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REPORT FROM THE COMMISSION

**On some key aspects concerning Directive 2003/41/EC on the activities and supervision
of institutions for occupational retirement provision (IORP Directive)**

(presented by the Commission)

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(Text with EEA relevance)

1. INTRODUCTION

The IORP Directive (Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision) was published in the Official Journal on 23 September 2003 and had to be implemented by Member States by 23 September 2005. As of 2007 all Member States had notified their implementation measures, although two infringement procedures for incorrect implementation are still open.

The IORP Directive explicitly sets out reporting requirements for the Commission on four key aspects. Article 15(6) requires a regular report at least every two years on the rules regarding the calculation of technical provisions. Article 21(4) requires a one-off report within four years of the entry into force of the IORP Directive on the application of investment rules (point (a)), progress achieved in the adaptation of national supervisory systems (point (a)) and cross-border custodianship (point (b)).

Although the IORP Directive required the Commission to issue the first regular report on technical provisions and the one-off report on the other three aspects in September 2007, the late implementation by a large number of Member States made it difficult for the Commission to report on practical experience with these four provisions within the timeframe foreseen. It was therefore agreed with Member States during the meeting of the European Insurance and Occupational Pensions Committee (EIOPC) of 5 April 2006 to carry out the required reporting in 2008, following prior examination of key implementation issues by the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).

Moreover, although there has been a notable increase in the number of cross-border pension arrangements over the past few years, the level of cross-border cases still remains relatively low. A recent survey carried out by CEIOPS shows that at the end of June 2008 there were 70 cases of cross-border activity in the European Economic Area (EEA), with 21 states acting as host states.¹

At the request of the Commission, the Occupational Pensions Committee (OPC) of CEIOPS engaged in an extensive fact-finding exercise concerning the actual implementation of the IORP Directive by Member States. It needs to be borne in mind in this context that the IORP Directive provides for minimum harmonisation,

¹ CEIOPS "2008 Report on Market Developments" of 11 November 2008, available at: http://www.ceiops.eu/media/docman/public_files/publications/reports/OPC-Report-Market-Developments2008.pdf

thus leaving in a number of areas some leeway to Member States in its implementation. The result of the work of the OPC is summarised in the Report entitled "Initial Review of Key Aspects of the Implementation of the IORP Directive" (OPC Report) of 31 March 2008.²

The OPC Report includes, but is not limited to, the key aspects on which the Commission is required to report. The OPC Report finds that although there is considerable diversity in the way these key aspects of the IORP Directive have been interpreted and implemented by Member States, there is little evidence of major problems arising from these differences. Given this, and given the limited experience with the application the IORP Directive, the OPC Report finds no reason at this stage for legislative changes to the IORP Directive.

CEIOPS submitted the OPC Report to the Commission on 2 April 2008, and the Report was subsequently discussed by the EIOPC during its meetings of 27 June and 26 November 2008. The discussion showed that Member States broadly agree with the conclusions of the OPC Report, and the Commission services took note of the fact that the vast majority of Member States agreed with CEIOPS' recommendation not to envisage a legislative revision of the IORP Directive at this stage.³

Building on the work carried out so far, and with a view to fulfilling the Commission's reporting requirements set out in the IORP Directive, the remainder of this report sets out the Commission's position on the following key aspects: technical provisions, investment rules, adaptation of national supervisory systems and custodianship. The report is limited to the fulfilment of the Commission's reporting requirement on the four aspects set out in the IORP Directive itself. The need for possible legislative changes arising from other important issues affecting IORPs, in particular solvency rules⁴, is being examined by the Commission separately from this report.

2. TECHNICAL PROVISIONS

Article 15(6) of the Directive introduces a reporting requirement for the Commission in relation to the calculation of technical provisions of IORPs in a cross-border context.⁵

² For the full report see CEIOPS' website:
http://www.ceiops.eu/media/docman/public_files/publications/submissionstotheec/ReportIORPdirective.pdf

³ EIOPC documents can be accessed on the Commission's website:
http://ec.europa.eu/internal_market/insurance/committee_en.htm

⁴ Further information on this work is available at
http://ec.europa.eu/internal_market/consultations/2008/occupational_retirement_provision_en.htm

⁵ Article 15(6) requires that "[w]ith a view to further harmonisation of the rules regarding the calculation of technical provisions which may be justified - in particular the interest rates and other assumptions influencing the level of technical provisions - the Commission shall, every two years or at the request of a Member State, issue a report on the situation concerning the development in cross-border activities." Moreover, "[t]he Commission shall propose any necessary measures to prevent possible distortions caused by different levels of interest rates and to protect the interest of beneficiaries and members of any scheme."

The examination of the calculation of technical provisions of IORPs was started by the OPC and subsequently pursued in more detail by the Solvency Sub-Committee (SSC) of CEIOPS. The work of the SSC was summarised in the "Survey on fully funded, technical provisions and security mechanisms in the European occupational pension sector" (SSC survey) dated 31 March 2008.⁶ This survey provides a detailed and comprehensive review of the valuation assumptions and security mechanisms for occupational pension funds, which exist in Member States. As far as technical provisions are concerned, it underlines that IORPs in the different Member States use different methods and assumptions to determine their technical provisions. This results in significant variations in the size of technical provisions across countries for comparable defined benefit commitments. Important factors that affect the level of technical provisions in the different Member States include the underlying valuation assumptions, in particular the assumptions for interest rates and mortality, as well as the nature of inflation and salary indexations of pension benefits.

CEIOPS submitted the SSC survey to the Commission on 7 April 2008. The Commission welcomes the finding of the SSC report. It has served as a good basis for the public consultation on the harmonisation of solvency rules for IORPs subject to Article 17 of the IORP Directive and IORPs operating on a cross-border basis that the Commission launched in early September 2008. The potential further harmonisation of the rules regarding the calculation of technical provisions from a cross-border perspective is one of the areas explicitly addressed in this consultation. The consultation period ended at the end of November 2008. In order to draw first lessons from this public consultation, the Commission has scheduled a public hearing in Brussels on 27 May 2009.

The outcome of the consultation and of the public hearing will assist the Commission in deciding whether or not to come forward with a proposal to further harmonise the rules for the calculation of technical provisions in the context of cross-border activities. As is normally the case, any proposal from the Commission would, in line with the Better Regulation approach, be subject to a rigorous impact assessment.

3. INVESTMENT RULES

Article 21(4)(a) of the IORP Directive requires the Commission to "issue a report reviewing the application of Article 18 [...]", which contains the qualitative and quantitative investment rules for IORPs. The examination carried out identified a number of issues.

First, the OPC Report finds that the introduction of the 'prudent person' rule referred to in Article 18(1) has had an impact on the regulatory framework in many Member States and that, although quantitative investment limits still play an important role, more attention was being paid now to qualitative aspects of the investment rules.

Second, the OPC Report also points to a lack of common understanding of the scope of the single issuer rule, which aims at preventing excessive reliance on a particular

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http://www.ceiops.eu/media/docman/public_files/publications/submissionstotheec/ReportonFundSecMech.pdf

asset, issuer or group (Article 18(1)(e)).⁷ In addition, promoting convergence in single issuer rules is especially relevant in a cross-border context, given the explicit exemption from home state investment rules which host states can impose on "guest-IORPs" within certain quantitative and qualitative limits (Article 18(7)(b) of the IORP Directive). As regards quantitative limits, it was confirmed that host states can apply these to guest-IORPs only if the investment rules applied to IORPs located in the host state itself are equally strict or even stricter. Therefore, it was not possible to apply higher limits in this context than the ones explicitly spelt out in the IORP Directive. As regards qualitative limits, i.e. the categories of assets covered by Article 18(7)(b) of the IORP Directive, it might be useful to refer to other pieces of EU legislation such as the MiFID Directive⁸, which provides for definitions of 'financial instruments', 'transferable securities' and 'money-market instrument'.⁹

Third, there is a lack of common understanding of the term 'risk capital markets', relevant to Article 18(5)(c) which prohibits Member States from preventing IORPs located in their territory from investing in such markets. In line with the recommendations of the OPC Report, and following input from the Commission, further attempts of clarification have been undertaken with a view to possible "level 3-guidance" by CEIOPS on this issue. This further work has demonstrated that the different definitions across Europe depend on the purpose and context in which the concept of risk capital is applied (competition or internal market rules, closed or open definitions, including or excluding quasi-equity instruments) and that the issue has not yet had cross-border relevance in practice. Rather than issuing abstract guidance, the matter should be kept under review.

Fourth, six Member States use the possibility provided by Article 18(7) of the IORP Directive to impose as a host country additional investment limits.¹⁰

The findings of the OPC suggest that despite some differences in the application of investment rules, these do not seem to hinder the convergence process towards an internal market and cross-border activities of IORPs. The Commission supports this conclusion, and encourages CEIOPS to continue its analysis in relation to risk capital markets and the single issuer rule. As a special case of the latter, further work may also be required for self-investment rules, which limits investment in the sponsoring undertaking (Article 18(1)(f)).¹¹

Ongoing convergence in the application of investment rules should contribute to the security, quality, liquidity and profitability of IORPs portfolios as a whole, thus

⁷ Article 18(1)(e) specifies that "the assets shall be properly diversified in such a way as to avoid excessive reliance on any particular asset, issuer or group of undertakings and accumulations of risk in the portfolio as a whole. Investments in assets issued by the same issuer or by issuers belonging to the same group shall not expose the institution to excessive risk concentration".

⁸ Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments, Official Journal L 145, 30.4.2004.

⁹ See Articles 4(1)(17), 4(1)(18) and 4(1)(19) of the MiFID Directive.

¹⁰ Article 18(7) allows Member States to impose additional investment limits on guest IORPs operating in their territory. According to the Directive such limits are only acceptable if the same or stricter rules are imposed on the IORPs based in their own country.

¹¹ This rule has to be complied with by Member States, unless use has been made of the option in Article 22(4) of the Directive.

improving occupational retirement provision across the EU in both qualitative and quantitative terms.

CEIOPS and the Commission will continue to monitor the operation of the investment rules also in the light of any lessons to be learnt from the financial crisis.

4. ADAPTATION OF NATIONAL SUPERVISORY SYSTEMS

Article 21(4)(a) of the IORP Directive also requires the Commission to "issue a report reviewing [...] the progress achieved in the adaptation of national supervisory systems". In this context, the provisions of Article 21(1) to (3) of the IORP Directive are also of relevance because they provide for close cooperation between national supervisors and the European Commission in order to ensure a uniform application of the IORP Directive and to facilitate supervision of IORPs' operations.

In order to facilitate cooperation, CEIOPS set up the OPC in February 2004. The work of this Committee, in which the Commission participates as an observer, led to the agreement of the "Budapest Protocol" in February 2006.¹² This protocol governs supervisory arrangements and the exchange of information between home and host state supervisors of cross-border IORPs. The Budapest Protocol includes also supervisory authorities from across the EU which are not formally members of CEIOPS, thus offering a broad basis for further development of cross-border supervision for occupational pensions.

The Commission welcomes and supports the ongoing work of supervisors not only under, but also on the Budapest Protocol, which is currently being reviewed by the OPC with a view to a public consultation by CEIOPS of a revised version in the first half of 2009.

5. CUSTODIANSHIP

Article 21(4)(b) of the IORP Directive requires the Commission to report on the application of the second sub-paragraph of Article 19(2). This provision sets forth that home Member States are allowed to make the appointment by an IORP of a custodian or depositary compulsory. However, when doing so, they must not restrict IORPs from appointing a duly authorised custodian or depositary established in another Member State, as specified in the first sub-paragraph of Article 19(2).

The OPC Report notes that divergent approaches exist in relation to the appointment of a custodian and the kind of body which is appointed to fulfil this role, including the functions that it performs. There are also differences in the role of competent authorities, some of whom play a role in the process of the custodian's appointment. The OPC does, however, not consider these divergences of practice to be an issue. At

¹² The "Protocol relating to the Collaboration of the Relevant Competent Authorities of the Member States of the European Union in Particular in the Application of the Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the Activities and Supervision of Institutions for Occupational Retirement Provision (IORPs) Operating Cross-Border" is available at <http://www.ceiops.eu/content/view/19/23/>

the moment it is too early to conclude whether the provisions on custodianship in the IORP Directive create issues for supervision, although, looking ahead, the OPC earmarks a number of issues that may require further attention.¹³

In particular, the OPC notes that where a custodian or depositary is located in another Member State than the IORP, it is useful to enhance the cooperation between IORP Supervisory Authorities and foreign custodian/depositary Supervisory Authorities (especially in the case where the supervisory authority is not a CEIOPS member), mainly to guarantee the appropriate application of Article 19(3) of the IORP Directive in the case of freezing of the assets.¹⁴ If enhanced cooperation within the current EU legal framework is not possible, the OPC takes the view that this may be an issue that could require a legislative change.

The Commission welcomes this assessment and encourages further cooperation between supervisory authorities. It stands ready to take up the matter with CEIOPS, if necessary. The need for possible future changes will also depend on the outcome of the more general work relating to European supervisory arrangements.¹⁵

6. CONCLUSION

As regards the four key aspects on which the IORP Directive requires the Commission to report, the Commission considers that there is no immediate need for legislative change. This report is, however, limited to the fulfilment of the Commission's reporting requirements set out in the IORP Directive itself. The need for possible legislative changes arising from other important issues affecting IORPs, in particular solvency rules, is being examined by the Commission separately from this report.

The Commission believes that the IORP Directive has already delivered first results in the establishment of an internal market for occupational retirement provision organised on a European scale. More time is needed for the full effects of the Directive to unfold.

At the same time, the examination carried out by CEIOPS has indicated that there is a need to continue the monitoring of several aspects of the IORP Directive. The possible further harmonisation of the rules on the calculation of technical provisions can be considered in the context of the Commission's ongoing work on solvency rules for IORPs. In the area of investment rules, there is a need for further clarification of the definition of risk capital markets and the scope of the single issuer

¹³ In addition, the Commission is currently reviewing the manner in which Member States have implemented the present principles in Directive 85/611/EEC (UCITS Directive) regarding the responsibility and liability of the depositary, as a response to the Madoff case. Depending on the outcome of this work, it might also be necessary to review the relevant provisions in the IORP Directive.

¹⁴ Article 19(3) requires that "[e]ach Member State shall take the necessary steps to enable it under its national law to prohibit, in accordance with Article 14, the free disposal of assets held by a depositary or custodian located within its territory at the request of the institution's home Member State."

¹⁵ For further information, see the Report of the High Level Group chaired by Jacques de Larosière of 25 February 2009 and the Commission Communication on "Driving European Recovery" of 4 March 2009 (COM(2009) 114 final).

rule. The Commission and CEIOPS will also continue to monitor the operation of the investment rules also in the light of the financial crisis. The Commission is supportive of enhanced cooperation between supervisors and welcomes the planned public consultation by CEIOPS on the Budapest Protocol. As regards custodianship, the Commission encourages enhanced cooperation between IORP Supervisory Authorities and foreign custodian/depositary Supervisory Authorities and stands ready to put forward legislative proposals if needed. The need for possible future changes will also depend on the outcome of the more general work relating to European supervisory arrangements.

The Commission remains committed to the continued verification of the correct implementation of the IORP Directive by Member States and continues its work in this area. The Commission also encourages CEIOPS to continue its work on the broader issues raised in the OPC report, and will further monitor and promote the improved cooperation between supervisors in order to ensure a uniform application of the IORP Directive.