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Insight Briefing

Addressing Europe's pensions challenge

Key messages on reforms under discussion at European level

Europe faces a major challenge in ensuring adequate retirement income for its citizens. Traditional pension systems are coming under significant pressure because the percentage of the population that is retired has increased significantly over recent decades, and this trend will continue for years to come.

This comes at a time when public finances are already stretched. Reforms are, therefore, being introduced in many countries which aim to guarantee the sustainability of state managed pay-as-you-go schemes and this often translates into lower pension benefits.

The challenge is, therefore, to find ways to implement these reforms, while ensuring a certain standard of living for pensioners.

Insurance Europe believes that mutually reinforcing pension pillars will become increasingly important in responding to the pension challenge facing Europe.

Europe's insurance sector also thinks that, if properly carried out, the reforms which are currently being discussed at European level — a review of the institutions for occupational retirement provision directive (IORP II) and the creation of a standardised pan-European personal pension product (PEPP) — have the potential to contribute to the objectives of sustainability of pension systems and adequacy of pension income.

IORP II

In March 2014 the European Commission published a proposal to review the directive governing IORPs. Insurance Europe welcomes its main objectives: to facilitate the development of occupational retirement savings and to create safer and more efficient markets for occupational pensions for the benefit of employees.

Insurance Europe believes IORPs play an important role in providing retirement income to workers. Consequently, it welcomes the objectives of the directive review, because all European workers should enjoy access to quality occupational pensions, managed in a professional and transparent way, irrespective of whether the providers of these products are regulated by the IORP directive (which applies to most pension funds) or Solvency II (the framework that applies to insurance companies).

With respect to governance, Insurance Europe supports an approach which is in line with well-established rules for financial services providers.

For example, proportionate and effective risk valuation would encourage pension funds to assess their ability to engage with short and long-term risks, as well as to deliver on their pension promise.

The issue of transparency is also particularly important: all

workers should be given adequate information about the risks they bear and the nature of their pension promise.

The prudential treatment of IORPs is another important point. The fact that the directive does not seek to harmonise them results in important differences between member states being maintained and, as a result, in different levels of resilience of IORPs.

Within this context, it is important for members and beneficiaries that cross-border IORPs be fully-funded at all times. This guarantees a high level of protection for members and beneficiaries, even when a foreign IORP (subject to different prudential rules) manages their pension promise.

By contrast, removing the full-funding requirement would not only potentially harm members and beneficiaries, but would also potentially lead to regulatory arbitrage as a result of the divergent prudential rules applicable to IORPs, as well as further increase the prudential gap between insurers and pension funds.

Article 4 of the IORP directive gives member states the possibility to apply the IORP directive to insurers' occupational pensions business. This option has been made use of by a number of member states where insurers are the major providers of occupational pensions, in order to guarantee an equal treatment with IORPs.

Given that Solvency II comes into force in January 2016, transitional measures proposed by the Commission allow insurers making use of the article 4 provisions to keep competing with IORPs on a level playing field until the end of 2022. These transitional measures should be further extended until IORPs' quantitative requirements have been revised.

A Pan-European pension product

In July 2014, the Commission called for the European Insurance and Occupational Pensions Authority's (EIOPA) technical advice in view of the development of an EU single market for personal pension products, inviting EIOPA to advise on the cross-border, prudential regulation and consumer protection measures that would be required to develop an EU-wide framework for such products.

In July 2015, EIOPA launched a consultation on the creation of a standardised PEPP. In its response, Insurance Europe acknowledged the importance of examining possible ways of encouraging and supporting citizens to save for their retirement.

Consequently, it welcomed that the proposed PEPP has been clearly identified as a personal retirement savings product, with an inherent long-term nature, aiming to deliver a retirement income.

The retirement objective can only be achieved if the PEPP includes key long-term savings features, such as minimum investment periods. Should that be the case, the introduction of PEPPs will impact the allocation of funds towards long-term illiquid investments, which would be beneficial to the European economy.

Furthermore, the PEPP would need to come with the option for the consumer to ask for additional biometric risk coverage, either during the accumulation or decumulation phase (taking into account national practices).

From a consumer protection perspective, the PEPP should entail an appropriate level of security for policyholders. Specificities of pension products, particularly compared with investment products, should be taken into account appropriately.

Insurance Europe acknowledges that such an initiative faces major challenges, particularly in light of close links to areas of national competence, and stands ready to contribute to the forthcoming discussions.

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