companies competing in the same market?

Although IORPs and insurance companies both provide occupational pension schemes, they do not really compete in the same market. Two reasons:

- In principle employers, can choose to have their pension scheme administered by their own company pension fund or may conclude a contract with a life insurance company. But in quite a number of situations employers (and thus their employees) are obliged to participate in a sectoral pension fund. The choice of whether or not to create a pension fund, company or sectoral, is often made in consultation with workers' representatives.

- The products provided by IORPs and insurance companies have quite different characteristics, as I have already indicated.

Should IORPs be considered as financial institutions?

According to the IORP Directive, IORPs are financial institutions. But our message is that they should be treated differently from life insurance companies and that should be the main point to be considered. IORPs operate in a completely different manner. Many IORPs have built-in 'self-corrective' mechanisms to ensure their long-term solvency.

I have already mentioned these mechanisms: possibility to adjust contribution and benefit parameters, specific governance structure with social partners involved, long-term investment horizon and the fact that IORPs do not seek to make a profit.

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