The new European regulatory framework for private pensions

Addressing today‘s and future challenges

Mefop Conference on „EU Framework and Italian Pensions Funds: Challenges and Opportunities“

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Outline

- Current and future challenges of the private pensions sector
  - EIOPA’s occupational pensions stress test

- Insights in EIOPA’s work:
  - IORP II implementation
  - Pan-European personal pension product (PEPP)
  - Quantitative, analytical tools

Pension gap?

Mind the Gap - Quantifying the pension savings gap in Europe.

In 2016, we updated our landmark *Mind the Gap* study of Europe's pension savings gap. This latest research shows that Europe's pension savings gap remains substantial, surpassing €2 trillion a year – equivalent to 13% of Europe's GDP.

Global Pension Timebomb: Funding Gap Set to Dwarf World GDP

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- The world's six largest pension saving systems – the US, UK, Japan, Netherlands, Canada and Australia – are expected to reach a $224 trillion gap by 2050, a new study by the World Economic Forum shows

The gender pension gap is widening, report finds

Adviser finds fewer women than men can afford to save into a personal pension

'Women are likely to have less money left over at the end of the month to contribute towards savings, compared to men' © WWPhotography/Alamy

Josephine Cumbo, Pensions Correspondent 2
OCTOBER 22, 2017

The gap between the number of men and women saving into a personal pension in the UK has widened significantly in recent years, according to research.

"Further reforms are needed that are both fiscally and socially responsible. We cannot risk a resurgence of old-age poverty in the future. This risk is heightened by growing earnings inequality in many countries, which will feed through into greater inequality in retirement." OECD Secretary-General Angel Gurría

In middle-income countries, large gaps in pension coverage exist among lower-income, informal sector workers. This is compounded by demographic pressures straining the ability of pension systems to finance benefits. This is particularly true in transition economies in Eastern Europe and the former Soviet Union, where pension spending is frequently the largest government expenditure, as well as a major source of fiscal deficits, and accelerated ageing has reduced the number of younger workers supporting older workers that need pension coverage.

The World Bank is in a unique position to take intellectual leadership and collaborate with various development partners in building strong pension systems in developing countries. The Bank has been involved in pension reform in more than 90 countries and provided financial support for reform to more than 70 countries.

Need to save (more) for future retirement income

- Demographic changes, aging populations across Europe
- Challenged national budgets and state pensions
- Stressed economic environment: low yields, negative interest rates
- Unemployment – “broken careers”
- Often low available income
- Increasingly mobile workforce
- Low levels of consumer trust in pensions
- Divergent pensions landscape in Europe

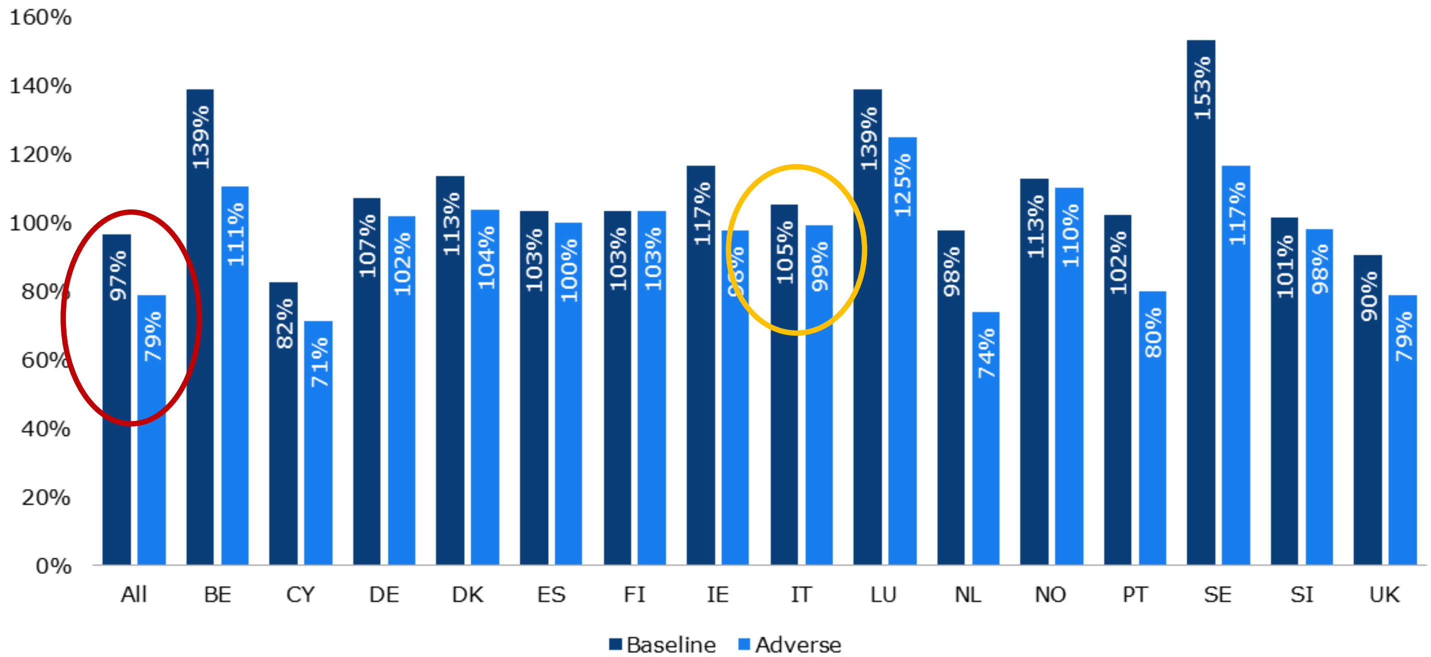
EIOPA’s occupational pensions stress test

- To **assess resilience** of IORPs to an **adverse market scenario (“double hit”)**
  - National and common balance sheet for defined benefit (DB) and hybrid pension schemes
  - Market value of investment assets for defined contribution (DC) schemes
- To **assess the potential transfer of shocks from occupational pension funds to the real economy** and **financial markets**
- **Not a pass-or-fail exercise** for participating occupational pension funds

Vulnerabilities of DB pension funds: national balance sheet

- Aggregate funding ratio at EU level declines from 97% in baseline to 79% in adverse scenario corresponding to 3%/21% shortfall of assets over liabilities (EUR 49bn/301bn)
- National funding and valuation standards are highly heterogeneous

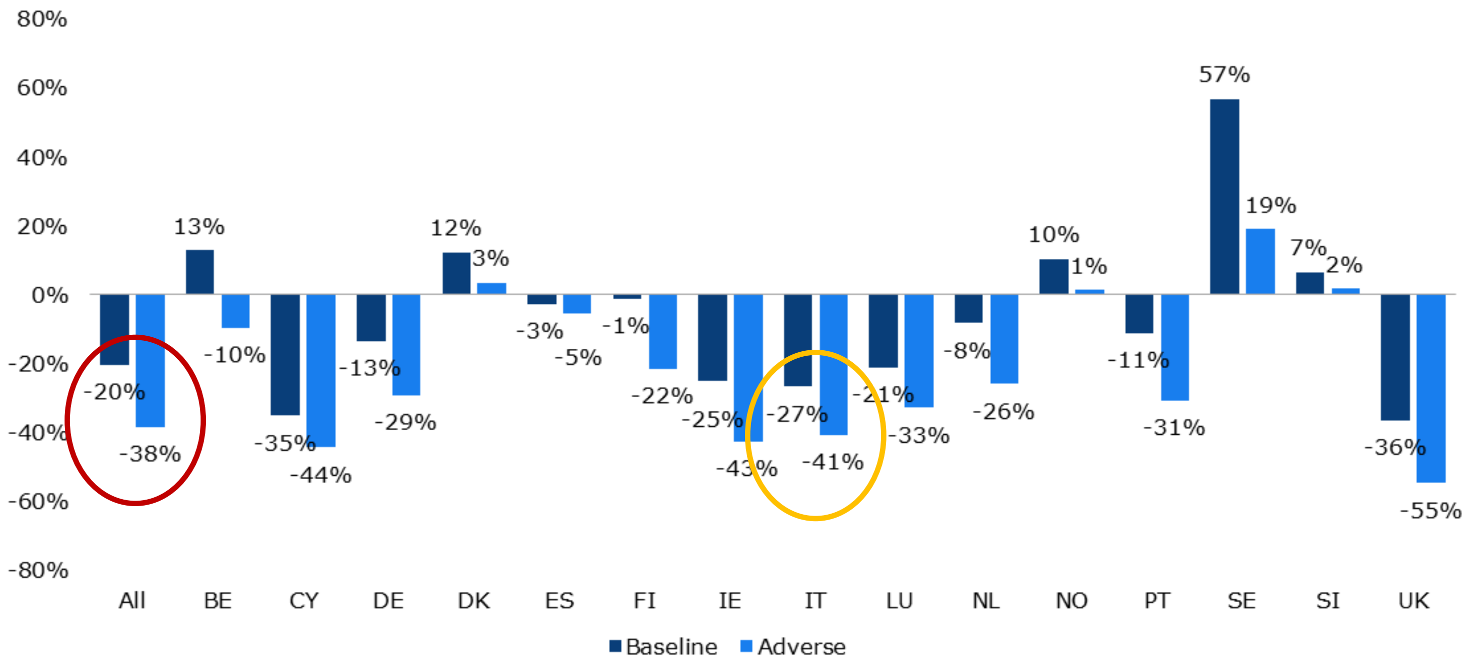
Funding ratio in baseline and adverse market scenario, % liabilities



Vulnerabilities of DB pension funds: common balance sheet

- Aggregate EU deficit of 20% of liabilities in baseline scenario (EUR 349bn), increasing to 38% in the adverse market scenario (EUR 702bn)

Excess of assets over liabilities on common, market-consistent balance sheet (excl. sponsor support, pension protection schemes and benefit reductions) in baseline and adverse market scenario, % liabilities (excl. benefit reductions)



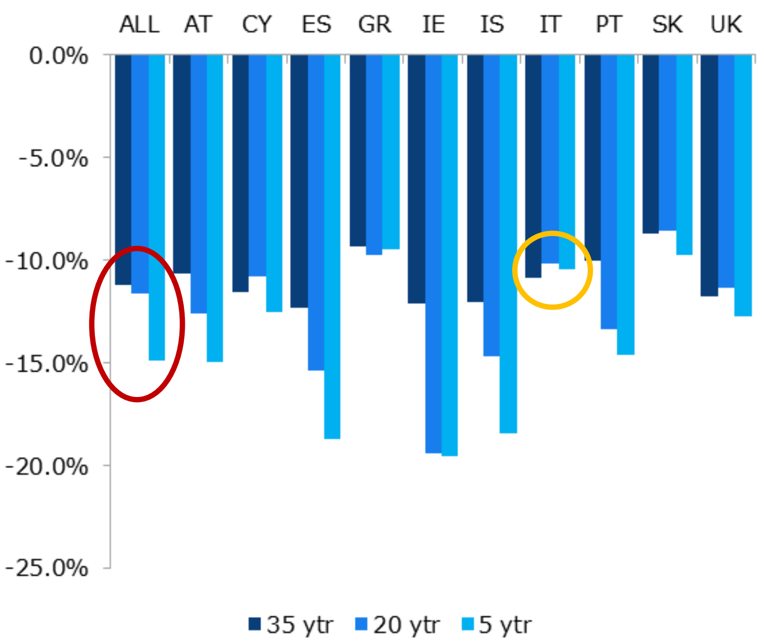
Plan members bear the risk in Defined Contribution schemes

- EIOPA stress test shows that the adverse scenario has at EU level a more severe impact on projected replacement rates of older members closer to retirement due to higher accumulated pension wealth

- More modest impact in Italy, especially for older representative members due to relatively high allocations to fixed income assets

- Design of Defined Contribution schemes needs careful consideration because all risks are borne by the plan members!

Impact of adverse market scenario on replacement rate of representative members 35, 20 and 5 years before retirement by country, members weighted average, % change compared to baseline



Replacement rate is defined as pension income (based on inflation-linked annuity) divided by final salary of the representative plan members at retirement.

The EU pensions landscape is and will be changing

- Pressure on Defined Benefit pension promises
  - Significant underfunding
  - Big corporate failures in some MSs
- On-going shift from Defined Benefit to Defined Contribution
  - Accelerated by persistent low-interest and low-yield environment
  - Supported by recent Pension reforms in Europe
- Sustainability of investments
- IORP II further promotes cross-border activities

Promoting private pensions

- Raising awareness, foster private pensions:
  - **Occupational pensions** via IORPs
  - **Personal pension products** (PPPs), in particular via PEPP

- Policy tools:
  - Transparency (relevant, simple and clear)
  - Governance
  - Risk management
  - Sound supervisory practices
  - Analytical toolkit

Transparency

- Information to members and beneficiaries of IORPs and PEPP savers is of paramount importance:
  - Standardised, relevant, decision-useful information about the <u>pension promise</u>:

    e.g.: real net return, default investment option, pension projections
  - Transparency about the <u>pension provider</u>:
    - Funding and solvency
    - Risk management: risk evaluation for pensions
    - Remuneration, conflict of interests, governance

Governance

- Fostering an effective implementation of key governance requirements of IORP II:
  - setting EIOPA's supervisory expectations on the structure and content of the **Statement of Investment Policy Principles** (SIPP), the **Own-Risk Assessment** (ORA) and the **recovery plan**
  - integrating **ESG factors** in IORPs' investment governance
  - develop a supervisory framework setting EIOPA's supervisory expectations on the **risk evaluation** of IORPs
  - implementing EIOPA's opinion on a common framework for risk assessment and transparency

Product standardisation and central authorisation

- 2^{nd} regime – Pan-European Personal Pension Product (PEPP)
  - o Regulation – overcoming hurdles of cross-border activities
  - o Enables standardisation:
    - Transparency
    - Economies of scale
  - o Enables flexibility:
    - to adapt to needs of local markets

➢ Truly European quality label endorsed by central authorisation

Improving the analytical toolkit

- EIOPA is mandated to monitor and assess market developments in the area of occupational pensions and to undertake economic analyses of markets, with a view to:
  - detect emerging risks and threats of adverse developments which may seriously jeopardise the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the EU and
  - assess relevant micro-prudential trends, potential risks and vulnerabilities and their impact on potential market developments on the institutions with EIOPA's scope of competences.

EIOPA's initiative to improve pensions statistics in Europe

- Receive all necessary information to enable better financial stability analyses and a sound statistical basis
- One single framework: Consolidate and streamline all quantitative reporting (to EIOPA) on IORPs
- Currently a number of mostly incomparable reports on pensions globally and in Europe
- Enhance efficiency through one set of taxonomy and definitions - in line with ECB requirements (incl. Eurostat and OECD definitions)
- Generally improve reporting processes

EUROPEAN INSURANCE
AND OCCUPATIONAL PENSIONS AUTHORITY

Thank you for your attention.